Dear Mr Hoogervorst


The National Audit Office is responsible for the audit of all UK central government entities and for the audit of the UK Whole of Government Accounts. The public sector in the UK has adopted IFRS, subject to some limited adaptations for the public sector context, and we are therefore very interested in the developments in this regard.

Please find attached our responses to the questions raised in the above discussion paper.

Yours sincerely

Maggie McGhee

Director General, Audit
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?

In general terms we agree with these preliminary views.

We support the proposal that the Conceptual Framework should be the starting point in any standards project and that deviations from it should be minimised. However, we do not think that it is necessary to prejudge the extent of this by declaring that the expectation of deviation would be rare. We agree that it is important that were there are such deviations that the reasoning for these should be clearly explained within the relevant standard.

We note that the proposal in 1.31 that the Conceptual Framework would not override extant standards and the acknowledgement that there could be some ongoing conflicts for some time. Paragraph 1.28 however proposes that the Conceptual Framework would be able to assist other parties to understand and interpret existing standards. Given there is an acceptance that there will be conflicts between the two how will this work in practice?

Section 2: Elements

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?

In general terms we agree with the definitions of assets and liabilities in (a) and (b) above. However, we question whether the definitions of asset and liability need to
include “as a result of past events”. Paragraph 2.16 (c) acknowledges that this is a useful phrase to assist in the identification however this appears to therefore be more than conceptual.

We support the clear separation of the definition of an asset/liability from whether they should be recognised.

We are concerned that (c) is not specific enough or will require additional definitions to support it. What exactly do the terms “value” and “economic benefit” mean? “Value” particularly could be highly subjective.

**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 with the proposals.

Our view is that existence uncertainty and outcome uncertainty should be explicitly differentiated. We would support the Conceptual Framework leaving the specifics of the impact of these risks to a standards level (as proposed in paragraph 2.35 (b))

**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 do not believe that all of these items should be identified as elements. We support the identification of income, expense, asset, liability and equity as elements. The others proposed are generally descriptors for the movements in these items and any requirement to include them could be left to the standards level.

It may be useful to for the discussion around income and expense to be very explicit that these include gains and losses.

**Section 3 Additional guidance to support the asset and liability definitions**
Question 5

Constructive obligations are discussed in paragraphs 3.39–3.62. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations—and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50.

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

We agree with this preliminary view. Additional guidance around the matters listed in 3.50 would be welcome although caution should be exercised that this remains at a conceptual level and does not extend into the territory of standards.

Constructive obligations are perhaps more common in the public sector; governments make promises and there is considerable room for debate as to whether the individual reporting entity has a liability. This is particularly problematic where it is a non-exchange transaction. Considerations of the principles around economic compulsion could usefully consider the public sector angle.

Question 6

The meaning of ‘present’ in the definition of a liability is discussed in paragraphs 3.63–3.97. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains conditional on the entity’s future actions. Three different views on which the IASB could develop guidance for the Conceptual Framework are put forward:

(a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions.

(b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions.

(c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity’s future actions.

The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favour of View 2 or View 3.

Which of these views (or any other view on when a present obligation comes into existence) do you support? Please give reasons.

We support the general principle outlined in View 2. We feel that this is an appropriate framework under which the standards level can consider the specifics of different situations. We favour the continuation of including constructive obligations (as in our response to question 5 above) however we feel that it is important that the obligation should have to exist at “present”. It is View 2 that encompasses this with the “practically unavoidable” in terms of future action by the reporting entity.
Question 7
Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

Nothing further to add

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 are generally in agreement with this preliminary view. We agree that relevance and faithful representation should be the primary drivers. There is a judgement to be made in terms of whether information is sufficiently relevant to justify the cost. On the assumption that this judgement would be determined as part of the standard setting process this is reasonable. However, we do wonder whether there should also be a cost justification in respect of (b)? It may be that a measure of the asset or liability could be determined which would result in faithful representation however it would be at a disproportionate cost.

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 proposals but hope to see the Conceptual Framework continue to support partial derecognition so that, at a standards level, it can be dealt with appropriately. We suggest that these possible approaches are heading towards being prescriptive and moving away from being conceptual and are not needed within the Conceptual Framework itself.

