Mr Hans Hoogervorst  
Chairman, The International Accounting Standards Board  
30 Cannon Street, London EC4M 6XH  
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Dear Mr Hoogervorst


We believe that reviewing the Conceptual Framework to be one of the most important tasks undertaken by the IASB and welcome the opportunity to comment on the Discussion Paper (DP/2013/1) A Review of the Conceptual Framework for Financial Reporting. We are a group of academics who gathered specifically to consider the Discussion Paper. In the Appendix we provide details of our relevant academic and standard setting experience.

Our submission makes some general observations about the Discussion Paper in the introduction. The next sections provide comments and answers to some of the questions posed in the Discussion Paper. We also include suggestions of alternative ways the IASB might approach the issues of measurement (Section 6) and presentation (Section 8).

Yours sincerely

Professor Michael Bradbury

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Associate Professor Bryan Howieson

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Introduction

Our major observation on the Discussion Paper is that it appears to have taken a ‘bottom-up’ rather than a ‘top-down’ approach. That is, it develops ‘concepts’ from current standards and practice rather than developing concepts and conceptual solutions from theory or a set of stated assumptions. As a result, the Discussion Paper too often reverts to the solution: ‘we will address this issue in a particular standard’. This is a major weakness in the Discussion Paper, especially if the fundamental purpose of the Conceptual Framework is to assist standard setters in developing standards. We believe the Conceptual Framework will be more useful if it presents fundamental concepts of financial reporting rather than codifying current practice.

Examples of concepts that should form part of the revised Framework include capital maintenance, business model and unit of account. We understand the difficulty of defining these concepts and acknowledge that the Discussion Paper has not done so. However, without clarity about these concepts it is difficult to advance other areas of the Framework, such as measurement and presentation. We encourage the IASB to provide some preliminary views about these concepts so that they can then be debated in the community, leading to the development of suitable concepts to be considered for inclusion in the Framework.

The remainder of our submission provides feedback on various sections, as indicated. We also provide responses to several of the questions within the Discussion Paper and provide suggestions of other ways the IASB might approach the sections on measurement and presentation.

Sections 2 and 3 – Elements of Financial Statements

Elements:

Paragraph 23 of the Discussion Paper portrays the identification of elements as the particular components “from which financial statements are constructed”. This approach can lead to some nonsensical outcomes – for example, para. 2.52 treats ‘cash’ as an element but cash is a component of the element ‘assets’. We believe that elements are primitive foundational concepts that are independent of the financial statements in which they may be reported (e.g., it is possible that new types of financial statements may be developed as user needs or technologies change as was the case with the move away from funds statements to cash flow statements. Unless the nature of economic rights and obligations changes, the same basic elements will be required no matter what form of financial statements are prepared). Our preference would be for the Framework to clarify that the format of financial statements is not the basis on which elements are identified.

Definition of an Asset:

We agree that the change to the definition of an asset helps clarify that an important defining characteristic of an asset is that it embodies ‘economic resources’ which may or may not ultimately be realised. Some caution is necessary, however, with the definition of resources as the reference to “other source of value” does little to place boundaries around the concept and provides opportunities for wide interpretations in practice.

We also note that, although the Discussion Paper is only focused upon entities in capital markets, the IASB’s Framework is applied in some jurisdictions (e.g., Australia and New Zealand) in the public sector, not-for-profit, and non-capital market settings. The explanation in paragraph 3.6 of the Discussion Paper that economic benefits take the form of “potential cash flows” may imply that some items that are currently reported as assets in the private and public not-for-profit sectors may not meet the definition of an asset under the revised Framework. A similar concern relates to
paragraph 3.27 which notes that the economic benefits must flow to the entity rather than another party. Again, in a not-for-profit context, the economic benefits from the use of an asset may flow to third parties rather than the entity holding the resource. We recognise that the IASB is not addressing the needs of the not-for-profit sector, however the IPSASB is also developing a conceptual framework and it highly desirable that the two frameworks share common concepts.

**Definition of Liabilities:**

Paragraph 3.50(a) suggests that clarity could be provided about the application of ‘constructive’ obligations by indicating that the entity must have a duty or responsibility to another party or parties. However, some further clarification of the term ‘party or parties’ would be appropriate. In the Discussion Paper, it is not clear whether the term would extend to, say, the natural environment which might not normally be viewed as a ‘party’ in the form of a person or business entity. The example in paragraph 3.52 seems to imply that for an obligation to arise for the rehabilitation of land there must be a local community (or similar entity) that would be impacted by the lack of rehabilitation. However, if the potential rehabilitation related to land in a remote area without any human habitation present, would the constructive obligation still arise?

