Accounting Standards Board
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Conseil des normes comptables

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Submitted electronically via www.ifrs.org

International Accounting Standards Board
30 Cannon Street, 1st Floor
London EC4M 6XH
United Kingdom

Dear Sirs:

**Re: Conceptual Framework for Financial Reporting (ED/2015/3)**

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the International Accounting Standards Board's (IASB) Exposure Draft, "Conceptual Framework for Financial Reporting," issued in May 2015.

The AcSB is Canada's national accounting standard-setting body, holding the legal authority to set accounting standards in Canada. Since 2011, the AcSB has operated under the strategy of endorsing and then importing IFRS into Canada for application by publicly accountable enterprises, other than pension plans. To date, our policy has been to adopt IFRS as issued by the IASB, without modification (with the exception of deferring for a period of time the initial adoption of IFRS by investment and rate-regulated entities). As of January 1, 2015, all such deferrals by the AcSB have ended. The AcSB consists of members from a variety of backgrounds, including financial statement users, preparers, auditors and academics. Additional information about the AcSB can be found at www.frascanada.ca.

The views expressed in this letter take into account comments from our outreach, consisting of discussions with members of the AcSB's Conceptual Framework Discussion Group, User Advisory Council, and Academic Advisory Council, as well as outreach to Canadian stakeholders, individual members of the AcSB and its staff. The Conceptual Framework Discussion Group includes preparers, auditors, users and academics who discussed the full proposal over multiple meetings. However, the views expressed in this letter do not necessarily represent a common view of the members of the AcSB, its committees or staff. Formal positions of the AcSB are developed only through due process.

We strongly support the high priority given to this project by the IASB. We regard the improvements proposed to the *Conceptual Framework* as important and welcome the completion of this phase of the project.

We think that, going forward, the *Conceptual Framework* should be updated periodically to ensure it remains fit for purpose. In our view, periodic improvements focused on a particular aspect of the *Conceptual Framework* are preferable to a single large project that addresses all aspects every 10 or 20 years. For example, we agree that the IASB should continue with projects on the less developed areas of the *Conceptual Framework* such as the distinction between liabilities and equity, and presentation and disclosure. In addition, as the IASB works with the *Conceptual Framework* and identifies areas that have become outdated, projects should be initiated to update those areas. We think that the IASB should aim to achieve a balance so that the *Conceptual Framework* is updated when necessary while maintaining a relatively stable foundation to support the future evolution of standards and appropriately bridge changes in the IASB membership.

The FASB is actively working on several topics to improve its *Conceptual Framework*. We consider it essential that the two frameworks remain largely consistent. Should they start to diverge, the development of standards that will provide a common approach to financial reporting will not be possible.

We agree with the approach taken by the IASB to focus on those changes that will provide clear and significant improvements to the existing *Conceptual Framework*. We also support many aspects of the proposed *Conceptual Framework*. For example:

- We agree with the positioning of stewardship within the discussion of the objective of financial reporting. We agree that stewardship should not be an additional, separate and equally prominent objective of financial reporting.

- We agree with the reintroduction of an explicit reference to substance over form. We think that this reference is sufficient and that no additional clarification is required.

- We agree with the proposals to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information. Further, we support the IASB's decision to not replace "faithful representation" with "reliability".

- We agree with the element definitions.

- We agree with the inclusion of the unit of account discussion. We see the proposals as a step in the right direction.

- We think that the material included on business activities is sufficient and should not be expanded.

In addition, we agree with the scoping decisions made by the IASB on this project as practical and necessary to move the more developed chapters forward on the current timeline and without delay. We are pleased that work will continue on the projects on Financial Instruments with the Characteristics of Equity and the Disclosure Initiative. We strongly believe that a similar approach is needed for measurement.

A significant amount of thought, analysis, discussion and education is needed to develop measurement concepts and principles that will be useful and effective for developing principles-based measurement requirements in new and amended standards. As noted in our response in Appendix A, we think in-depth work is needed into what the conceptual underpinnings should be for measurement. We urge the IASB to add a research project on measurement to its agenda. The fact that the FASB is currently working on the measurement chapter of its *Conceptual Framework* reinforces the need for the IASB to continue its work in this area.

In addition to the need for further work on measurement, we have a number of concerns including the following:

- We disagree with the reintroduction of prudence and are concerned that certain paragraphs endorse an asymmetrical approach that is inconsistent with neutrality.

- If a decision is made to re-introduce the notion of prudence, we are concerned that the guidance that draws a distinction between “prudence as caution” and “prudence as asymmetry” is included only in the Basis for Conclusions; we recommend this material be included in the *Conceptual Framework* itself.

- In our view, the proposals on derecognition are underdeveloped and require further work.

- We think the proposals regarding transactions with holders of equity claims should be removed because this material provides guidance on transactions with related parties without a sufficiently robust discussion. The proposal is inadvertently establishing a principle to measure transactions with related parties at current value when the IASB has never had an agenda project to consider this question.

- We do not agree with setting up a rebuttable presumption that certain amounts may not be reclassified to profit or loss from Other Comprehensive Income (OCI) because we think that the underlying principle should be a presumption that income or expenses included in OCI should be reclassified in a future period.

