JOINT OUTREACH EVENT

IASB EXPOSURE DRAFT ED/2015/3

CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

WARSAW

30 SEPTEMBER 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 IASB staff and has been approved for publication by representatives of EFRAG, the KSR and the World Bank Centre for Financial Reporting Reform, who attended the joint outreach event.

Joint Outreach Event

This feedback statement has been prepared for the convenience of European constituents, summarising a joint outreach event held by EFRAG and the Polish Accounting Standards Committee (KSR), in cooperation with the World Bank Centre for Financial Reporting Reform and the IASB, on 30 September 2015.

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 KSR, the IASB or EFRAG;
- receive input for the KSR's comment letter to EFRAG and the IASB; and
- learn whether the preliminary comments, as set out in EFRAG's draft comment letter, were shared by European constituents.

Anne McGeachin (IASB Technical Principal) presented selected issues from the Exposure Draft; Rasmus Sommer (EFRAG Senior Technical Manager) summarised EFRAG's document for public consultation; and the World Bank consultant, Gilbert Gélard, provided his personal comments. An open debate took place with participants.

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

Issues covered

Participants discussed prudence, uncertainty, the definitions of the elements, measurement, presentation, and other issues.

Participants discussed the following issues:

- Prudence and uncertainty
- Definitions including additional guidance
- Measurement and presentation (OCI and recycling)
- Other issues

Comments received

Prudence and uncertainty

The Exposure Draft proposes to reintroduce the concept of prudence in the Conceptual Framework. EFRAG's document for public consultation expresses the view that the Conceptual Framework should focus on how prudence is relevant in standard setting and the Conceptual Framework should acknowledge that having higher thresholds for the recognition of assets than for liabilities (asymmetric prudence) sometimes results in the most useful information. The World Bank consultant did not agree with the view that prudence should be defined from the standard setter's perspective. He also expressed a concern that asymmetric accounting could result in hidden reserves.

A participant thought that the definition of prudence in the Exposure Draft deviated from how the term is commonly understood.

A participant underlined the importance of the meaning of prudence. He believed that the concept was usually defined as 'caution in terms of conservatism'. The IASB Technical Principal noted that the definition of prudence was very close to the definition in the old Conceptual Framework (from 1989). She noted that, under the Conceptual Framework, conservatism and prudence were never considered to have the same meaning. However, she acknowledged that this had not been clearly articulated in the past. She also noted that conservatism was similar to asymmetric prudence, i.e. that more evidence is needed for the recognition of gains than for the recognition of losses. She concluded that, whilst the use of asymmetric accounting is possible when developing a standard, the IASB did not want to establish the concept as a principle in the Conceptual Framework. The World Bank consultant added that the discussion on prudence was often related to discussions on dividends and the possible distribution of unrealised profits. He noted that it was not within the mandate of the IASB to provide guidance on how much dividend an entity could distribute. That issue was in the scope of company law.

A participant thought that prudence should affect the behaviour of preparers, not standard setters.

A participant acknowledged that dividends were determined by applying company law, but noted that company law referred to financial statements that are based on accounting standards. She explained that the concept of prudence originated from merchant activities and was intended to ensure business safety by supporting the survival and development of the company. Contrary to the views expressed in EFRAG's document for public consultation she thought that prudence should affect the behaviour of preparers (the application of accounting standards), not standard setting (the regulation).

Definitions including additional guidance

In the Exposure Draft, changes to the definitions of an asset and a liability are proposed. The World Bank consultant expressed a hope that the changed definition of a liability would solve the issues with the accounting for levies.

A participant was uncertain about whether goodwill would meet the proposed definition of an asset.

A participant asked whether goodwill would qualify as an asset (if positive) or a liability (if negative). The participant believed that, in her opinion, negative goodwill would not be considered a liability according to the new definition. With regard to positive goodwill, the IASB Technical Principal noted that, whilst this was not discussed in the Exposure Draft, she believed that it would be considered an asset. She added that internally generated goodwill would also be considered an asset, but would not qualify for recognition.

