David Schraa
Regulatory Counsel

November 24, 2015

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street, First Floor
London, EC4M 6XH
United Kingdom

RE: ED/2015/3 Exposure Draft - Conceptual Framework for Financial Reporting (ED) and Exposure Draft - ED/2015/4 – Updating References to the Conceptual Framework[1].

Dear Mr. Hoogervorst:

The Institute of International Finance (IIF), via its Senior Accounting Group (SAG), welcomes the opportunity to comment on the Exposure Draft - ED/2015/3 - Conceptual Framework for Financial Reporting (ED) and the Exposure Draft - ED/2015/4 – Updating References to the Conceptual Framework.

The SAG shares the IASB's objective to describe the objective of and concepts for general purpose financial reporting in the Conceptual Framework (CF). The SAG acknowledges the work done to update and improve the existing framework. Nevertheless, in some areas the SAG does not see how the proposed language would help the IASB in its standard setting activities.

The SAG is also concerned about the implications of other areas where the updated text may not represent an improvement. This is particularly the case with the revised definition of a liability, which may place too much emphasis on the entity's having no practical ability to avoid the transfer, which can often be difficult to determine, and less on whether the obligation has arisen from past events. The revised definition will need extensive testing to understand whether it is likely to give different results from the existing practice in a wide variety of circumstances and whether these differences would represent an improvement. For the purpose of defining a liability, the SAG believes that it would be more relevant, more easily understandable, and more practical to consider whether there is an expectation of outflows of

[1] The present letter provides responses to the list of questions raised in ED 2015/3 while comments on the ED/2015/4 have been included below question 18.

economic benefits from the entity in settlement of the obligation, as laid down in the current definition.

Moreover, the SAG believes that dealing with the existing inconsistency regarding the definition of financial liabilities in IAS 32 *Financial Instruments: Presentation* in the distinction between financial liabilities and equity should be a priority before attempting to change the definition of a liability within the CF. To that end, the SAG welcomes the IASB's research project on this issue.

Finally, while the SAG does not underestimate the challenges faced by the IASB to find a conceptual basis of the use of OCI, given the fundamental role of financial performance for both preparers and users, the SAG believes that the IASB should continue its work on this issue.

The SAG would be pleased to pursue any issues raised in this letter more fully. Should you have any comments or questions on this letter, please contact the undersigned or Dorothee Bucquet (dbucquet@iif.com; +1 202 682 7456).

Very truly yours,

<u>Detailed Comments on the list of questions</u>

Question 1—Proposed changes to Chapters 1 and 2: amendments to the existing CF
Do you support the proposals:
(a) to give more prominence, within the objective of financial reporting, to the importance of providing information needed to assess management's stewardship of the entity's resources;

The SAG understands that the proposed ED aims to address certain stakeholders' opinions by explicitly including in the CF the concept of "management's stewardship". Given the elasticity and range of potential meanings and uses of that concept, the SAG supports the IASB's proposal to include consideration of this concept as a component of the general objective of financial statements supporting investment decisions; however, management's stewardship, i.e. how effective the deployment of the asset has been, should not be given greater priority than as part of the overall objective. As a result, the SAG would be concerned if the inclusion of the concept were intended or interpreted to have broader implications or consequences.

(b) to reintroduce an explicit reference to the notion of prudence (described as caution when making judgments under conditions of uncertainty) and to state that prudence is important in achieving neutrality;

While the SAG acknowledges the view of certain stakeholders that there should be an explicit reference to "prudence" in the CF, the SAG believes that this could cause confusion and could adversely affect the concepts of "relevance" and "faithful representation" if it were used to prohibit the recognition of unrealized gains or to require bias to be used in measurement. Many members of the SAG would therefore prefer not to see the term "prudence" used in the CF.

The SAG disagrees that conceptually "neutrality is supported by the exercise of prudence" as stated under 2.18 because as noted in 2.17 "a neutral depiction is without bias". Although the ED attempts to define "prudence" as the exercise of caution when making judgments in conditions of uncertainty, the word inevitably has some ambiguity, both intrinsically and because of the past use of the term, which risks some stakeholders' placing undue emphasis on it.

If the IASB decides to include the word in the CF, the SAG suggests that its definition and explanatory text should remain as set out in 2.18 and in the description of "cautious prudence" under BC 2.9 and BC 2.10. The SAG strongly believes that any attempt to broaden this definition or link it to the definition of "asymmetrical prudence" as discussed under BC2.11 to BC 2.15, is unnecessary. In particular, it would be contrary to the neutrality and objectivity of financial statements to introduce a general expectation that losses should or would be recognized earlier than gains. When using the CF for standard-setting purposes, the SAG recommends the IASB consider each proposed standard on its own merits, given the facts and circumstances at issue.