Additional detail about these concerns along with responses to the questions posed in the Exposure Draft and drafting suggestions are provided in the Appendices to this letter.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me or, alternatively, Rebecca Villmann, Director, Accounting Standards (+1 416 204-3464 or email rvillmann@cpacanada.ca) or Kathryn Ingram, Principal, Accounting Standards (+1 416 204-3475 or email kingram@cpacanada.ca).

Yours truly,

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**APPENDIX A**

| **Question 1—Proposed changes to Chapters 1 and 2** |
| --- |
| Do you support the proposals:<br><br>(a) to give more prominence, within the objective of financial reporting, to the importance of providing information needed to assess management's stewardship of the entity's resources;<br>(b) to reintroduce an explicit reference to the notion of prudence (described as caution when making judgements under conditions of uncertainty) and to state that prudence is important in achieving neutrality;<br>(c) to state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form;<br>(d) to clarify that measurement uncertainty is one factor that can make financial information less relevant, and that there is a trade-off between the level of measurement uncertainty and other factors that make information relevant; and<br>(e) to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information?<br><br>Why or why not? |

***Stewardship (Question 1a)***

1. We do not object to giving more prominence to the concept of stewardship because we think the concept is already present in paragraph OB4 of the existing *Conceptual Framework*. We acknowledge the existence of diversity in interpretation with some believing the existing chapter ignores the need for information to help users assess management's stewardship while others think that the concept is present.

2. We agree with the way the IASB has positioned stewardship, within the discussion of the objective of financial reporting. Stewardship should not be an additional and equally prominent objective of financial reporting. We think the information provided to make decisions about buying, selling or holding equity and debt instruments is also information that users need to assess stewardship. And clearly, users need to assess stewardship in order to make investment decisions.

3. However, we recommend that if the *Conceptual Framework* uses the term "stewardship", it should be defined. We observe that from a legal perspective within Canada, corporate directors are charged with stewardship responsibilities to not only preserve the value of the company but also to ensure adequate returns for the risks the company is taking. Without a common definition

of stewardship, directors in Canada would only be able to consider this legal context. Therefore, we suggest that paragraph 1.22 could be amended to use the term "accountability" to better define stewardship:

"Information about how ~~efficiently and effectively~~ the entity's management has discharged its responsibilities to use the entity's resources efficiently and effectively helps users assess management's accountability for~~stewardship of~~ those resources. This concept is often referred to as stewardship. Such information is also useful for predicting how…"

4. We note that the IASB's mission statement, highlighted in paragraph IN5 of the Exposure Draft, uses "accountability". We think it would be beneficial to align the *Conceptual Framework* with the mission statement. We also note that the International Public Sector Accounting Standards Board uses "accountability" in its *Conceptual Framework* and throughout its standards.

5. In addition, we think that there might be other information to take into consideration when assessing management's efficient and effective use of entity resources and recommend amending paragraphs 1.4 and 1.22.

***Prudence (Question 1b)***

6. We disagree with reintroducing an explicit reference to the term "prudence" because we are concerned that it will continue to be interpreted to mean asymmetric conservatism, which is inconsistent with neutrality. This concern is supported by our outreach which demonstrated that although prudence is explicitly defined in the Exposure Draft, it continues to be interpreted by stakeholders to mean asymmetry.

7. We consider neutrality to be an essential aspect of the credibility of financial statement information and are concerned that some of the material in the *Conceptual Framework* can be seen to endorse bias, as discussed in paragraph 10.

8. However, if "prudence" is to be reintroduced, we agree that this discussion is appropriately positioned within the context of neutrality. We also agree with the proposed definition of prudence as "the exercise of caution when making judgements under conditions of uncertainty". We recommend adding a statement to paragraph 2.18 to provide greater clarity that the same degree of caution should be used when recognizing either positive or negative changes in any estimate. Such a discussion could better emphasize that estimates should be unbiased and that the degree of caution applied should promote a balanced approach so that estimates of assets and liabilities are neither understated nor overstated.

9. We acknowledge the IASB's attempt to achieve clarity in the Basis for Conclusions by drawing a distinction between the two notions of "prudence as caution" and "prudence as asymmetry". However, we are concerned that this guidance is included only in the Basis for Conclusions; we think it should be included in the *Conceptual Framework* itself. Paragraph BC2.9 is a good example of material that should be included in the *Conceptual Framework*.

10. We are concerned that paragraphs BC2.11 to BC2.15 endorse an asymmetrical approach that is inconsistent with neutrality. In particular, the last sentence in paragraph BC2.11 and the first part of paragraph BC2.14 state:

    "However, the IASB also thinks that not all asymmetry is inconsistent with neutrality." (BC2.11)

    "Hence, accounting policies that treat gains and losses asymmetrically could be selected in accordance with the proposals in the Exposure Draft if their selection is intended to result in relevant information that faithfully represents what it purports to represent. Such an approach is reflected in many existing Standards, for example IAS 37 *Provisions, Contingent Liabilities and Contingent Assets,* requires different recognition thresholds for contingent liabilities and contingent assets…" (BC2.14)

    We think this material is inconsistent with the concept of neutrality and should be removed. The *Conceptual Framework* should adopt a symmetrical approach to neutrality and prudence rather than attempting to justify current accounting standards as is done in the excerpt from paragraph BC2.14 above. Any asymmetry the IASB considers necessary should be decided and justified at the standards level. An accounting policy needs to be applied neutrally by the preparers of the standards unless the standard itself requires asymmetry. We acknowledge that the IASB can decide at a standards level whether to depart from this approach and require preparers to adopt requirements that treat gains and losses asymmetrically. We think the Basis for Conclusions for an individual standard should explain that exception rather than include these inconsistent explanations as part of the Basis for Conclusions to the *Conceptual Framework*.

