



Our Ref.: C/FRSC

Sent electronically through the IASB Website (www.ifrs.org)

14 January 2014

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

IASB Discussion Paper of A Review of the Conceptual Framework for Financial Reporting

The Hong Kong Institute of Certified Public Accountants is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We welcome the opportunity to provide you with our comments on this Discussion Paper (DP). Our responses to the questions raised in your Invitation to Comment are set out in the Appendix for your consideration.

We appreciate the effort of the IASB to initiate a project to revise the *Conceptual Framework* by issuing this DP. We broadly agree with the issues raised by the IASB and welcome in particular the attention on the definition of a liability as a 'present obligation arising from past events', given the current difficulties and inconsistent interpretation in the Standards of the concepts of constructive obligation and contingent liability.

We have also raised a number of concerns and recommendations on matters that we consider have not been sufficiently addressed or we consider should be a priority for the IASB as consequential projects. In particular:

- In our response to question 1, we recommend that the IASB identify possible conflicts between the revised *Conceptual Framework* and requirements in the existing IFRS and assess whether such conflicts should be removed or be justified so as to ensure its consistent application when being finalised.
- In our response to question 4, we highlight the difficulties in distinguishing revenue from gains and other income and ask for explicit guidance in the *Conceptual Framework* which explains the meaning of the word 'revenue' under IFRS, particularly since it is a mandatory disclosure caption under IAS 1.
- In our response to question 8, we recommend that the IASB should revisit the prohibition on amortisation of purchased goodwill as we consider that amortisation of goodwill would more faithfully represent that purchased goodwill is replaced by goodwill that is generated internally over time. Amortisation of purchased goodwill would also increase comparability between entities that grow their business organically and those that grow through acquisition and subsequent nurture.
- In our response to questions 19, 21 and 26 we urge the IASB to prescribe what should be the primary measure of an entity's performance so as to provide a conceptual basis



for distinguishing between items that should be recognised in profit or loss and items that should be recognised in other comprehensive income.

- In our response to question 20 on the matter of recycling we highlight a fundamental inconsistency in terms of the current accounting treatment for changes in fair value arising under the revaluation model in IAS 16 *Property, Plant and Equipment* and the fair value model in IAS 40 *Investment Property* and we urge the IASB for a 'quick fix' in this area.
- In our response to question 25 we highlight that there is a need for more guidance on how a reporting entity should measure its assets and liabilities when the going concern assumption is no longer appropriate.
- Although it is not specifically mentioned in our detailed response, IASB should consider to enhance the *Conceptual Framework* or in some other IFRS to highlight key principles and provide guidance on the preparation of combined financial statements under common control as currently IFRS does not include specific guidance in this respect.

Also we recommend reinstating the pre-2010 guidance on the concept of prudence when revising the *Conceptual Framework* as stated in our reply in Question 22.

If you have any questions regarding the matters raised in this letter, please contact Ben Lo, our Associate Director of Standard Setting at ben@hkiipa.org.hk.

Yours faithfully,

Simon Riley
Acting Director, Standard Setting

SR/BL

Encl.



Hong Kong Institute of CPAs

Comment on IASB Discussion Paper of A Review of the Conceptual Framework for Financial Reporting

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 the proposed purposes of the revised *Conceptual Framework* set out in paragraphs 1.26 to 1.28 of the DP. That is, we agree that, in addition to the primary purpose stated above, the *Conceptual Framework* is an important document which assists parties other than the IASB to understand and interpret existing Standards and to develop accounting policies when no Standard or Interpretation specifically applies to a particular transaction or event.

We also agree that in rare cases where the IASB would have to issue a new or revised IFRS which conflicts with the *Conceptual Framework* so as to meet the overall objective of financial reporting, reasons for such departure should be set out in the relevant Basis for Conclusions. In this connection, we recommend that the IASB should set out what are conceptually the acceptable reasons to justify departure (an example of which would be cost-benefit consideration) when it is in the stage of developing its exposure draft.

In addition, given the important role of the *Conceptual Framework* in helping preparers develop and apply an accounting policy in the absence of an IFRS that specifically applies to a transaction, other event or condition (as described in paragraph 1.27), we recommend the IASB to identify possible conflicts between the revised *Conceptual Framework* and requirements in the existing IFRS and assess whether such conflicts should be removed or can be justified so as to ensure consistent application of existing IFRS requirements. In this regard, please also note our comments in response to question 20 where we highlight an immediate inconsistency in respect of the treatment of valuation gains on non-financial assets which we consider should be addressed as a matter of priority.



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?