(c) to state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form;

While the SAG agrees that substance of an economic phenomenon should be considered to achieve a faithful representation of financial information, the SAG believes that the legal form is also relevant to considerations of faithful representation. There is often less of a dichotomy between legal form and economic substance than is indicated by 2.14 and understanding the terms of the contract is often critical to understanding its economic substance. This raises concern in the context of financial instruments where the terms of the legal contract are particularly important in determining the appropriate accounting.

As such we are concerned that paragraph 4.54 of the ED suggests that the "implied", i.e., non-contractual, elements of a transaction should be taken into account as if they were contractual, which would appear to be contrary to the conclusion reached in IFRS 9 "Financial Instruments" paragraph B4.1.13 for Instrument E, where the general legislative power of write down is not taken into account in determining whether the contractual cash flows of the instrument would be solely payments of principal and interest.

The SAG agrees that substance has a role to play in financial reporting; however, it should take a prominent, but not dominant, place. In the first instance, legal form should prevail, as it is undisputable and enforceable, and should be complemented, if deemed necessary, with reflection of the substance of the economic phenomenon. The SAG believes that the additional insertion proposed by the ED under paragraph 2.14 would put too much emphasis on the economic phenomenon and therefore we would propose to remove it.

(d) to clarify that measurement uncertainty is one factor that can make financial information less relevant, and that there is a trade-off between the level of measurement uncertainty and other factors that make information relevant; and

On the one hand, the SAG agrees that measurement uncertainty is an important factor in considering whether the resulting financial information is useful. However measurement uncertainty itself does not necessarily make information irrelevant. As stated in 2.13, a high level of measurement uncertainty does not prevent the use of an estimate if that estimate provides the most relevant information.

On the other hand, uncertainty can make the resulting information less faithfully representative. Putting the discussion of measurement uncertainty only under relevance may suggest that relevance has more importance than faithful representation, whereas the SAG believes it should be considered in both contexts.

(e) to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information?

The SAG agrees that relevance and faithful representation should remain the two fundamental characteristics of useful financial information.

Question 2—Description and boundary of a reporting entity: new chapter

Do you agree with:
(a) the proposed description of a reporting entity in paragraphs 3.11–3.12; and

The SAG has no comments on this question.

(b) the discussion of the boundary of a reporting entity in paragraphs 3.13–3.25?

SAG members disagree with the statement under 3.23 that, in general, consolidated financial statements are more likely to provide useful information to users of financial statements than unconsolidated financial statements. Consolidated and unconsolidated financial statements are often equally important but in different ways, but the ED as drafted does not capture this balance. For example, creditors or minority shareholders may have claims only on a sub-consolidated entity. There is no reason to introduce bias toward consolidated statements.

Question 3—Definitions of elements: new chapter

Do you agree with the proposed definitions of elements (excluding issues relating to the distinction between liabilities and equity):
(a) an asset, and the related definition of an economic resource;

The SAG has no comments on this question.

(b) a liability;

The key issue around the definition of a liability is the underlying definition of a "present obligation", where the entity has no practical ability to avoid the transfer. This key issue is discussed under question 4.

(c) equity;

The SAG supports the ED's definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

The SAG also welcomes the IASB's undertaking of a project to address problems in distinguishing between liabilities and equity. As stated by BC4.104, the research project could require changes to the definitions of a liability or equity in the CF. However, the IASB expects that any such project would not lead to changes in the Exposure Draft's proposals to identify whether the reporting entity has a present obligation to transfer an economic resource.

(d) income; and
(e) expenses?

The SAG does not have comments on the definition of income and expenses.

Question 4—Present obligation
Do you agree with the proposed description of a present obligation and the proposed guidance to support that description? Why or why not?

The IASB set out three views on situations in which a present obligation to transfer economic resources arises (BC4.55). The SAG understands "view 1", representing the strict-obligation approach was rejected by the IASB because it would define a liability too narrowly. In contrast, "view 3" would not set any meaningful limit on recognizing a liability, therefore "view 2", which defines present obligation as a situation where an entity "has no practical ability to avoid the transfer", is the only remaining viable option. But that raises the issue of how to apply it.

It is understood that the definition of a liability should be assessed in light of two conditions as stated under 4.31: "no practical ability to avoid" and that the "obligation arisen from past events". However, there are situations where whether or not a past event has occurred is difficult to determine, so this may not be an effective counter-balance when there is no practical ability to avoid a future obligation. The example of a bank levy illustrates this point, whereby the "past event" could be the passing of relevant legislation rather than operating in the market over time so there is a danger of recognizing a perpetual liability which would have other unintended knock-on effects on measurement. The SAG suggests that examples of many different types of liabilities should be tested against the definition before concluding whether it represents an improvement to the current definition.