11. Further, we are concerned that paragraph BC5.45 could be used to support an asymmetrical approach and think the last sentence should be removed as shown below:

    "Some respondents to the Discussion Paper suggested that more measurement uncertainty is tolerable when recognising expenses than when recognising income. They described this as an application of asymmetric prudence (applying the terminology in paragraph BC2.6), not cautious prudence. The IASB thinks that the level of measurement uncertainty that makes a measure lose relevance depends on the circumstances and can be determined only when developing specific Standards. ~~Hence, the Conceptual Framework neither requires nor prohibits a symmetrical approach that would set the same level of measurement uncertainty as being tolerable for the recognition of both income and expenses.~~"

12. We think it essential that the *Conceptual Framework* deal explicitly with the risk that bias could affect a measurement. A discussion of moral hazard in the *Conceptual Framework* could enhance the discussion of neutrality and any discussion of the concept of prudence. We recommend adding the following discussion of moral hazard, which includes paragraph BC2.5(e), to the *Conceptual Framework*:

    "Moral hazard is a term used to describe situations when a party has the opportunity to take risks or act with self-interest, to the detriment of another. The exercise of prudence helps to align the interests of shareholders and managers and can reduce moral hazard."

***Substance over form (Question 1c)***

13. We agree with the proposal to reintroduce an explicit reference to substance over form because it strengthens the description of faithful representation. We view this addition to be a significant improvement. Further, we think the reference to substance over form is sufficient and no additional clarification is required.

***Measurement uncertainty (Question 1d)***

14. We disagree with the proposed clarification that there is a trade-off between the level of measurement uncertainty and other factors that make information relevant. We recommend removing the reference to a trade-off in paragraph 2.13. A high level of measurement uncertainty does not make a measure less relevant but does affect whether a faithful representation can be achieved. If the most relevant measure is not capable of faithful representation due to a high level of measurement uncertainty, the next most relevant measure should be considered.

***Faithful representation (Question 1e)***

15. We agree with the proposals to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information. We support the IASB's decision to not replace "faithful representation" with "reliability" for the reasons stated in the Basis for Conclusions. Specifically, many interpret "reliability" to have a narrow meaning of being precise or easily verifiable. We think "faithful representation" describes more clearly what has always been intended by this qualitative characteristic.

| **Question 2—Description and boundary of a reporting entity** |
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| Do you agree with:<br><br>(a) the proposed description of a reporting entity in paragraphs 3.11–3.12; and<br>(b) the discussion of the boundary of a reporting entity in paragraphs 3.13–3.25?<br><br>Why or why not? |

***Description of a reporting entity (Question 2(a))***

16. Overall, we agree that the reporting entity chapter should be included in the *Conceptual Framework* because the definition of a reporting entity forms the underlying basis for a set of general purpose financial statements. The description of a reporting entity provides the pillars to be used in other chapters, for instance, in identifying assets and liabilities within the elements.

17. However, we think that the description of a reporting entity in paragraphs 3.11 to 3.12 and in the glossary is too open-ended. A preparer needs to be able to portray the historical financial position and performance of that reporting entity. If such a portrayal is not possible, the preparer should not be permitted to provide pro-forma statements that can include future oriented information or hypothetical amounts, rather than GAAP information derived from past and current data. These pro-forma statements could not be labelled as general purpose financial statements nor could they be considered IFRS compliant.

***Boundary of a reporting entity (Question 2(b))***

18. We prefer the approach used in the March 2010 Exposure Draft on "The Reporting Entity" that has been carried forward into paragraph BC3.8 of the Basis for Conclusions (i.e., that a reporting entity is a "circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders and other creditors"). This description provides a good starting point that could be built upon to include boundaries that define a reporting entity.

19. In our view, it is important to link the description of a reporting entity to the objective of financial reporting. We also think that the statement in paragraph 3.12 that a reporting entity may not be a legal entity is important and should be retained.

20. More importantly, we think that the description of a reporting entity cannot be complete without incorporating the concept of control. The chapter discusses both direct and indirect control but does not make an explicit statement that control should be the basis upon which the reporting entity is determined. For example, an explicit statement from the perspective of consolidated financial statements is made in paragraph BC3.10 of the Basis for Conclusions and should be moved to the *Conceptual Framework* itself.

21. Additionally, the *Conceptual Framework* discusses control in paragraphs 4.17 to 4.23. We recommend that this discussion be brought forward to this section and a cross-reference included in Chapter 4.

22. In summary, we recommend that the reporting entity should be described with linkage to the objective of financial reporting. The financial statements of the reporting entity should include all of the assets and liabilities that it controls. For this information to be useful, it would need to tie into the qualitative characteristics of financial reporting from Chapter 2 of the *Conceptual Framework*. It would also be helpful to include in the *Conceptual Framework* the other information in paragraph BC3.8 to enhance the description of a reporting entity.

23. In Canada, combined financial statements can be used in some limited circumstances. Therefore, we are supportive of the inclusion of a reference to combined financial statements in the *Conceptual Framework* as IFRS guidance in this area is needed. However, we think that paragraph 3.17 as currently written does not provide robust enough parameters as to what is included or excluded in such financial statements and reflects an area that might be considered for future standard setting activities by the IASB.

