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http://eifrs.ifrs.org/eifrs/CLUserForm?project=27

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Re: A Review of the Conceptual Framework for Financial Reporting.

We are writing on behalf of the International Corporate Governance Network (ICGN). The ICGN is a global membership organisation of over 500 institutional and private investors, corporations and advisors from 50 countries. Our investor members are responsible for global assets of US$18 trillion.

The ICGN's mission is to raise standards of corporate governance worldwide. In doing so, the ICGN encourages cross-border dialogue at conferences and influences corporate governance public policy through its Committees. We promote best practice guidance, encourage leadership development and keep our members informed on emerging issues in corporate governance through publications and the ICGN website. Information about the ICGN, its members, and its activities is available on our website: https://icgn.org/.

The purpose of the Accounting and Auditing Practices Committee (A&A Practices Committee) is to address and comment on accounting and auditing practices from an international investor and shareowner perspective. The Committee through collective comment and engagement strives to ensure the quality and integrity of financial reporting around the world.
https://icgn.org/committees/itemlist/category/24

ICGN continues to support the establishment of a single set of independently developed, high quality international accounting standards, which primarily serves the needs of current investors in their decisions as capital providers and secondarily, potential investors and other users.

We are pleased to respond to your request for comments on the Conceptual Framework (CF). The ICGN recognizes the infrequency of reviews of the CF. This makes the current review most important as it is likely to set the framework for accounting standards for several years in the future. Therefore the ICGN recommends it is not a process to be rushed.

The CF is vital to all users as it will set a common understanding of all concepts underpinning IFRS. It will therefore be valuable for accounting educators, regulators, lawyers and others when they come to use accounting terminology. Therefore we do not agree that the primary purpose of the CF is only to '*assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs*'.

As well as guiding the IASB, investors believe the CF should also be a guide to the auditing profession and to users of financial reports on the principles underlying IFRSs. Thus it is imperative that terminology and materials in the CF be clear, comprehensive and as precise as possible, and accessible to all users of IFRSs. The ICGN believes that the draft CF does not adequately address key conceptual issues, such as from whose point of view financial statements (FS) should be prepared. We consider the current definition of the main users as existing and potential investors, lenders, and other creditors is too broad and firmly believe that the primary audience should be the holders of ordinary shares. These are the ultimate owners of a company, the providers of the risk capital and bearers of the residual risk. Financial statements should provide them with the information they need, not only for the purposes of deciding to buy, sell or hold their shares, but also to fulfill their responsibilities as owners – assessing company management and the strategies adopted for the longer term.

Below we answer the specific questions in the CF.

Section 1 Introduction

Question 1
Paragraphs 1.25–1.33 set out the proposed purpose and status of the *Conceptual Framework*. The IASB's preliminary views are that:
(a) the primary purpose of the revised *Conceptual Framework* is to assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs; and
(b) in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the *Conceptual Framework*.
If this happens the IASB would describe the departure from the *Conceptual Framework*, and the reasons for that departure, in the Basis for Conclusions on that Standard. Do you agree with these preliminary views? Why or why not?

We agree with these preliminary views. This is also the function of the current *Conceptual Framework* as we see it. However, we would like to stress that he CF is an important document for everyone involved in financial reporting. As users of financial information, we are very interested in its development because it will greatly influence the information we ultimately receive, and we appreciate the opportunity to comment on it. The CF is also of interest to preparers, auditors and academics. Any conflicts between CF and accounting standards should require transparent and convincing explanation.

Section 2 Elements of financial statements

Question 2
The definitions of an asset and a liability are discussed in paragraphs 2.6–2.16. The IASB proposes the following definitions:

(a) an asset is a present economic resource controlled by the entity as a result of past events.

(b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.

(c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.

Do you agree with these definitions? Why or why not? If you do not agree, what changes do you suggest, and why?