More generally, the SAG notes that including the notion of economic compulsion in the concept of "no practical ability to avoid" is a "slippery slope" and goes beyond the frontier of the current use of "constructive obligation"[2]. As explained above, in the absence of a clearly related and limiting "past event", it could for example create a liability with infinite duration.

In addition, the SAG is concerned about the increased complexity and subjectivity implied by the economic assessment required to satisfy the definition of a liability. Indeed, paragraph 4.32 requires an economic assessment of the consequences of meeting the obligation or avoiding it[3], including assessing which situation would be "significantly more adverse". In addition to its inherent complexity, this assessment depends on facts, assumptions and circumstances and could change over time. The proposed definition would not only be much more subjective but would be open to interpretation, and could lead to endless debate with auditors, potentially undermining comparability.

While the SAG acknowledges the IASB's concern expressed in BC4.4 that "the explicit reference in the definitions of assets and liabilities to the flows of economic benefits blurs the distinction between the resource or obligation and the resulting flows of economic benefits", for the reasons explained above, the SAG believes that for the purpose of defining a liability, it is more relevant, more easily understandable, and more practical to consider the expectations of future outflows of economic benefits, as laid down in the current definition.

In addition, the SAG believes that the application of this proposed definition presents a fundamental change from the way some capital instruments with step-up arrangements are currently classified under IAS 32. The SAG is concerned about how economic compulsion could be used to create liabilities, which are not obligations because they can in fact be avoided, particularly if circumstances change.

Finally, the ED acknowledges major inconsistencies with IAS 32: these should be dealt with as a priority. As proposed pursuant to the alternative view of Suzanne Lloyd and Patrick Finnegan[4], the SAG recommends deferring any change in the definition of a liability to completion of the IASB's research project "Financial Instruments with Characteristics of Equity".

Question 5—Other guidance on the elements
Do you have any comments on the proposed guidance?
Do you believe that additional guidance is needed? If so, please specify what that guidance should include.

The SAG has no comments on this section.

Question 6—Recognition criteria
Do you agree with the proposed approach to recognition? Why or why not? If you do not agree, what changes do you suggest and why?

[2] As also defined by IAS 37 paragraph 10.
[3] Unless legally enforceable.
[4] BC AV8 to AV14.

The SAG has no comments on this section.

Question 7—Derecognition
Do you agree with the proposed discussion of derecognition? Why or why not? If you do not agree, what changes do you suggest and why?

The SAG has no particular comments on this section, however it does not see to what extent this new chapter would enhance the helpfulness of the CF.

Question 8—Measurement bases
Has the IASB:
(a) correctly identified the measurement bases that should be described in the Conceptual Framework? If not, which measurement bases would you include and why?
(b) properly described the information provided by each of the measurement bases, and their advantages and disadvantages? If not, how would you describe the information provided by each measurement basis, and its advantages and disadvantages?

The SAG agrees with the two main measurement bases, but notes that the ED is not exhaustive in listing the examples under those measurement bases and hence would recommend the IASB indicate this fact. For example, entry-value measurement is part of the current value measurement bases but is absent from the ED.

Question 9—Factors to consider when selecting a measurement basis
Has the IASB correctly identified the factors to consider when selecting a measurement basis? If not, what factors would you consider and why?

The criteria determining measurement basis replicate those that underpin the useful character of financial reporting by expressing some additional information; however the ED does not provide further guidance on which criteria would be more relevant in a given particular situation for the purpose of selecting a measurement basis. As such, the SAG does not object to the proposed factors, but at the same time does not see how they are helpful from a standard-setting perspective.

Question 10—More than one relevant measurement basis
Do you agree with the approach discussed in paragraphs 6.74–6.77 and BC6.68? Why or why not?

The ED suggests under paragraph 6.75 that the use of dual measurement bases would be rare. The SAG notes that portfolios measured under FV through OCI can represent a large amount of assets; therefore the SAG disagrees that "in most cases" there should be only one measurement basis.

Question 11—Objective and scope of financial statements and communication
Do you have any comments on the discussion of the objective and scope of financial statements, and on the use of presentation and disclosure as communication tools?

The SAG has no comments on this section.

Question 12—Description of the statement of profit or loss
Do you support the proposed description of the statement of profit or loss? Why or why not?
If you think that the Conceptual Framework should provide a definition of profit or loss, please explain why it is necessary and provide your suggestion for that definition.