Three different perspectives are provided for interpreting a ‘present obligation’ in paragraphs 3.75 – 3.97 of the Discussion Paper. View 1 may be too restrictive in terms of its informational content and tends towards a liquidation perspective for the reporting entity. View 2 is supported because it provides more information about obligations that cannot be avoided and prior experience with accounting practices suggests that view 3 might result in too much ‘earnings management’.

**Income/Expenses, Gains/Losses & Profit or Loss/OCI:**

We agree with the view expressed that income and expenses are appropriately defined by reference to increases and decreases in economic benefits. However, the discussion in paragraphs 2.43 to 2.51 regarding distinctions about income/expenses, gains/losses and profit or loss/other comprehensive income is largely unhelpful and unconvincing because the distinctions are made without a frame of reference. Without adoption of a clear notion of capital and capital maintenance, there is no basis for establishing why these distinctions might make economic sense or be decision useful to financial statement users.

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

**Question 10**

a) We agree with the existing definition of equity as a residual as the alternative would create potential classification problems.

b) Agree.

c) This is taking a parent view of the firm rather than an entity view. The view should be argued at a conceptual level and if an entity view is appropriate then the answer to this question is to disagree.

d) The approach is based on a parent view and seems to be inserted to justify the treatment of instruments like puttable instruments for cooperatives. We believe this is best done at a standards level and the CF should not be used to justify such departures from the concept of what is equity.
Section 6 - Measurement

The Discussion Paper states the IASB’s preliminary view is that the Framework should not recommend measuring all assets and liabilities on the same basis (paragraph 6.14). It states that a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements (paragraph 6.35(b)). Accordingly, the Discussion Paper proposes that a measurement method\(^1\) be selected based on how the asset contributes to future cash flows (paragraph 6.17(a)). This is an unsatisfactory approach for determining the measurement method in a particular accounting standard because the choice will depend on how management decides to utilise the asset. The same problem exists for a liability where the measurement method “…will depend on how the entity will settle or fulfil that liability” (paragraph 6.17(b)). If the Framework follows these proposals it will not provide sufficient guidance for standard setters. Accordingly, we outline two possible approaches that could be used to develop a more useful measurement section in the Framework.

Our objective in this comment is not to state which of these two approaches we prefer, but to provide another way of advancing the measurement section of the Framework. Our concern is that, as currently presented, the approach in the Discussion Paper will not provide useful guidance to the Board. We recommend an objective-based approach, using a preferred theoretical position or a position based on an agreed set of assumptions.

Possible approach 1: A Single Measurement Approach

We do not underestimate the political difficulty in gaining general acceptance for a Framework that recommends a single measurement approach. We are aware of standard setters’ past history in failing to develop a single measurement basis in a conceptual framework. Nevertheless, this is an opportunity for the IASB to develop a Framework that is aspirational and will give clarity for setting future standards. We recommend the Board adopts one measurement method as the measurement objective. In our view, one measure is needed for almost all business decisions, whether they are to replace, maintain or adapt assets into another business. That measure, even in a going concern situation, is: what can I sell an asset for now in an arm’s length transaction? Thus we conclude a measure that captures current market price (i.e. fair value as defined in IFRS 13 Fair Value Measurement) is an appropriate measurement objective.

Subsequently, how the measurement objective would be best met in each standard should be considered on a standard-by-standard basis. Standards ought to be written only when there is a need for them. That is, standards should be written or revised only when there are new transactions and events requiring a standard, or when a significant problem with an old standard has been identified. This follows the old adage “if it ain’t broke, don’t fix it”. The adoption of a single measurement method as the measurement objective in the Framework does not change current practice. A useful starting point is to assume current practice is close to optimal in terms of costs and benefits because it has evolved from the operation of market forces. Therefore, any change, such as adopting a fair value measure in a standard, would only occur if the change can clearly demonstrate net marginal benefits.

When a standard is being revised or a new standard is being written, the Board would be guided by the Framework to consider fair value as the measurement objective. However, the Board may decide not to use fair value because of cost benefit considerations. For example, the Board may have concerns about the cost of obtaining a reliable measure of fair value (in terms of precision or verifiability) and therefore decide that replacement cost or amortised historic cost are preferable.

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\(^1\) The Discussion Paper uses ‘measure’ as a noun, which may be confusing for some readers. For clarity we use the term ‘measurement method’ as well as the term ‘measure’.
methods for the standard being developed. The *measurement method* that best meets the *objective* for a particular standard can differ, on a standard-by-standard basis, as the Board considers the primary and enhancing characteristics of the Framework and the cost constraint (paragraph 6.30).