With respect to the definition of an asset, we agree that the term 'present' is a useful addition to the definition to ensure symmetry with the liability definition. We also agree with retaining the term 'past events' to ensure adequate focus is placed on the need to identify when or how the resources came to be controlled in order to ensure it is correctly recorded.

For the definition of a liability, we agree with the IASB's proposal to shorten the definition to focus on a 'present obligation' arising from a 'past event' as it can help ensure the focus is directed to the inherent obligations that have been incurred by an entity as of the reporting date.

However, as discussed in our responses to questions 5 and 6, the concept of a 'present obligation' which arises as a result of a 'past event' has proved challenging in practice due to conflicting requirements at the standards level in this regard, for example the strict cut-off approach now required under IFRIC 21 *Levies* compared to the requirements in respect of provisions for bonuses and voluntary redundancy payments as set out in IAS 19 *Employee Benefits* or the view in IAS 32 *Financial Instruments: Presentation* that payments which are contingent on the entity earning future profits are present obligations. We believe that this is a key area on which more clarity is needed at the Conceptual Framework level to drive consistency at the standards level.

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 agree that the term 'expected' can be removed by emphasising the notion of 'present' in the revised definitions of an asset and a liability as stated in our response to Question 2. We also agree with the proposed approach of dealing at the standards level with cases of significant uncertainty as to whether an asset or liability exists at the standards level. This is on the proviso that any such development of requirements would also have due regard to cost-benefit principles to be contained in the *Conceptual Framework*, as addressed further under Question 11 of this letter.

However, some constituents have raised concerns that the term 'capable of producing' is indeed a probability threshold and so we would recommend the IASB ensures that the *Conceptual Framework* is explicit on the difference between the two concepts to avoid further confusion.

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 with how the elements are defined in the DP and welcome the IASB providing more definitions to ensure consistent application of the *Conceptual Framework*. However, we consider that the DP fails to address the practical difficulties we have encountered in differentiating revenue from gains. For example, we have encountered the following questions:

- should a dealer in securities or commodities report their trading activities net or gross, and could either measure be properly described as 'revenue'?
- for a financial institution, is 'net interest income' a measure of 'revenue'?
- does 'revenue' only arise when a transaction with an external party occurs, or could the revaluation gain on revaluing agricultural produce under IAS 41 *Agriculture* be properly described as 'revenue'?



In this regard, stating that 'revenue' 'arises in the course of the ordinary activities of an entity' adds nothing to an understanding of what 'revenue' is, as opposed to gains (realised or unrealised) or other income, since IAS 1 *Presentation of financial statements* is explicit that an entity shall not present any items of income or expense as 'extraordinary items' and therefore the concept of 'ordinary activities' appears to encompass all activities. We would welcome explicit guidance in the *Conceptual Framework* which explains the meaning of the word 'revenue' under IFRS, particularly since it is a mandatory disclosure caption under IAS 1.

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 have found the application of the concept 'constructive obligation' to be problematic because within the Standards themselves the concept appears to be applied inconsistently, making it difficult to identify how narrowly the concept should be interpreted. For example, IFRIC 21 *Levies* takes an extremely strict cut-off approach to identifying a present obligation, whereas, for example, under IAS 19 *Employee Benefits* an entity would accrue for the expected costs of a redundancy programme, even though in practice the company is in most cases capable of cancelling the programme, given that few employees would object to being allowed to keep their jobs if given the chance.

In this connection, if the concept of 'constructive obligation' is retained, then we recommend the IASB provides more clarity in this area at the *Conceptual Framework* level and be explicit as to how a constructive obligation can be distinguished from economic compulsion or obligations that are in theory avoidable but only by ceasing to operate. Some of our constituents consider that such clarity can only be obtained if the concept of 'constructive obligation' is limited to include only obligations which are enforceable on the entity by others while unenforceable constructive obligations should be excluded from its definition. This would mean that a published past practice which creates an expectation in others that an entity will act in a certain way would not be sufficient in and of itself to create a 'constructive obligation' for the entity, if those 'others' have no effective means to force the entity to act in that way if the entity chooses not to.

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.

As stated above, we support the concept that a liability is a present obligation arising from past events. Given this, we do not support View 3 as we do not agree that an obligation which is conditional on the future actions of an entity could be described as a 'present' obligation. Instead, at the 'present' it remains to be seen whether at some future date a 'present obligation' will crystallise or not.