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 with the proposal in (a) and (b) to define equity as a function of assets and liabilities rather than defining it independently. By retaining it as a function of assets and liabilities it reduces risk of gaps or overlaps in classification.

We are not clear on the efficacy of item (c) it would suggest that reserves both distributable and non distributable would be subsumed into the measurement of equity and in some form be transferred between classes.

We do not believe that (d) is appropriate. In the public and not-for-profit sector it is not unusual for there to be no equity instruments issued. Where an entity has issued no equity instruments this concept could mean that all non-secured liabilities would be the most subordinated class and that they would be treated as if they were an equity claim.
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 these preliminary views and consider that these proposals best meet the objective of faithful representation.

The proposals in (c) could result in the measurement for the statement of financial position differing from the most appropriate measurement basis for the movements during the year in the statement of profit or loss. We are satisfied that this could be an appropriate position to be in and supports later assertions that no particular primary statement has primacy over the others. Any difference between such measures could be reported in the OCI.

**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.

These views are moving away from being conceptual. The conceptual basis is that different measurement bases may be appropriate under different circumstances, which we support.

More specifically we are concerned about (a) in that administrative buildings would appear to be within this category and we would not agree that a cost based measure would normally provide more relevant information. Similarly there is a risk in respect of (b) as this conflicts with 6.80 which proposes that inventories would not be at exit price. Paragraph 6.80 does not give a conceptual basis for its assertion. If these descriptors were kept at a conceptual level then the standards can be used to determine the appropriate application for the specific matters they are considering.

**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.

Again, as per our response to question 12, these seem to be moving into more detail and direction than is required in a conceptual framework. There are also a number of non-specific phrases used that could be subject to very different interpretation as to their intent; for example: “likely to be the only viable”, “will normally”, “are likely”.

**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;

(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?

Based on our previous responses we do not consider it is necessary to include these as separate items. These are simple examples of when the somewhat prescriptive content of #11, #12 and #13 are not “normally” or “likely” to be the most appropriate. This level of detail should be considered as part of the standard setting process when determining the appropriate measurement basis.

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

We think it would be helpful if the Conceptual Framework explicitly considered initial measurement and subsequent measurement as separate matters. We are concerned that paragraph 6.24 says that subsequent measurement will always be the same as initial measurement as we do not believe this is a valid assertion.

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 that this guidance should be usefully included in the Conceptual Framework

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 this approach but also that standard setters should be encouraged to give consideration to their disclosure requirements. This is supported by the proposal in 7.48 for a disclosure objective in all standards.

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 that these should be included and with the principles proposed. They could be further enhanced by more explicitly linking them to the qualitative characteristics and objectives of financial reporting.
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?

The Conceptual Framework has not established profit or loss as a material primary performance measure. Without this underpinning it does not appear appropriate to require this subtotal at a conceptual level.

Our view is that the conceptual level should be to support having appropriate subtotals relevant to the business mode of the reporting entity. The standards can then determine what these are and how they are determined. In many jurisdictions the requirement for certain subtotals is likely to be determined by corporate reporting legislation.

**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 preliminary view. We do not believe that all items presented in OCI should be recycled into profit and loss: for example – actuarial gains and losses on pension schemes given the long term nature of the underlying arrangement.

**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 support the broader approach set out in the proposals. Where matters should be reported should be left to the standards level where differing business models can be considered. However, we agree that it would be useful for the Conceptual Framework to have principles as to what might influence the decisions of the standard setters. For example: the distinction between realised and unrealised gains and losses.

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.

Whilst we understand and agree that “prudence” as a concept was often misused and in principle should be adequately covered by the requirement of neutrality we feel that the description of neutral could be improved and extended to make this clearer.

We believe that prudence is relevant when considering recognition but not measurement. We do not feel that these chapters need significant changes.

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 would support the IASB considering whether a business model concept is relevant when it develops or revises particular standards.

We feel that generally the concept of a business model is well understood. If it was felt that it might be defined or described then we would propose that it encompasses how an entity is organised/achieves its measures of success and incorporates considerations of its motivations.

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 this does not need to be in the Conceptual Framework

**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 do not have any other suggests as to relevant situations.

**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 agree with these plans.