We agree with these definitions. This is how we interpret the current conceptual framework. However, we agree that the proposed definitions are clearer as unnecessary terms are removed. We like the emphasis on rights associated with assets. One source of confusion in the past has been that IFRS and US GAAP states the same thing using different terms. (On the other hand, we find it hard to believe that people have had problems distinguishing between assets and liabilities on the one hand and the cash flows involved on the other.) All sources of misunderstandings have not been removed. We refer to our answer to question 3 below. In our opinion, the concept “event” should also be defined as it is crucial to the proposed definition.

Question 3
Whether uncertainty should play any role in the definitions of an asset and a liability, and in the recognition criteria for assets and liabilities, is discussed in paragraphs 2.17–2.36. The IASB’s preliminary views are that:

(a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is ‘expected’. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources.

(b) the *Conceptual Framework* should not set a probability threshold for the rare cases in which it is uncertain whether an asset or a liability exists. If there could be significant uncertainty about whether a particular type of asset or liability exists, the IASB would decide how to deal with that uncertainty when it develops or revises a Standard on that type of asset or liability.

(c) the recognition criteria should not retain the existing reference to probability.

Do you agree? Why or why not? If you do not agree, what do you suggest, and why?

We find the proposed solutions conceptually unclear, but they may still work in practice. We believe that the probability threshold is still in place. It is implicit in the phrase “capable of producing economic benefits”2.35 states: “The important thing is that there are at least some outcomes in which an economic resource must be capable of producing economic benefits”. This is a probability threshold. In other words, there must be some outcomes with positive probability in which non-negligible benefits are received. Despite the forgoing, we think the definition will work in practice as long as everyone realizes that this is the meaning of the formulation. The issue of more precise probability thresholds may be left to individual standards and professional judgment. Again, this is exactly the way we interpret the current definition. Benefits must be reasonably possible. We do not see the proposed definition as involving a change. However, it is of concern that the IASB is of the view that the issue of probability has changed. We do not understand this conclusion.

Furthermore, we find the concept “existence uncertainty” unclear. There is only one example given, which does not explain the concept very well. “Outcome uncertainty” is, on the other hand, fairly clear (and many examples are presented). The relationship between the two concepts is confusing as well. This is perhaps not crucial, but more attention should be given to this matter to avoid future misunderstandings.

Question 4
Elements for the statement(s) of profit or loss and OCI (income and expense), statement of cash flows (cash receipts and cash payments) and statement of changes in equity (contributions to equity, distributions of equity and transfers between classes of equity) are briefly discussed in paragraphs 2.37–2.52. Do you have any comments on these items? Would it be helpful for the *Conceptual Framework* to identify them as elements of financial statements?

We agree that there is no need for more precise definitions of gains, losses, cash flows and distributions of equity. There seems to be a common understanding of these terms. Thank you for clarifying why services purchased with equity are expenses.

Elements of OCI are, on the other hand, in urgent need of more precise definitions. Most users do not understand the fundamental differences between OCI and other elements of the profit and loss statement. It is not clear as to why the terms “income” and “gains” are used as opposed to “expenses” and “losses”. The difficulty involved in defining OCI may be that this term is conceptually unclear.

Further, the ICGN considers that issues with OCI stem, in part, from the lack of clear objectives for financial reporting which would then determine presentation and disclosures. The CF should state clearly the objectives of financial reporting.

Section 3 Additional guidance to support the asset and liability definitions

Question 5
Constructive obligations are discussed in paragraphs 3.39–3.62. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations—and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50. Do you agree with this preliminary view? Why or why not?

We agree with this preliminary view. Liabilities should include constructive obligations, obligations, which are likely to be honored even if they are not legally enforceable. Recognition of constructive obligations provides useful information to investors. We also agree to the guidance in 3.50. There is no liability if there is no counterparty, which will lose if resources are not transferred. Most restructuring obligations are of this form.

Question 6
The meaning of 'present' in the definition of a liability is discussed in paragraphs 3.63–3.97. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains
conditional on the entity's future actions. Three different views on which the IASB could develop guidance for the *Conceptual Framework* are put forward:
(a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions.
(b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions.
(c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity's future actions.
The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favour of View 2 or View 3. Which of these views (or any other view on when a present obligation comes into existence) do you support? Please give reasons.