24. We suggest providing some guidance containing parameters for combined financial statements. The following wording describing combined financial statements is part of a standard that has been applicable in Canada for many years:

> "Combined financial statements may be useful in certain circumstances although they are not a substitute for consolidated financial statements. Combined financial statements could be useful where one individual owns a controlling interest in several corporations. They could also be used to present the financial position and the results of operations of a group of subsidiaries."

25. At a minimum, adding language to paragraph 3.17 would be helpful in describing the basis/bases of determining the boundary of a reporting entity depicted in combined financial statements, such as the combined financial statements used in common control circumstances.

***Other comments***

26. We discuss, under the description of a reporting entity, how the concept of control could be used as a basis for determining a reporting entity. However, the choice of direct or indirect control as the basis for determining how controlled entities are reported by the parent entity will depend on the nature of its activities and the information needs of its investors and creditors.

27. We recommend replacing paragraph 3.23 with wording similar to what is noted in the second sentence above in paragraph 26 and removing paragraphs 3.24 and 3.25 because they read as standards-level guidance and are overly prescriptive.

| **Question 3—Definitions of elements** |
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| Do you agree with the proposed definitions of elements (excluding issues relating to the distinction between liabilities and equity):<br><br>(a) an asset, and the related definition of an economic resource;<br>(b) a liability;<br>(c) equity;<br>(d) income; and<br>(e) expenses?<br><br>Why or why not? If you disagree with the proposed definitions, what alternative definitions do you suggest and why? |

28. We support the proposed definitions of elements. We agree that the definitions should focus on the resource or obligation that presently exists rather than on the future flows of economic benefits that might result. We also agree that there is no need to make major changes to the definitions of income and expenses, or to the guidance accompanying those definitions.

29. However, we think the IASB needs to define capital transactions and what is meant by "transactions with owners in their capacity as owners" in order to understand how to interpret the definitions of income and expenses.

30. We support using the liability definition as the basis for distinguishing between liability and equity instruments. We think some of these instruments are complex and further developing concepts to distinguish liabilities from equity in this Exposure Draft would delay the completion of this project. Therefore, we support the continued work by the IASB on the Financial Instruments with Characteristics of Equity research project to alleviate the inconsistences found in IAS 32 *Financial Instruments: Presentation.*

31. We continue to think identifying the past event in order to determine whether an asset or liability exists presently (i.e., at the reporting date) is not necessary. We acknowledge that the reference to past events may be helpful in determining how to portray that event but agree with the discussion in paragraph BC4.20 that this could better be explained in the supporting guidance rather than in the definition. However, if the IASB intends to retain the notion of past event in the definitions, we recommend adding a discussion on how the notion pertains to the asset definition because the discussion on past events in paragraphs 4.36 to 4.39 relates only to liabilities.

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

32. We agree that the probability threshold should not be included in the elements definitions because in some cases it is uncertain whether an asset or liability exists. The most obvious example is litigation that is a low-probability/ high-severity event. The IASB should leave situations like this one to standards-level guidance.

33. Paragraph 4.32 provides too broad an interpretation of the phrase "no practical ability to avoid". We think the wording in paragraphs 4.33 to 4.35 are more appropriate and recommend reworking these paragraphs as shown below:

4.32 ~~An entity has no practical ability to avoid a transfer if, for example, the transfer is legally enforceable, or any action necessary to avoid the transfer would cause significant business disruption or would have economic consequences significantly more adverse than the transfer itself. It is not sufficient that the management of the entity intends to make the transfer or that the transfer is probable.~~

4.34 Many obligations are legally enforceable as a consequence of a contract, legislation or similar means. Obligations can also arise, however, from an entity's customary practices, published policies or specific statements that require the transfer of an economic resource. If the entity has no practical ability to act in a manner inconsistent with those practices, policies or statements, the entity has an obligation. The obligation that arises in such situations is often described as a constructive obligation. It is not sufficient that the management of the entity intends to make the transfer or that the transfer is probable.

4.33 If an entity prepares financial statements on a going concern basis, the entity:

(a) has no practical ability to avoid a transfer that could be avoided only by liquidating the entity or ~~ceasing trading~~ going out of business; but

(b) has the practical ability to avoid (and hence does not have a liability for) a transfer that would be required only ~~on~~ when the ~~liquidation of the~~ entity is liquidated or ~~on the cessation of trading~~goes out of business.

4.35 In some situations, the requirement for an entity to transfer an economic resource may be expressed as being conditional on a particular future action by the entity, such as conducting particular activities or exercising particular options within a contract. The entity has an obligation if it has no practical ability to avoid that action.

34. We also recommend adding the phrase "such that another party has a right" to paragraph 4.31(b) to reflect the notion of promissory estoppel. Such a clarification would reflect the notion that an entity cannot impose a liability on itself because there needs to be a counterparty, even if it is society at large. It would also help reinforce the wording in paragraph 4.25. In summary, we propose that paragraph 4.31(b) be revised as follows:

4.31(b) The obligation has arisen from past events that establish the extent of the obligation, such that another party has a right; in other words; the entity has received the economic benefits~~,~~ or has conducted the activities~~, that establish the extent of its obligation~~.