The advantage of adopting a single measurement objective and a single measurement method that best meets the objective is that this approach provides a sound framework for the Board to make decisions about measurement. If we know what the *measurement objective* (fair value) is, then we can assess whether the *measurement method* is the best way to meet the objective or whether some other measure is a more appropriate surrogate in the circumstances.

**Possible approach 2: A Stated Assumption Approach**

A second approach to measurement is to list some fundamental assumptions and then document using a decision-tree analysis how the outcomes of the assumptions will impact on standard setting.

For example, the Board might make the assumption that it should develop a ‘business model approach’ to measurement. Using this approach the Board might identify two business models based on: (1) assets-for-sale and (2) assets-for-use. The Board might then decide that the most appropriate measurement method for the assets-for-sale approach is fair value and the most appropriate measurement method for assets-for-use is amortised cost. Alternatively, other measures may be selected as the most appropriate (e.g. replacement cost for assets-for-use). Our point is that the Framework will be more useful if it provides a clear process within which to make decisions about measurement.

Using this approach, some guidance may be required as to whether a particular model must be applied within a standard or whether the alternative models are a free choice. In addition, relevant disclosures will be required at the reporting entity level to ensure transparency about the underlying model being used.

**Section 7—Presentation and disclosure**

**Question 16**

While we agree the Framework is a critical document for the IASB, we do not consider the primary purpose of the Framework is to assist the IASB. The Framework is important for many stakeholders and is specifically referred to in IAS 8. Also, consistent with our introductory comments about the role of the Framework, we believe the Framework is the appropriate place to address presentation and disclosure objectives and that improvements in financial reporting are more likely to result from the incorporation of these projects into the Framework, rather than trying to progress them separately.

**Question 17**

We believe that the Framework should provide more guidance on materiality, because it is a fundamental concept of financial reporting.

**Question 18**

Paragraph 7.49 states that “disclosure guidance in Standards should seek to promote disclosure (including presentation) in the financial statements as a form of communication guided by Standards, as opposed to a mechanism whose sole purpose is compliance with specific requirements of Standards”. We support this objective and the broad communication principles in paragraphs 7.49 and 7.50 as a means to provide guidance on disclosure issues.
We also encourage the Board to look to academic research to further inform the debate around communication principles. They are many insightful papers about communication of accounting information.

Section 8 – Presentation Profit or Loss and OCI

Question 19

We understand the demand of some constituents for a total or subtotal for Profit or Loss, reflecting the widespread use of this earnings measure. We can therefore understand the Board’s preliminary view as a pragmatic response to demands from practitioners. However, the Discussion Paper does not define profit or loss. Consequently, it seems inconsistent with the Framework as a guidance statement to require disclosure of an item that it has not defined. Therefore, we disagree with the preliminary view. However, we do agree that the Board could require presentation of a totals or subtotal for Profit or Loss in new or revised standards.

Question 20

The Discussion Paper provides a useful overview of issues relating to performance measurement and recycling. The paper argues that if Profit or Loss is the performance measure, then the items ‘below the line’ need to be recycled into Profit or Loss (8.24). However, because the Discussion Paper does not arrive at an underlying concept of financial performance (such as Profit or Loss), it is difficult for us to find a conceptual justification for recycling. The Discussion Paper notes, in para 8.25, the recycled amounts may provide little useful information about future performance, that recycling adds complexity and may obscure income and expenses, and recycling can be used to manipulate financial results. Lack of transparency and understanding of OCI items and recycling lead us to prefer a Framework that does not permit recycling.

In relation to cash flow hedges, the matter should be dealt with at the standards level. The Framework should provide clear principles and guidance for standard setters. We recognise there may be departures at a standards level to accommodate particular circumstances.

Question 21

We commend the Board for proposing principles to be used to identify Profit or Loss and OCI items. Approach 2A leans towards acknowledging Profit or Loss as the primary performance measure because it requires all the items ‘below the line’ in OCI to be recycled into Profit or Loss. Approach 2A provides a basis for recognising an item in Profit or Loss or OCI, namely relevance, which is consistent with one of the Framework’s existing primary qualitative characteristics. A clear approach to determining the classification of an individual item will be helpful for standard setters. We can see merit in Approach 2A as many users favour Profit or Loss as the primary performance measure. To promote transparency and consistency of reporting under this approach, we agree all items in OCI should be recycled. Nevertheless, our preferred position would be for a Framework that did not permit recycling, as discussed in the next section.