- *Are differences between the two elements of comprehensive income clearly articulated?*
- *What criteria would be helpful for the recognition of amounts in OCI?*

The SAG notes that the IASB is moving away from a two-component statement of comprehensive income to a model where the P&L is as inclusive as possible and where all items end up being reported in P&L. As a result, there is a rebuttable presumption that income and expenses are included in P&L and a rebuttable presumption that items included in OCI will be recycled in P&L.

The SAG also notes that there are no guidelines on what would be relevant to include in OCI other than the dual presentation that exists under IFRS 9. Since the IASB has been unable to progress work in terms of what performance means, it was difficult to be more precise in the ED. As also stated in BC7.35, each current use of OCI has an explanation, but there is no single conceptual basis that underlies all of those cases. BC7.42 concludes that the statement of profit and loss should be as inclusive as possible.

Overall, SAG members question the usefulness of the criteria listed in the ED for the purpose of making decisions about the presentation of income and expenses and in particular on what amounts should be reported in OCI and whether and when they should be subsequently reclassified into P&L.

While the SAG acknowledges the complexity and challenging nature of this issue, in light of the critical role of financial performance for both preparers and users, the SAG believes that the IASB should continue its work on the conceptual use of P&L vs OCI.

Question 13—Reporting items of income or expenses in other comprehensive income
Do you agree with the proposals on the use of other comprehensive income? Do you think that they provide useful guidance to the IASB for future decisions about the use of other comprehensive income? Why or why not?
If you disagree, what alternative do you suggest and why?
What other criteria would be helpful for the recognition of amounts in OCI?

See comments under question 12.

Question 14—Recycling
Do you agree that the Conceptual Framework should include the rebuttable presumption described above? Why or why not?
If you disagree, what do you propose instead and why?

See comments under question 12.

Question 15—Effects of the proposed changes to the Conceptual Framework
Do you agree with the analysis in paragraphs BCE.1–BCE.31? Should the IASB consider any other effects of the proposals in the Exposure Draft?

The SAG agrees with the inconsistencies listed by the ED.

Question 16—Business activities
Do you agree with the proposed approach to business activities? Why or why not?

The SAG welcomes the fact that the ED clearly states that the nature of an entity's business activities should affect standard setting[5].

Question 17—Long-term investment
Do you agree with the IASB's conclusions on long-term investment? Why or why not?

The SAG has no comments on this issue.

Question 18—Other comments
Do you have comments on any other aspect of the Exposure Draft? Please indicate the specific paragraphs or group of paragraphs to which your comments relate (if applicable).
As previously noted, the IASB is not requesting comments on all parts of Chapters 1 and 2, on how to distinguish liabilities from equity claims (see Chapter 4) or on Chapter 8.

The SAG has no additional comments.

SAG's comments on ED/2014/4- Updating References to the Conceptual Framework

Question 1—Replacing references to the Conceptual Framework
The IASB proposes to amend IFRS 2, IFRS 3, IFRS 4, IFRS 6, IAS 1, IAS 8, IAS 34, SIC-27 and SIC-32 so that they will refer to the revised Conceptual Framework once it becomes effective.
Do you agree with the proposed amendments? Why or why not?

The idea that users should have a reasonable knowledge of accounting is proposed for deletion in the accounting standards as part of the consequential amendments following the CF.

[5] The SAG notes that the ED does not use the label "business model"; however that should not prejudice its specific use in IFRS 9, for the reasons explained in the SAG's response letter on DP 2013/1.

The SAG believes that "accounting" should be included along with knowledge of the business and economic activities as part of the understanding that users should be expected to have. If users cannot be expected to have an understanding, it may be difficult to ensure that disclosures, such as of accounting policies, are focused on key assumptions and judgments and do not merely repeat the requirements of IFRS. As a consequence, the SAG does not support the amendment to remove that assumption from IAS 8 paragraph 6.

Question 2—Effective date and transition

The IASB proposes that:

(a) a transition period of approximately 18 months should be set for the proposed amendments. Early application should be permitted. (b) the amendments should be applied retrospectively in accordance with IAS 8, except for the amendments to IFRS 3. Entities should apply the amendments to IFRS 3 prospectively, thereby avoiding the need to restate previous business combinations.

Do you agree with the proposed transition provisions and effective date? Why or why not?

The SAG is concerned that there is an expectation that preparers will identify accounting policies that are inconsistent with the CF when it is issued and change their policies retrospectively, within 18 months. It may require considerable work to determine whether an accounting policy is based solely on policies that may be inconsistent with the CF, or has been developed by analogy with an existing accounting standard. If the accounting standard has not been amended for any inconsistency with the CF, it seems unreasonable to expect the entity to determine how the accounting standard would be amended and change the accounting policy accordingly. Given how the hierarchy in IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" is likely to work in practice, we recommend that there be no specific requirement to review and update accounting policies unless this is needed for consistency with a change in accounting standards.