Polish practitioners experienced considerable difficulties in distinguishing equity from liabilities.

A participant preferred to have definitions of both equity and liability.

Several participants noted that it was difficult for Polish practitioners to apply the definitions of equity and liabilities to differentiate between different sources of financing. One participant preferred to have both elements defined, instead of having one element being the residual. Another participant noted the difficulties of accounting for certain capital increases, such as when the entity was owned by the state. She also noted the important effect on profit or loss of this classification. The IASB Technical Principal acknowledged the huge difficulties in distinguishing between equity and liabilities and the resulting impact on the income statement. However, she thought that one element had to be defined as the residual to avoid the creation of any gaps between both elements. The World Bank consultant added that if both elements were strictly defined, this could result in items that would not fall into either category and hence would not have to be disclosed. The EFRAG Senior Technical Manager noted that a few IASB members had expressed dissenting views to the Exposure Draft, due to the lack of guidance on this topic. He added that the view expressed in EFRAG's document for public consultation was that the separate project on liabilities and equity the IASB had initiated should result in subsequent changes to the Conceptual Framework.

A participant thought that more guidance was needed on the unit of account.

A participant thought it was important that the Conceptual Framework included guidance on the unit of account as this issue had often been debated. He acknowledged that the issue might need a broader debate. The IASB Technical Principal agreed that this issue needed to be resolved and welcomed any input from participants. The EFRAG Senior Technical Manager noted that EFRAG tried to apply the guidance on the unit of account included in the Exposure Draft on various cases and concluded that the proposed guidance was not considered particularly useful.

A participant thought the Conceptual Framework should consider non-financial aspects of economic activity.

A participant believed that the focus on regulation and control of rights in the definition of an asset would result in a very narrow interpretation of economic activity. He felt that the definition was too restrictive. Secondly, he noted that the economic benefits of the economic entity were defined to include only cash flows and the potential to generate a surplus. Thirdly, he thought it was unclear how the economic entity related to the reporting entity. Finally, he noted that the public interest was not discussed in the Conceptual Framework. He questioned whether the notion of fair value was beneficial to the public interest. The IASB Technical Principal referred to the very broad definition of economic resources. However, she noted that sustainable reporting was not within the IASB's mandate, as the IFRS focus on reporting to the entity's providers of capital. The EFRAG Senior Technical Manager noted that EFRAG's document for public consultation included a question to constituents on who should be considered the users of general purpose financial reporting in the Conceptual Framework.

A participant thought that the concept of fair presentation was missing in the Exposure Draft.

The use of new terminology increases the difficulties in understanding the guidance.

A participant thought that it was important to use consistent terminology in standard setting. He noted the focus on the notion of control in the consolidation standards, which, in his view, introduced a significant change. He believed that this contradicted the Exposure Draft that referred to economic benefits. He added that new terms had been introduced in the Exposure Draft and that increased the difficulty in understanding the guidance. He noted that 'fair presentation' was not mentioned in the Exposure Draft and asked for the meaning of 'economic decisions'. The IASB Technical Principal agreed that a consistent use of words was very important. She noted that the consistency was improving over time, for example, due to the efforts of the taxonomy team. However, it was difficult to spot inconsistent terms during standard setting. She acknowledged that the concept of fair presentation was mentioned in IAS 1 *Presentation of Financial Statements*, but not in the Conceptual Framework. She believed this should be considered.

A participant was uncertain about the impact of the new definition of a liability on the scope of items described as provisions in IAS 37.

A participant asked whether the scope of items described as provisions in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* would change as a result of the new definition of liabilities. The IASB Technical Principal noted that provisions are defined as being a type of liability. Hence, if IAS 37 were to be amended in accordance with the Exposure Draft, the scope of items described as provisions would reflect the new definition.