We favour Approach 2A over 2B because the former provides principles for standard setters to follow to help distinguish between Profit or Loss and OCI items. Approach 2B involves more judgement and discretion and thus provides less guidance and opens the Board to higher levels of lobbying about classification and recycling decisions for individual items.
Possible approach: Disclosure solution

We outline below another possible approach to presentation for consideration by the Board. It is based on the idea of clear display of all items, which allows users to extract information as required and determine earnings metrics (Profit or Loss; OCI; or other metrics) that are useful to them. Preparers have some choice regarding placement of remeasured items, however, their choice is transparent to users. In this scenario, assume that measurement of items is in accordance with existing IFRS.

Principles for presentation of items in the Statement of Comprehensive Income:

1. The Statement of Comprehensive Income has three sections. The first section includes operating items measured at cost or amortised cost. The first subtotal is ‘Operating Income before remeasurement’. The second section includes remeasured items that form part of Operating Income, where preparers choose the remeasured items they want to include in this section (i.e. because they view the item as part of operating income). The second subtotal is ‘Operating Income’. The third section has all the other remeasured items and the third subtotal is ‘Other Comprehensive Income’. The total of all three sections is ‘Comprehensive Income’.

2. Preparers can choose to include remeasurements in section 2 or 3. For example, a trading bank might include the remeasurement increment/decrement on trading securities in section 2 (part of operating income); a non-financial sector entity with a fair value remeasurement on available for sale securities could show the gain or loss in section 2 or 3. The choice is transparent; allowing users to adjust a firm’s second and third earning measures (‘Operating Income’ from section 2 and ‘Other comprehensive income’ from section 3) to suit the user’s purposes for the earnings measure (i.e. performance assessment; income projection and so forth).

3. Items are recorded in the Statement of Comprehensive Income only once, in one of the three sections. Thus items and changes in value of items are recognised as they occur; there is no recycling. The principle is that value changes, when required to be measured by IFRS, are recognised during the period in which they occur. Compared to current recycling practices, we believe this is a more transparent approach and less subject to manipulation through managerial decisions about the timing of realisation of gains and losses.

4. This approach means preparers can show what they consider to be ‘Operating Income’ and accommodates preparers’ preferences about whether remeasurement items should be included in operating income. As long as items are clearly labelled and displayed, financial statement users can add or subtract items, if they disagree with the preparers’ classification of an item as ‘operating’ or ‘OCI’.

5. This approach would accommodate to some extent the current practice of adjusting IFRS Profit or Loss for items considered to be non-operating while improving comparability of information because items commonly adjusted (e.g. gains and losses on remeasurement under IFRS) are visible in one place, the Statement of Comprehensive Income, in an audited document.

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2 We acknowledge that ‘remeasurement’ needs to be defined. A suitable approach is provided in the Discussion Paper in paragraph 8.51. Similarly, operating income will need to be defined to indicate whether it includes interest and finance expenses.
Appendix A

Michael Bradbury is Professor of Accounting at Massey University, New Zealand. He served on the Financial Reporting Standards Board of the Institute of Chartered Accountants of New Zealand from 2000 to 2009. He was on the International Joint Working Group for Financial Instruments from 1998 to 2000 and on the International Financial Reporting Interpretations Committee of the International Accounting Standards Board from 2004 to 2008. He is currently on the IFRS Advisory Council. His research interests are in financial reporting and financial analysis.

Phil Hancock is Winthrop Professor of Accounting at the Business School at the University of Western Australia. He was the author of Discussion Paper 14 Financial Reporting by Financial Institutions and Accounting for Financial Instruments in 1990 for the Australian Accounting Research Foundation. Phil was a member of the Urgent Issues Group (UIG) in Australia from May 2002 until it was disbanded on June 30, 2006. His research interests include financial reporting in the for-profit and not-for-profit sectors and accounting education.

Bryan Howieson is Associate Professor in the School of Accounting and Finance at the University of Adelaide, South Australia. He has acted as a consultant to the Australian Accounting Research Foundation and the Australian Accounting Standards Board on projects associated with accounting for investment properties and the application of control in the not-for-profit sector. His research interests include financial reporting, accounting standard setting and accounting education.

Ann Tarca is Winthrop Professor in the Business School at the University of Western Australia. She is a chartered accountant with more than 15 years’ experience teaching and researching in the area of international accounting and financial reporting, including the application and development of IFRS. In 2011-2012 she was an Academic Fellow in the Education Initiative at the IASB in London.

Matthew Tilling currently splits his time between being a Senior Manager at BDO WA and the Head of Accounting at the Business School of the University of Notre Dame. Over the last 15 years Matt has mixed professional and academic work in financial accounting. In addition to providing technical advice, consulting and training on accounting standard issues such as fair value and financial instruments, Matt regularly publishes in accounting texts and journals.