We support the Board's preliminary view. View 1 seems both theoretical and extreme. View 3 has many of the same features. Thus, View 2 is the one which makes sense even though it involves more discretion and may require more guidance via specific standards. Investors are interested in more than the strict legal liabilities of the entity.

The discussion is clear and detailed. However, we miss a discussion of consequences for reporting. Which definition will lead to reported earnings numbers that make sense to users?

Question 7
Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

The ICGN supports the inclusion of additional guidance on economic resources and control. We find that the additional guidance on economic resources and control is unclear. The way we understand sections 3.4 – 3.15, the definition of an economic resource is very broad; phenomena such as know-how, customer relationships and existing work force are economic resources. The reasoning seems to be that any "source of value" (anything that produces benefits) is an economic resource. An economic resource does not have to have an owner (this is not completely clear as sometimes an owner seems to be implicit – 3.15 in particular). An asset must, however, have an owner (the entity), which controls the resource: *An entity controls an economic resource if it has the present ability to direct the use of the economic resource so as to obtain the economic benefits that flow from it* (3.23). Thus, control seems to have two characteristics. One is the narrow sense of control (ability to direct). The second is the right to benefits (ownership). This is not clear from the discussion.

In section 3.21 – 3.22, control is analyzed with respect to principals and agents. Agents do not have control since they have no ownership (but has control in the narrow sense?). Does the principal have control? The discussion does not say. We also miss a discussion of control with respect to know-how, customer relationships and existing work force. These have been the difficult cases in the past. May the entity have control of these resources, and if so, when?

Section 4 Recognition and Derecognition

Question 8
Paragraphs 4.1–4.27 discuss recognition criteria. In the IASB's preliminary view, an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability because:
(a) recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or
(b) no measure of the asset (or the liability) would result in a faithful representation of both the asset (or the liability) and the changes in the asset (or the liability), even if all necessary descriptions and explanations are disclosed.
Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

This is all very confusing!

We certainly agree that financial statements should not include information "if the level of uncertainty in the estimate is too large" (section 4.9; see also 4.26). Investors cannot rely upon such information. Indeed if such information is introduced in financial statements, investors will not know what information to trust (even if estimation uncertainty is disclosed in footnotes). Unreliable information will pollute the whole communication process.

The confusing part is the terminology. The issue we are talking about here is reliability of information (to everyone but the IASB?). In the face of universal opposition (including the ICGN), the Board in 2010 removed the term "reliability" from the Conceptual Framework and replaced it by "faithful representation". Ever since, representatives of the IASB have said repeatedly that this is just a change of wording. Faithful representation is supposed to mean the same thing as reliability. Now, the IASB will have to admit that this is not the case. Reliability is suddenly part of relevance.

This raises another issue: If estimation uncertainty is not an aspect of faithful representation, what does faithful representation mean in the current context? No one seems to know the answer to this question. Since we do not understand what it means for a measure to be a faithful representation, we are unable to comment on part (b) in question 8. We note that the document does not include any examples of measurements that are not faithful representations of assets or changes in assets. Such examples would certainly be helpful.

The ICGN recommends that the IASB revisit the terminology of the qualitative characteristics in light of the difficulties that have surfaced here.

Question 9
In the IASB's preliminary view, as set out in paragraphs 4.28–4.51, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria. (This is the control approach described in paragraph 4.36(a)). However, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the
changes that resulted from the transaction. Possible approaches include:
(a) enhanced disclosure;
(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or
(c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.
Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Again, we see some conceptual problem here in terms of the distinction between the "control approach" and the "risk and rewards approach". This distinction was important to the revenue recognition debate. However, the final exposure draft recognized that "control" and "risks and rewards" are closely related (ED 2011/6; 37 (c)). Our interpretation of the control concept is that it now includes "risk and reward". An entity cannot control a resource unless it has a right to receive the cash flows it generates. It follows that "risks and rewards" must belong to the entity. This is fine! "Control" and "risk and rewards" are Siamese twins. If they are separated, and sometimes they will be, problems will arise. See our response to question 7 above and our responses to the exposure drafts on revenue recognition.