35. We recommend that the Basis for Conclusions include some examples such as perpetual preferred shares or additional interest payable on a loan in default to demonstrate how the guidance in paragraph 4.31(b) could be applied. We also encourage the IASB to continue to test the application of the definitions as the guidance is finalized, specifically, how the guidance could affect liabilities within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*

***Constructive Obligations***

36. We think the guidance in paragraph 4.34 on a constructive obligation is more specific and therefore an improvement over what is stated in the existing *Conceptual Framework* and is better articulated in this Exposure Draft than it was in the Discussion Paper.

| **Question 5—Other guidance on the elements** |
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| (a) Do you have any comments on the proposed guidance?<br>(b) Do you believe that additional guidance is needed? If so, please specify what that guidance should include. |

***Executory Contracts***

37. We disagree with the guidance proposed on executory contracts in paragraph 4.41 stating that "[t]hat right, and the obligation to exchange economic resources, are interdependent and cannot be separated. Hence, the combined right and obligation constitute a single asset or liability." This statement is inconsistent with how the IASB has defined an asset and a liability. Rather, we see the right and obligation as identifiable assets and liabilities that could be combined because they relate to a single unit of account given their interdependency. In other words, the unit of account for an executory contract would be at the contract level. This approach is supported by paragraph BC4.85, which refers to the ability to separate the right and the obligation. Once either side performs under the contract, it ceases to be an executory contract and two new units of account (an asset and a liability) are formed.

38. In addition, nothing in the *Conceptual Framework* states that rights and obligations must be separable in order to result in both an asset and a liability and the IASB explicitly rejected using this as a criterion in establishing its proposals for the recognition of assets. Furthermore, using inseparability to justify the creation of a single net right or obligation in an executory contract is contrary to the substance of these arrangements.

39. Finally, we recommend that the discussion on executory contracts should follow the unit of account discussion for a more cohesive flow.

***Unit of Account***

40. We are supportive of the inclusion of the unit of account discussion within the *Conceptual Framework* and think the proposals are a step in the right direction.

41. While the unit of account for a particular item should be determined at the standards level, it is important that the concepts relating to unit of account are addressed in the *Conceptual Framework* to ensure new and revised standards are developed using a consistent rationale.

42. However, we think the unit of account discussion in paragraph 4.58 is incorrect and inconsistent with the balance of the discussion on the unit of account. Paragraph 4.58 states "[a] unit of account is selected for an asset or liability after considering how recognition and measurement would apply…" In our view, what the asset or liability is must be identified before the unit of account for either recognition or measurement can be determined. We propose the following changes to paragraph 4.58:

    "A unit of account is selected once the~~for an~~ asset or liability is determined. Once the unit of account is selected, the entity ~~after~~ considers~~ing~~ how recognition and measurement will apply, not only to that asset or liability, but also to the related income and expenses. …"

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

43. We support the recognition criteria because, in our view, removing the probability and reliability criteria in the existing *Conceptual Framework* is a step forward. We think that all items that meet the definition of assets and liabilities should be recognized. If the definitions of the elements are valid, there must be a presumption to recognize all items that meet those definitions. Any possible exceptions to the principle should be addressed at a standards level.

44. We think that the *Conceptual Framework* needs to explicitly distinguish between uncertainty about the existence of an asset or liability and uncertainty about the probability of its outcome to support why the recognition criteria are not needed.

45. Further, we prefer the approach taken in the Exposure Draft of framing the qualitative characteristics and cost/benefit constraint as recognition criteria, to the exception approach taken in the Discussion Paper.

46. However, we think some recognition criteria or guidance would be helpful in setting standards for liabilities subject to a high level of existence uncertainty. In such circumstances, it seems to us impossible to include material in the standard without some reference to "probability". This concern could be addressed by reinforcing the ability to assess the uncertainty at a standards level.

47. As noted in our response to Question 1, we are concerned that paragraph BC5.45 could be used to support asymmetrical prudence and think that the last sentence of this paragraph should be removed for this reason.

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

48. In our view, the proposals on derecognition are underdeveloped and require further work. We recommend that this work be undertaken in a separate project. However, we note that this separate project would be a lower priority than a new project on measurement as discussed below.

49. We think the IASB should aspire to one approach to derecognition in the *Conceptual Framework*. We support the control approach because this approach is consistent with the element definitions.

50. We agree with the concepts in paragraphs 5.25 to 5.27. However, we recommend that the guidance should be at the level of rights and obligations rather than assets and liabilities. The guidance as currently written appears to implicitly assume a unit of account, which creates confusion. It is important to first think about deconstructing the existing unit of account to consider the individual rights and obligations and then consider which rights and obligations no longer exist, and how the new and remaining rights and obligations should be reconstructed into a new unit of account. Whenever there is a substantive change in the rights or obligations in a unit of account, that unit no longer exists and hence should be derecognized and a new unit recognized for any continuing and new rights or obligations. By considering the rights and obligations first and the unit of account second, the guidance on derecognition will be clearer.

51. We struggle with the notion of an entity retaining a component of an asset or liability in paragraphs 5.27, 5.30 to 5.32, because the element definitions focus on rights and obligations. As a result, we recommend that this guidance should refer to rights and obligations instead of components.

52. We recommend the following changes:

    5.25 Derecognition is the removal of all or part of a previously recognised asset or liability from an entity's statement of financial position. For an asset, this normally occurs when the entity loses control of all or part of the previously recognised asset; for a liability this normally occurs when the entity no longer has a present obligation for all or part of the previously recognised liability.

