JOINT OUTREACH EVENT

IASB EXPOSURE DRAFT ED/2015/3

CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

HELSINKI

14 OCTOBER 2015

This feedback statement has been prepared for the convenience of European constituents by the EFRAG Secretariat and has not been subject to review or discussion by either the EFRAG Board or the EFRAG Technical Expert Group. It has been reviewed by the IASB staff and has been jointly approved for publication by representatives of EFRAG, the Financial Supervisory Authority, the Ministry of Employment, and the Economy and the Confederation of Finnish Industries who attended the joint outreach event.

Joint Outreach Event

This feedback statement has been prepared for the convenience of European constituents to summarise a joint outreach event held by EFRAG, the Financial Supervisory Authority (FIN-FSA), the Ministry of Employment and the Economy, and the Confederation of Finnish Industries, in cooperation with the IASB, on 14 October 2015.

The joint outreach event was chaired by Virpi Haaramo, Senior Accounting Expert of the Financial Supervisory Authority.

The joint outreach event was one of a series organised across Europe, following the publication of the IASB Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting* ('the Exposure Draft'). The purpose of the outreach event was to:

- stimulate debate on the Conceptual Framework in Europe;
- obtain input from European constituents and to understand their main concerns and wishes, in particular from those that may not intend to submit a comment letter to the IASB or EFRAG;
- receive input for the FIN-FSA's comment letter to EFRAG and the IASB; and
- learn whether the preliminary comments, as set out in EFRAG's document for public consultation, were shared by European constituents.

Rachel Knubley (IASB Technical Principal), who participated by video-conference, presented the Exposure Draft on selected issues and Rasmus Sommer (EFRAG Senior Technical Manager) summarised EFRAG's document for public consultation. An open debate then took place with participants.

The participants had different backgrounds, and included users, preparers, auditors, regulators and academics.

Issues covered

Participants discussed the following issues:

- the role of the Conceptual Framework in standard setting;
- prudence, stewardship and measurement uncertainty;
- elements of financial statements, recognition and derecognition; and

- measurement, presentation (OCI and recycling) and the notion of performance.

Comments received

The role of the Conceptual Framework in standard setting

A participant was concerned that is was unclear as to how the theoretical concepts were to be applied in practice.

The Exposure Draft proposes that the Conceptual Framework should be a practical tool to support the IASB in its future standard setting. A participant was concerned that it was unclear how the theoretical concepts proposed in the Exposure Draft will be applied in practice. The IASB Technical Principal explained that the Conceptual Framework was intended as a practical tool to help the IASB in the development of standards. She acknowledged that some stakeholders would have preferred an aspirational document that chose one measurement basis or gave specific recognition criteria. However, she noted that this would have resulted in frequent deviations during standard setting. That was why, for example, in relation to measurement, the IASB chose to discuss the different measurement bases and to reflect the factors that the IASB would have to consider when selecting a measurement basis. She also noted that the Exposure Draft aimed to support people in understanding how the IASB would address difficult accounting issues.

A participant thought it was difficult to assess the impact of the Exposure Draft on future standard setting, as the IASB could depart from the Conceptual Framework.

A participant stated that it was difficult to assess the impact on future standard setting of the proposals in the Exposure Draft, if the IASB could diverge from the revised Conceptual Framework at any time. The IASB Technical Principal replied that departures were expected to be rare as the IASB would try to adhere to the Conceptual Framework. In cases where the IASB would depart from the Conceptual Framework, this would have to be explained in the Basis for Conclusions.

A participant was uncertain about the impact of the Exposure Draft on auditors.

A participant asked how the Exposure Draft was expected to impact auditors. The IASB Technical Principal noted that the Exposure Draft may have a direct impact on the accounting policies that were developed by preparers using the Conceptual Framework. However, she noted that, as the IASB had developed a fairly complete suite of standards, the cases where preparers would be applying the Conceptual Framework to develop accounting policies, due to a lack of guidance in IFRS, were expected to be rare. She expected that the Conceptual Framework would mostly be used by preparers to assess judgements and understand the background of standards.

Prudence, stewardship and measurement uncertainty

A participant thought that the Exposure Draft used the term 'prudence' differently from how people normally interpreted the term and was concerned about this.

The Exposure Draft proposes to reintroduce the notion of prudence in the Conceptual Framework. A participant noted that, as a non-native English speaker, he felt the Exposure Draft used the word 'prudence' differently from how the term was commonly understood. He thought that this would cause confusion. The IASB Technical Principal explained that the reintroduction of the notion of prudence along with its explanation was intended to articulate the goal of presenting an unbiased (neutral) picture of the company's transactions. The reintroduction of the term was intended to underline that preparers should think very carefully under conditions of uncertainty about the figures that they presented in the financial statements. The EFRAG Senior Technical Manager noted that he interpreted neutrality as the appropriate application of standards, even if these standards contained different recognition thresholds for assets than for liabilities. The participant stated that the IASB should not use the word 'prudence'.