Now we turn to the substantive issues. If the firm retains a component of an asset or a liability, we believe the firm should continue to recognize the asset or the liability (approach (c) above). Transferring accounts receivable and retaining the credit risk is a financing transaction, and accounts receivable should not be derecognized. We realize that the firm, which sells the receivable, will then have accounts that differ from the accounts of a similar firm, which has provided a guarantee to a third party (but has never owned the receivable). This is a comparability issue ("history matters"), but not a serious one. Recognizing the receivable as well as the obligation to the buyer of the asset, will provide a fair view of the risks and leverage involved. It is also possible to argue that history should matter. In one case, the valuation of the guarantee is based on a transaction, in the other it is just a subjective estimation.

Section 5 Definition of equity and distinction between liabilities and equity instruments

Question 10

The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1–5.59. In the IASB's preliminary view:

(a) the *Conceptual Framework* should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

(b) the *Conceptual Framework* should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:

(i) obligations to issue equity instruments are not liabilities; and

(ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a)).

(c) an entity should:

(i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure, or an allocation of total equity.

(ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.

(d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

This is a difficult issue. Many claims on the entity's cash flows will have characteristics that make them different from equities and liabilities in the strict sense. For investors it is important to predict the risks and returns of each claim. For financial presentation purposes it may still be necessary to classify claims as either equities or liabilities. Currently there seems to be two alternative classification schemes. The one chosen by the IASB implies a fairly broad definition of equity which includes obligations to issue equity. The alternative is a narrower definition including only the most junior claim which in most cases will be common stock.

The ICGN membership is likely to have some differing opinions on this issue. Some members, who represent owners of voting stock, will prefer the narrow approach because they focus on the valuation of common stock and the stewardship of the owners' capital. The characteristics of senior claims may then not be very important since they will all have priority before common stock.

Other members will prefer the wider definition suggested by the IASB. This definition flows logically from the definition of liabilities. Equity will in this case contain claims with common characteristics. Their returns will in most cases be highly correlated with the enterprise return. However, there are problems with this approach as well. As noted in IAS 32, claims on a variable number of shares which depends on the value of equity should not be classified as equity. Owners of such claims may be indifferent between holding those and holding straight debt. The return of such claims will be fixed unless the firm enters bankruptcy. Hence there must be exceptions to the simple definition of equity proposed in the exposure draft which makes it less useful in practice.

Section 6 Measurement

Question 11
How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6–6.35. The IASB's preliminary views are that:
(a) the objective of measurement is to contribute to the faithful representation of relevant information about:
(i) the resources of the entity, claims against the entity and changes in resources and claims; and
(ii) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.
(b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;
(c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI;
(d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:
(i) for a particular asset should depend on how that asset contributes to future cash flows;
(ii) for a particular liability should depend on how the entity will settle or fulfil that liability.
(e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained; and
(f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.
Do you agree with these preliminary views? Why or why not? If you disagree, what alternative approach to deciding how to measure an asset or a liability would you support?

We find the approach to measurement in this chapter both logical and pragmatic. It recognizes the importance of the income statement as well as the balance sheet. Sometimes the margins generated by past transactions revealed by the income statement, is the most relevant to investors and analysts (6.13). In other cases the fair value of assets and liabilities are more relevant.

We also very much appreciate the discussion on the trade-offs that will have to be made. In 6.13 it is noted that estimating fair values may be costly and subjective. An objective (reliable) estimate may be very costly to obtain.

As noted above we still have problems with the concept of faithful representation. The meaning of the statement that "the objective of measurement is to contribute to the faithful representation of relevant information (6.10)" is therefore not immediately clear to us. We also note that hedge accounting may be required to make financial statements faithful representations (6.22).