5.26 Accounting requirements for derecognition aim to represent faithfully both:

(a) the rights and obligations~~assets and liabilities retained~~that exist after the transaction or other event that led to the derecognition (including any right~~asset~~ or obligation~~liability~~ acquired, incurred or created as part of the transaction or other event); and

(b) the change in the entity's rights and obligations~~assets and liabilities~~ as a result of that transaction or other event.

5.27 Those aims are normally achieved by:

(a) derecognising any rights or obligations~~assets or liabilities~~ that have been transferred, consumed, collected or fulfilled, or have expired and recognising any resulting income or expense.

(b) continuing to recognise the rights or obligations~~assets or liabilities~~ retained, if any~~ (the retained component), which become a separate unit of account~~. Accordingly, no income or expenses are recognised on the retained rights or obligations~~component~~ as a result of the derecognition of the transferred right or obligation~~component~~.

53. In addition to the changes above, we suggest that paragraph 5.27 should include a third requirement that deals with the rights or obligations acquired, incurred or created as part of the transaction or other event (as discussed in paragraph 5.26(a)) and recognizes the income or expense, being the difference between what is derecognized and recognized.

54. We recommend removing the material in paragraphs 5.28 to 5.36 from the *Conceptual Framework* because it represents standards-level guidance. Moreover, the underlying concepts are complex and the simplified manner in which they are presented is not helpful to fully illustrate this complexity. For example, we are concerned that using this additional simplified guidance to apply the requirements in IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments* could create confusion. Should this guidance be retained, we think examples would be needed to adequately illustrate the concepts given there is little guidance in IAS 39 and IFRS 9.

55. If this guidance is not removed, as we propose in paragraph 54:

    (a) We are concerned with the last sentence in paragraph 5.30(b) that states "[b]ecause the component that has been transferred must or may be reacquired, derecognising it may misrepresent the extent of the change in the entity's financial position." We disagree with this sentence because it seems to imply that whether or not the component should be derecognized is purely a function of the measurement basis chosen for the retained asset. We think the example actually supports derecognition of the entire original asset.

    (b) We think that paragraphs 5.34 to 5.36 on modification of a contract should give criteria to determine when modifications create assets and liabilities. For example, criteria to determine if there are distinct rights and obligations should be added as a result of a modification.

56. We do not find the examples in paragraph BC5.52 convincing. It appears to us that in the example in paragraph BC5.52(a) on the sale of receivables with recourse, there has been a substantive change in risk exposure. Many changes increase leverage or result in a disproportionate exposure (for example, derivatives). However, these changes should be captured when the item is re-measured and explained in disclosures. We think that in the example in paragraph BC5.52(b) on the sale and repurchase agreement, failing to derecognize the original asset ignores the fact that, absent other constraints, the entity does not control the transferred item and there is a risk of default by the transferee. We recommend removing these examples.

***Overall comments on Measurement (Chapter 6)***

57. Our response to the Discussion Paper recommended a two-step approach to developing measurement guidance in the *Conceptual Framework*. The first step would be to develop limited guidance as part of the current project. The second would be to undertake a research project to develop measurement concepts. We noted that it is not possible to make significant progress on the measurement chapter within the IASB's current project timeline and recommended that this work be undertaken separately over a longer period of time.

58. We find the proposals in the Exposure Draft to be largely consistent with our recommended first step and agree with the IASB's decision to not delay updating the rest of the *Conceptual Framework* to undertake research on measurement. We continue to think that further work on measurement is necessary, and the IASB should add a separate project to its agenda. We note that this approach is being taken for the other less developed sections of the *Conceptual Framework*. For example, the distinction between liabilities and equity is being explored in the research project on Financial Instruments with the Characteristics of Equity and more robust presentation and disclosure concepts are being developed as part of the Disclosure Initiative. We

think a similar approach to measurement is warranted because the material in the Exposure Draft is not conceptual in nature but instead sets out the measurement bases that are currently used in IFRS along with factors to consider when selecting a measurement basis. We appreciate the fact that the IASB is striving to address historical cost and current value in a neutral manner.

59. The measurement section in the *Conceptual Framework* should clearly articulate concepts and principles that set out necessary and sufficient criteria to determine the measurement basis for categories of assets and liabilities. In-depth work is needed into what those conceptual underpinnings should be. A significant amount of thought, analysis, discussion and education is needed to develop measurement concepts and principles that will be useful and effective for developing principles-based measurement requirements in new and amended standards.

60. As a result, we think that a separate project on measurement is needed and this work should:

(a) examine the existing research as well as theoretical and empirical evidence that pertains to the measurement of assets and liabilities to achieve the financial reporting objective;

(b) involve rigorous evaluation of each measurement family based on the qualitative characteristics;

(c) examine what role current value measurements for financial reporting purposes play relative to historical cost measurements, including how each measurement basis provides useful information to assess future cash flows and management's stewardship of the entity's resources;

(d) develop concepts that would result in identifying characteristics that are necessary and sufficient to portray the measurement of assets and liabilities with similar attributes in a consistent manner;

(e) generate discussion, debate and a better understanding of views between the IASB and its Accounting Standards Advisory Forum as well as other National Standard Setters in order to advance thought about measurement in financial reporting; and

(f) assess the costs and benefits of implementing any change in measurement basis including assessing the cost of changing as well as the ongoing costs of reporting in an interim and annual reporting environment.