In terms of deciding between View 1 and View 2, our view depends on how wide the IASB intends to describe the concept of 'practically unconditional'. We are tending towards View 2, on the basis that we consider the principle of substance over legal form to be a fundamental principle of IFRS and we have concerns that View 1 could undermine that principle by encouraging artificial structuring of transactions. However, we consider that clear guidance and examples of 'practically unconditional' would be necessary in order to minimise diversity in practice.

Specifically in this regard, we believe the conclusion drawn in scenario 6 of table 3.2 (variable lease payments) is not appropriate if view 2 is to be adopted, as we cannot see the presence of a 'present' obligation at contract inception when a payment only arises directly in proportion to future sales. For similar reasons, we do not see that a 'present' obligation arises at contract inception if an investor in a trust is promised under the trust deed that the trust will distribute a specified percentage of net income earned on an annual basis. We see no difference between these obligations and a promise made to a sales person that they will earn a percentage commission on any sales they make for the entity. In all these cases the cost (or distribution in the case of the trust) is incremental from a future activity and in our view it would be consistent with the definition of a liability for those liabilities to be accrued when that activity occurs and not before.



See also our comments in response to Question 5 in respect of concerns over the current definition of a constructive obligation. We would also like to see how different views presented in the DP can be applied in the context of rate-regulated activities.

Question 7

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

We agree with the IASB in establishing principles that emphasise the need for an entity to report the substance of a contract as stated in paragraph 3.102 of the DP, rather than its legal form, so as to achieve faithful representation. We also support the addition of further guidance on the definition of control contained in paragraphs 3.27-3.34 of the DP.

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?

We agree with the views of the IASB and in particular welcome the discussion on relevance and the cost constraint in paragraphs 4.9 to 4.11 and the linkage between this concept and faithful representation discussed in paragraph 4.20. However, we have the following comment in respect of the application of these concepts to the current treatment of goodwill:

We note that paragraph 4.9(c) states that recognising internally generated goodwill does not provide relevant information and is therefore not recognised. Paragraph 4.9(c) then discusses how 'in contrast' recognising goodwill at the time of a business combinations depicts more completely the economic resources acquired to be used by management and is therefore recognised. We would agree with this discussion on the different types of goodwill.

However, we also consider that the current requirements relating to the measurement of goodwill are inconsistent with this discussion, since the current accounting requirements treat purchased goodwill as if it had an indefinite useful life and thereby



fail to address the fact that over time purchased goodwill in most cases is inevitably replaced by goodwill that is generated internally (if its value is maintained at all). We recommend that the IASB should revisit the prohibition on amortisation of purchased goodwill and consider whether amortisation would more faithfully represent that purchased goodwill that is not lost through impairment is replaced by goodwill that is generated internally over time. Amortisation of purchased goodwill would also increase comparability between entities that grow their business organically and those that grow through acquisition and subsequent nurture.

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?

We agree with the IASB's view that an entity should derecognise an asset or a liability when it no longer meets the recognition criteria (i.e. the control approach), given that derecognition should be the mirror image of recognition.

With respect to the issue on partial derecognition, we suggest developing a test as to whether there is a significant change in character for the original asset or liability. If the change is considered as significant, the entire asset or liability shall be derecognised with a new asset or liability being recognised for the retained portion or otherwise, partial derecognition shall be applied if the change in character is not considered as significant.

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?

We agree that the *Conceptual Framework* should retain the existing definition of equity as the residual interest.

With respect to the approaches set out in the DP to help differentiate between liabilities and equity, we support the strict obligation approach (i.e. obligations to deliver economic resources are classified as liabilities) given that it is consistent with the existing and proposed definition of a liability.

We support the differentiation between primary equity claim and secondary equity claim as we believe they are fundamentally different (as one represents a right to share distributions in equity and the other represents only an obligation to deliver equity instruments) and the *Conceptual Framework* should reflect this distinction. In this connection, we also recommend that the IASB should provide more guidance on what instruments can be classified as primary equity claims.

With respect to the proposal to update the measure of each class of equity claim at the end of each reporting period, we believe the proposal is complex and in part inconsistent within a measurement model that defines and measures equity as a residual. We are therefore yet to be convinced that this approach would pass a cost-benefit assessment or provide decision-useful information to users.



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; and
 - (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 agree with the preliminary views in the DP, however, further consideration has to be given to (c) in providing conceptual justification for having different measurement basis for the same item in the statement of financial position and the statement(s) of



profit or loss and other comprehensive income (for example, an entity may hold a debt instrument either to collect contractual cash flows or for sale in order to maximise its return from a combination of collecting contractual cash flows and realising value appreciation which necessitates the use of a mixed measurement model).