Question 12
The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73–6.96. The IASB's preliminary views are that:
(a) if assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost-based measurements normally provide information that is more relevant and understandable than current market prices.
(b) if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.
(c) if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.
(d) if an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.
Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

We find the approach to measurement explained in this chapter logical, pragmatic and informative. In particular, we found the discussion of various types of cash flow based measurements enlightening. However, we believe it may be interesting to explore further the relationship between cost and cash flow based measures. Depreciation and amortization of assets as well as liabilities may depend on cash flows and may even change as expected cash flows change. Such methods may imply carrying amounts that depend on both acquisitions cost and cash flows. Will such methods be classified as cost based or cash flow based? As methods of this kind may be often providing relevant information, more attention should be paid to this issue.

Some minor comments: The price paid in a transaction to acquire an asset should be termed "cost" irrespective of subsequent measurement. Using the term "fair value" when subsequent measurement is "fair value" and "cost" if subsequent measurement is "cost" is likely to be more confusing (6.63). The approach to Day 1 gains and losses makes sense. Day 1 gains and losses may be recognized only when the seller is under duress (6.67). Here it should be added that duress is a necessary, but not sufficient condition. Even if the seller is desperate to transact, there may be many buyers and the price may be approximately normal.

Question 13
The implications of the IASB's preliminary views for the subsequent measurement of liabilities are discussed in paragraphs 6.97–6.109. The IASB's preliminary views are that:
(a) cash-flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.
(b) a cost-based measurement will normally provide the most relevant information about:
(i) liabilities that will be settled according to their terms; and
(ii) contractual obligations for services (performance obligations).
(c) current market prices are likely to provide the most relevant information about liabilities that will be transferred.
Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

We find the approach to measurement explained in this chapter to be again both logical and pragmatic. The classification of liabilities is informative. The connection between classes of liabilities and categories of measurement makes sense in principle. The details may be left to standard setting.

Question 14
Paragraph 6.19 states the IASB's preliminary view that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or fulfilled, may not provide information that is useful when assessing prospects for future cash flows. For example, cost-based information about financial assets that are held for collection or financial liabilities that are settled according to their terms may not provide information that is useful when assessing prospects for future cash flows:

(a) if the ultimate cash flows are not closely linked to the original cost;

(b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets or financial liabilities; or

(c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (ie the asset or the liability is highly leveraged).

Do you agree with this preliminary view? Why or why not?

We agree with the argument presented in 6.19. In certain cases cost based measurement may not be very relevant. Derivatives are one class of instruments for which this is the case because cost is not linked to future cash flows. (It is then very important that financial statements reflect hedging strategies.) We also agree that cost may not be useful when market (or other variable) factors have a disproportionate effect on the value of the asset. This is item (c). Item (b) requires more explanation. There may be variability in cash flows that can be handled by cost based methods.

Question 15
Do you have any further comments on the discussion of measurement in this section?

We have no further comments on measurement at this time.

Section 7 Presentation and Disclosure

Question 16
This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the Conceptual Framework. In developing its preliminary views, the IASB has been influenced by two main factors:
(a) the primary purpose of the Conceptual Framework, which is to assist the IASB in developing and revising Standards (see Section 1); and
(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8 of the DP), including:
(i) a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;
(ii) amendments to IAS 1; and
(iii) additional guidance or education material on materiality.

Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the Conceptual Framework on:
(a) presentation in the primary financial statements, including:
(i) what the primary financial statements are;
(ii) the objective of primary financial statements;
(iii) classification and aggregation;
(iv) offsetting; and
(v) the relationship between primary financial statements.
(b) disclosure in the notes to the financial statements, including:
(i) the objective of the notes to the financial statements; and
(ii) the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information.

Why or why not? If you think additional guidance is needed, please specify what additional guidance on presentation and disclosure should be included in the Conceptual Framework.

ICGN agrees with the proposals and welcomes the inclusion of a section on presentation and disclosure in the CF, which should help focus disclosure on relevance and avoid unnecessarily voluminous reporting.