61. Following completion of these activities, we recommend that the next step would be to publish a consultation document that stimulates broader discussion and debate among stakeholders. We think the benefit of this work will be to identify why there are differences in views as well as areas of agreement and build acceptance of the measurement concepts.

62. The fact that the FASB is currently working on the measurement chapter of its *Conceptual Framework* reinforces the need for the IASB to continue its work in this area. In our view, it is essential for the two frameworks to remain largely consistent. If the frameworks start to diverge, the development of standards that will provide a common global approach to financial reporting will not be possible.

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

63. We agree that the two broad measurement families, historical cost and current value, should be described in the *Conceptual Framework*.

***Disadvantages to allocations under historical cost***

64. The way the information on historical cost is currently presented makes this measurement basis seem simple and precise because it is based on transactions that have occurred. The *Conceptual Framework* should acknowledge that historical cost also has many complexities, despite its deeply-entrenched application over time, such that an over-familiarity with the conventions of historical cost methodologies has rendered any inherent subjectivity in measurement less visible. We agree with paragraph 6.16 that states, in part, "the historical cost of an asset or a liability can sometimes be as difficult to estimate as current value". The disadvantages of historical cost appear to be understated, specifically when considering historical cost measurements that involve accumulations, allocations or estimates. Including some additional examples in the *Conceptual Framework* would be a way to more clearly present these disadvantages. For example, inventory in a manufacturing environment is an accumulation of amounts developed by using conventions including differing allocations of various types of overheads and cost flow assumptions such as FIFO or weighted-average. These accumulated costs are always entity-specific and can be difficult to estimate. Similarly, other self-constructed assets can be subject to considerable estimation uncertainty. In both these examples, current value may be more precise and simpler to obtain than historical cost.

***Entry and Exit Values***

65. Although we agree with the IASB's decision in paragraph BC6.18(a) to reject categorizing measurement bases according to the use of entry and exit values, we think a discussion of entry and exit values under the current value family would be beneficial. We find the material in paragraphs 6.49 and 6.50 of the Discussion Paper helpful. These paragraphs acknowledge that some items have entry markets that are different from their exit markets and that the IASB might consider using an entry price rather than an exit price. Paragraph 6.50 also explains when entry and exit prices are likely to provide more relevant information.

66. In contrast, paragraph BC6.18 dismisses entry values stating that "[t]he IASB thinks that there is often little difference between entry and exit values in the same market, except from transaction costs." This statement is unhelpful because it is precisely when the prices are not in the same market that entry and exit prices are relevant. Many entities buy in one market and sell in another market. In addition, not all markets are equally accessible by all entities. We recommend that this material should be replaced with a discussion of the larger issue of whether an entry or exit market should be used. At a minimum, the material from the Discussion Paper could be used.

***Information provided by the various measurement bases***

67. We are not convinced that the material in table 6.1 regarding the information provided by various measurement bases is complete or useful. Specifically, we think:

    (a) the table should describe measurement upon initial recognition and highlight that interest expense and impairment under a current value measurement basis are allocations;

    (b) the table is illustrative of current practice rather than a precise description of the information provided by each measurement basis; and

    (c) a statement clarifying the purpose of the table should be included.

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

68. We support discussing the factors to be considered in selecting a measurement basis by reference to the qualitative characteristics of useful financial information. However, we think that paragraphs 6.64 to 6.73 represent standards-level guidance and should not be included in the *Conceptual Framework*. Should the IASB decide to keep this guidance, we explain our concerns with respect to related party transactions below.

***Related party transactions***

69. Paragraphs 6.69 to 6.71 seem to provide guidance on the measurement of related party transactions. This is troubling because the paragraphs are inadvertently establishing a principle to measure transactions with related parties at current value when the IASB has never had an agenda project to consider this question. These paragraphs do not discuss whether the same treatment should apply to both an arms-length transaction and a related party transaction. This chapter of the *Conceptual Framework* should clearly state that the underlying assumption throughout is that the measurement concepts apply to transactions conducted between arms-length parties, rather than weave in potential consideration of how to measure transactions between related parties without a robust discussion. For example, the discussion as to what acting in the capacity of a holder of equity claims represents is lacking. In addition, related parties are much broader and may not hold equity claims at all.

70. Although we think there is a need for a separate project on the measurement of related party transactions, we consider it inappropriate for these underdeveloped and incomplete concepts to be included in the *Conceptual Framework*. As a result, we recommend paragraphs 6.69 to 6.71 be removed.

***Unit of account***

71. We think a discussion of unit of account in the measurement chapter would be helpful. Although chapter 4 includes a discussion and paragraph 4.59 notes that “it may be appropriate to select one unit of account for recognition and a different unit of account for measurement”, the measurement chapter does not refer to unit of account. We recommend that guidance be added to the measurement chapter that:

    (a) includes the statement in paragraph 4.59; and

    (b) discusses factors to consider in deciding whether the unit of account for measurement should differ from the unit of recognition.

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

72. We agree that in some cases, more than one measurement basis for the same item in the same financial statements could provide useful information to the users of financial statements. We acknowledge that standard setting involves considering conflicting objectives of different stakeholders and developing generally accepted standards. In some circumstances, we also accept that in order to make improvements in financial reporting it might be necessary for the IASB to select a current value measurement basis for assets or liabilities in the statement of financial position and a different measurement basis to determine the related income or expenses in the statement of profit or loss. We support the use of different measurement bases when it would enable some assets and liabilities to be measured using a more relevant basis in the statement of financial position.