A participant thought it was unclear how a new concept of prudence would counteract natural management bias.

A participant referred to the statement in the Basis for Conclusions that prudence was intended to counteract any natural bias that management had towards optimism. She asked how this would be applied in the impairment testing of goodwill. The IASB Technical Principal explained that preparers would have to be cautious when determining future cash flows. This would not imply the systematic underestimation or overestimation of future cash flows, but be based upon a realistic and supportable estimation that reflected the preparer's reality.

A participant thought that the objective of assessing stewardship should not be included in the objective of providing information useful for making buying, holding and selling decisions.

The Exposure Draft gives greater prominence to the need to provide information needed to assess management's stewardship of the entity's resources in the description of the objective of financial reporting. Stewardship information is considered necessary for users for making decisions about buying, selling or holding equity and debt instruments. A participant preferred to have the objective of providing information useful for the assessment of stewardship separated from the objective of providing information for decisions about buying, selling or holding equity and debt instruments. He noted that only owners have the right to appoint and remove management. Creditors and other parties do not have that right. The IASB Technical Principal stated that the IASB interpreted the buy/hold/sell decisions more broadly than it was commonly understood. A decision to hold an instrument could be interpreted to mean that the investor wanted to keep management and/or improve governance. The participant disagreed with this view and noted that a distinction had to be made between the owners and other investors.

A participant thought it was difficult to assess the impact on future standard setting of giving more prominence to 'stewardship'.

A participant asked for concrete examples of disclosure requirements that were related to stewardship. Another participant added that an analyst told her that it was not useful to add the stewardship objective, as it was self-evident. This analyst noted that investors were always thinking about management's performance. The EFRAG Senior Technical Manager referred to a study on the use of financial statements that was co-sponsored by EFRAG and ICAS. One conclusion of the study was that financial statements were relatively more important for the assessment of stewardship than for providing information for buying, holding and selling decisions. For the latter objective, many other relevant sources of information were available. However, the information currently provided by financial statements was considered less relevant for the assessment of stewardship than for making buying, holding and selling decisions. The IASB Technical Principal believed that giving more prominence to stewardship would not result in significantly more disclosures as the concept had always been part of the Conceptual Framework. The only difference was that the concept was implicitly applied in the past, whereas the proposals in the Exposure Draft more clearly articulate its role.

Elements of financial statements, recognition and derecognition

A participant thought that the brief way of formulating definitions was elegant.

A participant was concerned about removing the reference to 'expected' from the definition of an asset.

In the Exposure Draft, some amendments to the definitions of assets and liabilities are proposed, and to the criteria for recognising and derecognising assets and liabilities. A participant thought that the brief way of formulating the proposed definitions was elegant. However, the participant was concerned that too many items would meet the definition of an economic resource and hence of an asset when taking into account that the IASB had removed the reference to 'expected' in the definition. The IASB Technical Principal noted that the reference to 'expected' was removed in the definition of an asset. The reason was that assets could exist, even if there was a low probability of cash inflows (such as a purchased option or a lottery ticket). However, the IASB Technical Principal noted that the asset's existence did not imply that the asset should be recognised. This would depend on whether recognising the asset would result in providing useful information that is faithfully represented.

A participant was concerned about introducing new terms.

A participant thought that economic substance could not be considered independently from the legal aspects.

A participant was concerned about the introduction of new terms such as 'practical ability' and the focus on customary practices. She asked whether this would have an impact on the accounting discussed in IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments*. She noted that the economic substance could not be considered independently from the legal aspects. The IASB Technical Principal replied that changes to the Conceptual Framework would not automatically trigger changes to existing standards.

A participant was concerned about the lack of guidance on the distinction between equity and liabilities.

A participant was concerned about the lack of guidance on the distinction between equity and liabilities. The IASB Technical Principal noted that a separate research project will address how to distinguish equity from liabilities, which may result in changes to the Conceptual Framework. Whilst acknowledging the current difficulties, the IASB Technical Principal noted that the alternative would have been to delay the finalisation of the revised Conceptual Framework.

A participant thought that the proposed definitions did not result in a useful outcome for deposit guarantee schemes.