Question 17
Paragraph 7.45 describes the IASB's preliminary view that the concept of materiality is clearly described in the existing Conceptual Framework. Consequently, the IASB does not propose to amend, or add to, the guidance in the Conceptual Framework on materiality. However, the IASB is considering developing additional guidance or education material on materiality outside of the Conceptual Framework project. Do you agree with this approach? Why or why not?

ICGN believe that the CF should include more guidance on the concept of materiality as there can be uncertainty for preparers on how what information to disclose. The result can be information that is not relevant – sometimes by disclosing too much (of little relevance) which complicates the comprehensiveness of the financial disclosure. We believe that materiality is based on principles that are largely entity specific and this requires the application of judgment by preparers. It would be beneficial for users of financial disclosure if there is more guidance for this judgment for the application of materiality by preparers. We believe that materiality is not being applied with the same rigor as the more clearly defined measured items in the financial statements. It is however critical to the users of financial disclosure.

Question 18
The form of disclosure requirements, including the IASB's preliminary view that it should consider the communication principles in paragraph 7.50 when it develops or amends disclosure guidance in IFRSs, is discussed in paragraphs 7.48–7.52. Do you agree that communication principles should be part of the Conceptual Framework? Why or why not? If you agree they should be included, do you agree with the communication principles proposed? Why or why not?

ICGN believes the communication principles should be part of the CF as they are vital to the usability of financial reports. The communication principles proposed in paragraphs 7.45-7.52 are comprehensive and we appreciate the emphasis on clear, balanced and understandable information. Disclosure as direct as possible without the loss of usefulness is very relevant to users of financial information.

Section 8 Presentation in the statement of comprehensive income—profit or loss and other comprehensive income

Question 19
The IASB's preliminary view that the Conceptual Framework should require a total or subtotal for profit or loss is discussed in paragraphs 8.19–8.22. Do you agree? Why or why not? If you do not agree do you think that the IASB should still be able to require a total or subtotal profit or loss when developing or amending Standards?

Users of financial reporting rely on transparent disclosure of which profit or loss is a key indicator for assessing the reporting entity's performance and prospects for future cash flow generation. In general, the profit or loss total or subtotal is regarded to have more predictive value than total comprehensive income as profit and loss involves past actions by the reporting entity that it has had control over. With OCI this is generally the case to a lesser extent – however a blurred line exists for banking groups and insurance companies. Market participants find it most useful to analyze recurring and predictive cash flows and the profit and loss excludes remeasurement gains/losses which are hard for users of financial reporting to predict and of which the timing and persistency is hard to determine. We believe that a subtotal for profit and loss would be the best way to bridge the gap between the pros and cons of the profit and loss total on the one hand and the comprehensive income on the other. The arguments presented in 8.20 and 8.21 are both valid. It should be made clear to users of financial reporting that the profit and loss is more closely aligned to the reporting entity's business model and prospects, but that OCI also includes useful information on issues that affect the riskiness and prospects of the reporting entity.

Question 20
The IASB's preliminary view that the Conceptual Framework should permit or require at least some items of income and expense previously recognised in OCI to be recognized subsequently in profit or loss, i.e. recycled, is discussed in paragraphs 8.23–8.26. Do you agree? Why or why not? If you agree, do you think that all items of income and expense presented in OCI should be recycled into profit or loss? Why or why not? If you do not agree, how would you address cash flow hedge accounting?

Recycling adds complexity to the use of financial reporting and can hinder the understandability and comparability of information in financial statements. As recycling may obscure income and expenses in a reporting period and we believe that the issue in this question requires a lot of consideration and caution regarding the extent to which income and expenses have to be recycled. We also agree with 8.25 (d) that profit or loss can be susceptible to earnings management as a result of recycling when recycling occurs upon realization. It is our view that the possibility of earnings management should be reduced to an absolute minimum where possible.

We also agree that the profit and loss is the primary source of information about the return a reporting entity has made with its economic resources, but are concerned with the timing of income and expense items as there is the possibility that these items can be recognized with discretion by the entity's management, thereby managing earnings and compromising the comparability and understandability of the financial statements. We understand that in some cases the comparability might actually improve thanks to recycling, but external users of financial reporting cannot easily make that judgment.