With respect to the preliminary views on subsequent measurement of assets and liabilities as stated in Questions 12-14, we believe they can be regarded as useful guidance for developing and revising IFRS.

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 generally agree with the preliminary views in the DP, however, the IASB should also acknowledge the existence of assets with hybrid purposes as mentioned in our response to Question 11 and to devise relevant measurement basis for such assets.

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 generally agree with the preliminary views in the DP, however, we believe it is important for additional guidance to be provided if a cash-flow-based measure is to be specified (for example, how to deal with uncertainties about the timing and amount of cash flows and whether it should reflect the market participant's or entity-specific view, etc).

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 preliminary views in the DP that current market price would be the relevant measurement basis for derivatives which are subject to significant variability in contractual cash flows when assessing prospects for future cash flows.

Question 15

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

The *Conceptual Framework* will likely define, and recognise the potential acceptability of, more than one measurement base or model to any given category of asset or liability. It is foreseeable that from time-to-time the IASB may propose to develop a standard that might permit or require a different measurement basis to be applied at initial recognition from that to be applied subsequent to initial recognition. In such a



case, we believe the IASB should provide a conceptual justification for the application of a mixed model in respect of the same asset or liability. At a standards level we believe the IASB should, over time, consider developing a conceptual justification for instances where this is found in the existing standards such as in the case of IAS 39 where some of our constituents expressed concerns over the lack of consistency to measure certain financial instruments at fair value on initial recognition, and to apply amortised cost subsequently.

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), 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*.

We agree with the proposals, however, we believe the IASB should demonstrate how these proposals would lead to a resolution of disclosure overload.

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?

We agree with the approach set out by the IASB as the primary purpose of the *Conceptual Framework* is to identify concepts when developing and revising IFRS. Detailed guidance with respect to the application of the concept of materiality should be addressed at the standards level, in particular in IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. We also consider it important that the IASB should avoid imposing quantitative thresholds that could be construed as bright lines as this would be inconsistent with a principles-based accounting framework.

We also support the development of educational material to provide guidance on how different materiality thresholds could be applied to items presented in primary financial statements and those disclosed in the notes to the financial statements. However, as judging materiality is a particularly sensitive matter between preparers, auditors and regulators, we request that such educational material (or illustrative examples) should undergo some sort of 'due process' (at least published in draft to enable public comment) before it is published.

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?



We agree with the communication principles as stated in the DP, and consider that they should be included in the *Conceptual Framework*, in order to stress the importance of financial reports as a communication tool for the entity and to address the issue of disclosure overload.

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?

We agree with the preliminary view in the DP that the *Conceptual Framework* should require a total or subtotal for profit or loss since it is considered as a key benchmark for analysing an entity's performance.

However, we urge the IASB to define what is meant by the term 'financial performance'. A definition of financial performance is considered as essential so as to provide a conceptual basis for distinguishing between items that should be recognised in profit or loss and items that should be recognised in OCI.

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 recognised subsequently in profit or loss, ie 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?

We agree with the IASB's preliminary view on the concept of recycling, however, discussions on recycling are closely related to the meaning of 'profit or loss' and 'other comprehensive income'. Without these concepts being defined, it would not be possible to carry forward the discussion on what items of income and expense presented in OCI are eligible to be recycled into profit or loss.

We believe that the concept of 'profit or loss' could be aligned more closely with the generally accepted concept of 'realised'. We therefore consider that in principle all items of income and expense presented in OCI should be eligible for recycling, as this approach can provide users with relevant information about a transaction or event that occurred in a particular reporting period, unless it can be proved otherwise.



Moreover, we suggest the term 'recycling' should be replaced with some other terminology as this term does not faithfully represent the economic phenomenon it purports to depict, given that the relevant income and expense which is being parked at OCI for the time being has never been presented in profit or loss. We would prefer terminology which distinguished between realised and unrealised amounts, as this would be more consistent with concepts in our companies law concerning distributable profits.

We also consider that on the question of recycling there is currently a fundamental inconsistency in terms of accounting treatment for changes in fair value arising under the revaluation model in IAS 16 *Property, Plant and Equipment* and the fair value model in IAS 40 *Investment Property* and we urge the IASB for a 'quick fix' in this area. Specifically, we consider that conceptually the following requirements are inconsistent and arguably flawed and should be re-considered:

- (a) the requirement under IAS 16 to compute depreciation of a revalued asset based on its revalued amount and to charge that depreciation to profit or loss, even though the revalued amount is required to be updated at each reporting date with the surplus arising from the revaluation recognised in other comprehensive income;
- (b) the prohibition in IAS 16 on recycling the revaluation amounts accumulated in equity to profit or loss at the time of disposal of the asset; and
- (c) the requirement in IAS 40 to recognise revaluation gains on investment properties directly in profit or loss rather than initially in other comprehensive income until realised.