The EFRAG Senior Technical Manager introduced several cases to discuss the impact of the new definitions on accounting practice. The first case was the accounting for deposit guarantee schemes. A participant noted that, in Finland, local GAAP allowed the payment to a deposit guarantee scheme to be accrued over time, as the activities were performed. However, when applying IFRS, this was not expected to be possible in the future. Under IFRS, the entire payment would have to be expensed at a point in time. The participant preferred to recognise the expense over time to match income and expense. Another participant referred to the ESMA opinion related to the accounting treatment of ex-ante, non-refundable cash contributions to deposit-guarantee schemes for which the obligating event is identified at a single point in time (for example on 1 January). However the EFRAG Senior Technical Manager noted that this opinion only relates to existing accounting guidance and, therefore, does not consider the proposals in the Exposure Draft.

A participant asked whether the new definition of a liability would result in the recognition of a liability for replacing equipment in a production environment. She felt that companies could conclude that they did not have a practical ability to avoid new investments in their production equipment. The IASB Technical Principal acknowledged that it could be debated whether a company had a practical ability to avoid renewing its production equipment. However, she questioned whether a past event could be identified. In addition, she noted that there was no outflow. At a future point when the asset is purchased, there will be an outflow and an inflow at the same time. So, effectively this was similar to an executory contract where there is neither an asset nor a liability, because of the future purchase that might be made.

Some participants preferred not to recognise unannounced restructuring provisions, due to considerable degree of judgement.

The next case that was discussed dealt with the accounting for costs related to external restructuring services that are necessary in order to be able to continue the business in the future. The entity had not announced its plans publicly and it had not been decided who would be asked to perform the services. A participant asked what the past event would be. The EFRAG Senior Technical Manager asked whether the management's observation that the company could not continue without a restructuring could be considered to be the past event and asked whether recognising such a provision would result in useful information. Some participants preferred not to recognise such provisions, due to the considerable degree of judgement involved and the fact that too much speculation was involved.

Measurement, presentation (OCI and recycling) and the notion of performance

A participant asked whether it would be appropriate to provide guidance on how disclosures should be communicated.

The Exposure Draft proposes some guidance on measurement, presentation and disclosure. One aspect of developing disclosures for companies is how to communicate issues in financial statements. One participant asked whether it would be appropriate to provide more guidance on how disclosures should be communicated in the Conceptual Framework. The IASB Technical Principal explained that the objective of the Conceptual Framework was to set out very high-level principles about presentation and disclosure, and focusing in particular on the idea that presentation and disclosure should be used as a communication tool between the preparers and users of financial statements. The IASB Technical Principal also referred to the Disclosure Initiative project which is intended to provide more detail on the very high-level principles in the Conceptual Framework.

A participant did not understand why it was so difficult to define performance.

The Exposure Draft states that profit or loss is the primary source of information about an entity's financial performance for the period. In addition, it introduces a rebuttable presumption that all income and all expenses should be included in profit or loss. The Exposure Draft, however, does not define performance. A participant asked why defining performance was so difficult. The IASB Technical Principal noted that the IASB had tried over the years to define performance. The IASB Technical Principal referred to the summary in the discussion paper of different approaches that could be taken (including focusing on different factors such as management's control, realised vs unrealised and the entity's business model). Past discussions had generated strong, but inconsistent, feedback from constituents. Therefore, the IASB acknowledged the difficulties and proposed to provide simple directions. The IASB Technical Principal also referred to the Primary Financial Statements research project that was expected to continue the work on this issue.

A participant thought that the Conceptual Framework should refer to cash flows or the statement of cash flows.

A participant noted that it seemed that financial performance was only based on income and expenses. She asked whether cash flows should also be part of financial performance. The IASB Technical Principal noted that the Conceptual Framework already acknowledges that information about cash flows could be part of financial performance. She also noted that, in other outreach events, the IASB had been told that the Exposure Draft did not discuss sufficiently the statement of cash flows.

A participant thought that the implications for accounting for agricultural activity were unclear.

A participant asked what the implications would be of the proposed guidance on the measurement at fair value in the standard on agriculture (IAS 41). The IASB Technical Principal noted that this would be influenced by what information users would find relevant. However, when asked about applying fair value through OCI, the IASB Technical Principal noted that a high hurdle had been established for the use of OCI.

A participant thought that the implications of EFRAG's proposal to companies with multiple business models were unclear.

A participant asked, in relation to EFRAG's proposals on the distinction between profit or loss and OCI, how this would be applied in companies that have multiple business models. The EFRAG Senior Technical Manager noted that it would not be different from current practice. Currently, an entity could, for example, hold buildings for different purposes. Some buildings could be used to generate cash flows indirectly (property, plant and equipment) or directly (investment property).

The term ‘business model’ could be interpreted in many different ways.

A participant questioned the use of the term ‘business model’ as it could be interpreted in many ways. The EFRAG Senior Technical Manager acknowledged the different possible interpretations of the term and that it could be useful to clarify the term. The IASB Technical Principal noted that this was the reason why the term ‘business activity’ was used in the Exposure Draft.