We believe that there should be limited recycling of remeasurements and only where that leads to higher levels of comparability and understandability of the performance of the entity and the allocation of its economic resources. Remeasurements that are expected to fully reverse or significantly change over the holding period of the asset or liability should not be recycled through profit and loss in cases where this does not improve the materiality of information in the profit or loss.

Question 21
In this Discussion Paper, two approaches are explored that describe which items could be included in OCI: a narrow approach (Approach 2A described in paragraphs 8.40–8.78) and a broad approach (Approach 2B described in paragraphs 8.79–8.94). Which of these approaches do you support, and why? If you support a different approach, please describe that approach and explain why you believe it is preferable to the approaches described in this Discussion Paper.

The transparency and comparability of the financial information is the most important to the users of financial reports. This is why we believe that the strictest definition of the application of recycling OCI items (when and only when the recycling results in relevant information) is the best option. This approach is the broad 'recycle when relevant' approach (2B). We believe that recycling all types of items in OCI can result in a profit and loss that is a mix of relevant and irrelevant items – not to mention an increased risk in earnings management. As the profit and loss is viewed by a lot of users as the criterion or a major input for measuring the performance of the entity's management, we support the enhancing of the predictability and understandability of profit and loss.

Under the narrow 'always recycle' approach (2A), with transitory remeasurements recycling does not always provide sufficiently relevant information about a transaction or other event in a subsequent period. Some think that recycling of income or expense results in income and expense in profit or loss that may provide little additional relevant information for the period, affecting comparability and understandability.

The broad 'recycle when relevant' approach (2B) might seem more complex and less consistent at first, but this approach gives the IASB discretion to determine when recycling may be the case. The narrow 'always recycle' approach (2A) provides little flexibility for the IASB to use OCI as IFRSs develop in the future.

This question deals with the choice between method 2A and 2B, but eliminating recycling would reduce complexity as recycling may obscure the income and expenses relating to the period. If income and expense are recognized in the statement of comprehensive income only once, the financial statements may be more comparable and understandable and perhaps profit or loss would be also be less susceptible to earnings management. As mentioned above, we believe that there should be limited recycling of remeasurements and only where that leads to higher levels of comparability and understandability of the performance of the entity and the allocation of its economic resources.

Section 9 Other issues

Question 22
Chapters 1 and 3 of the existing Conceptual Framework Paragraphs 9.2–9.22 address the chapters of the existing Conceptual Framework that were published in 2010 and how those chapters treat the concepts of stewardship, reliability and prudence. The IASB will make changes to those chapters if work on the rest of the Conceptual Framework highlights areas that need clarifying or amending. However, the IASB does not intend to fundamentally reconsider the content of those chapters. Do you agree with this approach? Please explain your reasons. If you believe that the IASB should consider changes to those chapters (including how those chapters treat the concepts of stewardship, reliability and prudence), please explain those changes and the reasons for them, and please explain as precisely as possible how they would affect the rest of the Conceptual Framework.

We believe the IASB should be open to reconsider Chapter 1 and 3 of the Conceptual Framework.

Prudence: being widely accepted as a concept, continues to lead to different interpretations and we believe that it would be helpful for the Conceptual Framework to be more explicit about prudence as the framework lays the foundation of the conservatism of recognition, measurement and disclosure principles. There has been some debate about how a foundation of standards can ignore the concept of prudence/conservatism and its individual standards can still be based on the spirit of prudence. We acknowledge that IAS1 was designed to have over-riding powers, but a prudence over-ride comes into action once an individual standard leads to a conflict with the objective of financial statements set out in the Conceptual Framework. As it is the Conceptual Framework that does not include the concept of prudence/conservatism, this over-ride loop is not effective and therefore we believe the Conceptual Framework should be more explicit about the concept of prudence.