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.

We are of the view that rather than attempting to define rule-based approaches to describe which items could be included in OCI, we recommend that the IASB should concentrate on setting out some overarching principles in the *Conceptual Framework* on what is meant by 'financial performance', 'profit or loss' and 'other comprehensive income', all of which are considered as pre-requisite in determining whether an item of income and expense could be included in OCI.



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 note the discussion in paragraph 9.7 of the DP relating to how the existing wording of Chapter 1 addresses the concept of stewardship through reference to 'information about ... how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources'. We agree that this discussion covers the concept of 'stewardship' without referring to it explicitly. We also note the IASB's concern that the word 'stewardship' may be difficult to translate. Nevertheless, we consider that it would be helpful if the discussion in Chapter 1 explicitly stated that the concepts described are commonly referred to as 'stewardship' in many English-speaking countries, so as to avoid any doubt on whether reporting on stewardship is still an objective of financial reporting.

We also believe that the term 'faithful representation' contained in the existing *Conceptual Framework* is sufficiently clearly defined, robust and appropriate.

With respect to prudence, we believe that the guidance on prudence in the pre-2010 *Conceptual Framework*, (as reproduced in paragraph 9.16 of the DP) should be reinstated in the revised *Conceptual Framework*. To us 'prudence' means the exercise of caution when making estimates and judgments under conditions of uncertainty, as per the pre-2010 *Conceptual Framework*, and we also note that this concept appears to have informed the formulation of the constraint on the recognition of variable revenue to be included in the new standard on revenue arising from contracts with customers and to be informing the move away from an incurred-loss model in the work on impairment for IFRS 9. A clear articulation in the *Conceptual Framework* would serve to distinguish between this concept and 'excessive prudence' or a bias towards conservatism – for example the concept of prudence cannot prevail over fundamental qualitative characteristics (relevance and faithful representation).



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?

We note that there has already been a move to use the term 'business model' in the development of new and revised standards (for example, in IAS 12 *Income Taxes* and IFRS 9 *Financial Instruments*). In this regard we have concerns that the term is open to misunderstanding and abuse, or inconsistent application, without some clear guidance at the *Conceptual Framework* level.

Some constituents believe the term 'intended use' rather than 'business model' to be more self-explanatory and resulting in a more robust application to specific assets and liabilities. The term 'intended use' is also better able to be used as a guiding principle when there is only one or a very few similar transactions. We would therefore prefer greater use of this term at the standard level, particularly in respect of classification and measurement and would urge caution on the use of the term 'business model' in this regard. Guidance on the meaning of 'intended use' could refer to the role of a business model in identifying the 'intended use' of an asset or liability i.e. when an entity has an established pattern of past practice.

In any event, whether 'business model' or 'intended use' is adopted, we consider it important that the IASB should develop guidance to ensure its consistent application. We therefore urge the IASB to develop a proper rationale as part of the revised *Conceptual Framework* and demonstrate how it can be applied in recognition, measurement, presentation and disclosure.

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's approach that the unit of account should be decided when developing new or revised IFRS, however, a set of principles is suggested to be developed in the revised *Conceptual Framework* to assist consideration in standards level projects.

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 situations as identified in the DP, however, we recommend that the IASB should provide more guidance with respect to going concern. In particular there is a need for more guidance on how a reporting entity should measure its assets and liabilities when the going concern assumption is no longer appropriate, given that the existing *Conceptual Framework* and IAS 1 only state that financial statements may have to be prepared on a different basis if going concern assumption is no longer appropriate and IAS 10 only indicates that ceasing to be a going concern after the reporting date should be treated as an adjusting event. This leaves many questions unanswered as to timing of recognition of future transactions (such as whether to accrue for expected operating losses to be incurred before liquidation) and measurement of assets and liabilities.

We also recommend that the IASB work with the International Auditing and Assurance Standards Board on this subject, as we understand that the IAASB has recently published an exposure draft which proposes auditors to include specific statements about going concern in their reports.

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.

We do not find the coverage in the existing *Conceptual Framework* on this topic of much practical use. Our main concern on capital maintenance is the requirement to distinguish and determine realised from unrealised profit for the purposes of determining the legality of distributions. Accordingly, we urge the IASB to define what is meant by the term 'financial performance' and to adopt a comprehensive approach to recycling as we mentioned in our responses to questions 19-21.

~ End ~