Measurement and presentation (OCI and recycling)

The Exposure Draft classifies measurement bases into two categories: historical cost measures and current value measures. The IASB Technical Principal referred to the meeting of the World Standard Setters where the guidance was tested on examples. The exercise demonstrated that people often focused on the effects on the statement of performance when deciding on a measurement basis.

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 will be included in the statement of profit or loss. The World Bank consultant stated that he considered the language to be too prescriptive for the Conceptual Framework. He also noted that the Exposure Draft states that changes in the value of an item that is measured at historical cost have to be recorded in profit or loss and believed that this could be interpreted as a preference for historical cost. The IASB Technical Principal noted that the IASB did not have a preference for historical cost.

A participant thought that guidance should be developed on how to distinguish between profit or loss and OCI, for recycling and control.

Another participant questioned whether OCI should exist.

A participant recalled that, when the Conceptual Framework was adopted, stakeholders had been told that more guidance would be provided along the way. He thought that more guidance was needed on the distinction between profit or loss and OCI, the notion of control and the distinction between realised and non-realised. He felt the current proposed presumption that everything is recorded in profit or loss was evasive. He questioned the conceptual basis for recycling all items. He therefore agreed with EFRAG that principles should be given to distinguish between profit or loss and OCI. Another participant questioned whether OCI should exist. The IASB Technical Principal noted that, by determining that only changes resulting from a current remeasurement can be recognised in OCI, a small step forward was made towards a more disciplined use of OCI. In response to EFRAG's proposal to focus on the concept of the business model to distinguish between profit or loss and OCI, the IASB Technical Principal was concerned that the concept might provide too much discretion to preparers, which would reduce comparability. Finally, the IASB Technical Principal noted that, whilst she could see the merits of a conceptual solution to distinguishing between profit or loss and OCI, the existence of OCI had provided a practical solution in the past that allowed the IASB to achieve important improvements in accounting, such as the immediate recognition of changes in pension liabilities.

A participant thought that the meaning of the different probability terms used in IFRS should be explained and that the relation between profit or loss, OCI and total comprehensive income should be discussed.

Another participant thought that the distinction between 'presentation' and 'disclosure' should be clarified.

Several participants referred to the terminology used in the Exposure Draft. One participant noted that the term 'total comprehensive income' was not mentioned and considered that the relation between profit or loss, OCI and total comprehensive income should be discussed. The participant also noted the different probability terms used in IFRS and asked whether a hierarchy of the terms could be provided. Another participant referred to the debate on the meaning of the terms 'presentation' and 'disclosure'. She had conducted a survey in which practitioners were asked for the meaning between the two terms. Most practitioners gave the following answers: 'same meaning', 'presentation refers to facts and figures, whilst disclosure refers to descriptive notes' and 'the meaning is determined by the context'.

The IASB Technical Principal acknowledged the importance of consistent terminology. She noted that the distinction between presentation and disclosure was changed during the drafting process. Therefore, it was possible that some inconsistencies had not been addressed. She confirmed that these would be resolved in drafting the final changes to the Conceptual Framework. She also agreed that probability thresholds used in IFRS could be interpreted differently and that this could be clarified further. However, she noted that the application of IFRS would always require judgement, for example, when applying the recognition criteria.

A participant noted that the term 'profits' is understood differently in the chapter on capital maintenance than in the chapter on presentation and disclosures.

Another participant asked for the current status of the Financial Statements Presentation project. The IASB Technical Principal replied that the project had been put on hold after the publication of an Exposure Draft. She noted that the Primary Financial Statements project might further develop some of the work performed in the Financial Statements Presentation project.

Other issues

A participant was uncertain about how the changes to the Conceptual Framework would affect standards.

A participant asked whether the Conceptual Framework would override the guidance in IFRS standards. The IASB Technical Principal clarified that this was not the case. Standards would only be amended in case of problems in the application of the standard. An inconsistency with the Conceptual Framework could remain unaddressed if there were good practical reasons for the inconsistency.