Stewardship: In the past, the ICGN has been strongly supporting the stewardship objective of financial reporting (see our previous submissions to the IASB on this subject). The decision of the IASB to drop the term "stewardship" from the conceptual framework in the final stages of the process created confusion. Many found the reason given for eliminating "Stewardship" – the difficulties translating the term into other languages – rather odd. However, we believe the description of the objectives of financial reporting in Chapter 1 of the conceptual framework encompasses what is commonly referred to as stewardship. We also appreciate the statements by the Board here and elsewhere that it has not been the Board's intention to remove stewardship as an objective of financial reporting. At this point, we do not find it necessary to reconsider the discussion of stewardship in chapter 1 of the CF.

Reliability: The ICGN has also been critical of the IASB's decision to replace "reliability" by "faithful representation". The use of these terms in this discussion paper has confirmed our view that this action was unfortunate. See our response to Q8 above. It seems clear that "reliability of measurement" cannot be replaced by "faithful representation". The decision to include "uncertainty of estimates" in "relevance" only confuses matters further. We therefore believe the IASB should reconsider its decision to drop reliability as a qualitative characteristic of financial information. The board should make another attempt to define these concepts in a way that may be understandable and acceptable to users of financial statements. Reliability is term that has many dimensions, and different respondents may focus on different aspects of the term. However, we still believe that it will be possible to agree on a common understanding of the term.

Question 23
Business model
The business model concept is discussed in paragraphs 9.23–9.34. This Discussion Paper does not define the business model concept. However, the IASB's preliminary view is that financial statements can be made more relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities. Do you think that the IASB should use the business model concept when it develops or revises particular Standards? Why or why not? If you agree, in which areas do you think that the business model concept would be helpful? Should the IASB define 'business model'? Why or why not? If you think that 'business model' should be defined, how would you define it?

ICGN believe that there is no harm in IASB defining the business model concept in the Conceptual Framework. However, we believe that application of it will only be sufficiently useful in a limited number of industries (e.g. insurance). We believe the concept of business model should not be applied in standard-setting as it could result in different classification, measurement and disclosure of the same economic item – identical financial assets being classified in different ways depending on the business model of the reporting entities. Also, we believe the business model concept is difficult to define and to enforce over time as entities and industries develop. This would add a layer of complexity to financial reporting that will not benefit the transparency and understandability for the users of financial reporting. Earnings management would also be one of our concerns if the management of a reporting entity has discretion over which business model is suitable from a reporting stand-point.

Question 24
Unit of account
The unit of account is discussed in paragraphs 9.35–9.41. The IASB's preliminary view is that the unit of account will normally be decided when the IASB develops or revises particular Standards and that, in selecting a unit of account, the IASB should consider the qualitative characteristics of useful financial information. Do you agree? Why or why not?

We agree with the IASB that the unit of account should be decided when particular Standards are revised and that qualitative characteristics of usefulness should considered.

Question 25
Going concern
Going concern is discussed in paragraphs 9.42–9.44. The IASB has identified three situations in which the going concern assumption is relevant (when measuring assets and liabilities, when identifying liabilities and when disclosing information about the entity). Are there any other situations where the going concern assumption might be relevant?

We agree with the identified situations where the going concern assumption would affect an entity's financial statement.

Question 26
Capital maintenance
Capital maintenance is discussed in paragraphs 9.45–9.54. The IASB plans to include the existing descriptions and the discussion of capital maintenance concepts in the revised Conceptual Framework largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change.
Do you agree? Why or why not? Please explain your reasons.

The ICGN agrees from a practical standpoint with the IASB that existing descriptions and discussion of capital maintenance could be left largely unchanged until the accounting for high inflation has been revised. However, we believe that ideally the Conceptual Framework should precede an accounting standard change on accounting for inflation. We support the current approach where management of a reporting entity selects the concept of capital maintenance that provides the most useful information to users of financial statements.

If you would like to discuss any of these points, please do not hesitate to contact Kerrie Waring, ICGN Managing Director at +44 207 612 7079 or kerrie.waring@icgn.org

Yours sincerely,

Elizabeth Murrall

Chairman, ICGN Accounting and Auditing Practices Committee

Michelle Edkins

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ICGN Accounting and Auditing Practices Committee

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