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

73. We agree with the objective and the scope of financial statements as presented in the Exposure Draft.

74. We agree with the proposal for presentation and disclosure as communication tools and think that the guidance on classification, aggregation, and presentation and disclosure objectives and principles is useful. However, we recommend that the *Conceptual Framework* be updated to reference materiality, which will help determine what information is relevant for reporting. We also support the IASB adding a project on the primary financial statements to its agenda because we think it will help with performance measurement.

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

75. We support the proposed description of the statement of profit or loss because we agree that it is not feasible to define profit or loss in the *Conceptual Framework* at this time. However, we recommend that total comprehensive income be explicitly defined in the *Conceptual Framework* as the difference between all recognized income and expenses for the period.

| **Question 13—Reporting items of income or expenses in other comprehensive income** |
|---|
| Do you agree with the proposals on the use of other comprehensive income? Do you think that they provide useful guidance to the IASB for future decisions about the use of other comprehensive income? Why or why not?<br>If you disagree, what alternative do you suggest and why? |

76. We agree with the proposals on the use of OCI because we think that this guidance will be useful to the IASB for its future standard-setting activities and to establish a framework for when OCI could be used and when it should not be used. We think that the introduction of a concept for the appropriate use of OCI will lead to more consistent income and expense classification between profit or loss and other comprehensive income in the future.

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

77. We do not agree with the inclusion of the first sentence of paragraph 7.27 that sets up a rebuttable presumption that certain amounts may not be reclassified to profit or loss from OCI because we think that:

    (a) the presumption in paragraph 7.26 should be the underlying principle of the *Conceptual Framework*; and

    (b) any deviation from the principle in paragraph 7.26 should be determined at the standards level with appropriate justification.

    We therefore recommend deleting the rebuttable presumption from paragraph 7.27.

78. Furthermore, we recommend amending paragraph 7.24 of the Exposure Draft to require that income and expenses can be recognized in OCI only when the amounts can be reclassified to profit or loss in a future period in some meaningful way. We think that this recommendation is consistent with the view expressed in paragraph BC7.56 that "[t]he absence of an appropriate basis for reclassification may be an indication that this particular item of income or expense should not be included in OCI in the first place." We also suggest that the last sentence of paragraph 7.27 that states "[i]f no such basis can be identified, this may indicate that the income or expenses should not be included in other comprehensive income" should be relocated to paragraph 7.24.

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

79. We agree with the analysis of the effects of the proposed changes to the *Conceptual Framework*. We have not identified any additional effects that the IASB should consider.

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

80. We agree with the proposed approach to business activities. We think the discussion of how an entity's business activity may affect the unit of account, measurement and presentation and disclosure is appropriate. We find the material included in the Exposure Draft related to business activities to be sufficient; it does not need to be expanded.

81. Although the type of business might affect the choice of the basis of measurement, we think this outcome would be rare and the measurement basis should be driven by concepts in the *Conceptual Framework* for the determination of measurement basis.

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

82. We agree that the *Conceptual Framework* should not refer explicitly to the business activity of long-term investments because we agree that the information needs of investors are not likely to be different due to different investment horizons as explained in paragraph BCIN.40. Also, we agree with the IASB's reasons explained in paragraph BCIN.38 that such an explicit reference would inappropriately embed standards-level detail in the *Conceptual Framework*, and there is no reason why the *Conceptual Framework* should refer specifically to one particular business activity when it does not refer to any other business activity.

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

***Exception***

83. We recommend that the statement in paragraph IN3 that "the IASB may sometimes specify requirements that depart from aspects of the [draft] *Conceptual Framework*" be removed. We think that this statement is unnecessary because Chapter 2 of the *Conceptual Framework* already provides criteria for such decisions.

84. Any departure from the *Conceptual Framework* should be a standards-level decision. We agree that due process should require an explanation of a departure from some aspect of the *Conceptual Framework* in the Basis for Conclusions for that standard. We recommend updating the Due Process Handbook at the next opportunity to make this requirement explicit.

**APPENDIX B – Drafting suggestions**

***Chapter 1***

85. Include a footnote in paragraph 1.3 referring to the term “future net cash inflows” to acknowledge that some entities, such as development stage entities, may generate net cash outflows rather than inflows.

***Chapter 2***

86. Delete the last sentence of paragraph 2.13, as it detracts from the main message and is confusing:

    ~~“On the other hand, a high level of measurement uncertainty does not prevent the use of an estimate if that estimate provides the most relevant information.”~~

***Chapter 3***

87. In paragraph 3.6, add a reference to the cash flow statement as well. Although the paragraph is not meant to read as a full list of what comprises a complete set of financial statements, the cash flow statement is an important statement that many users rely on for obtaining the information they need about an entity.

88. Expand the sentence in paragraph 3.6 that reads “not all assets and liabilities are necessarily recognized” to also say something to the effect that disclosures may be needed. As currently worded, this sentence is not a complete thought.

89. Remove paragraph 3.9, as it is unclear (e.g., why there is the need for “as a whole” after “entity”). This does not appear to provide any additional information beyond that included in the first chapter on the objective of financial reporting.

90. Explain what the IASB means by “cease trading” in paragraph 3.10 because that phrase has multiple interpretations. For example, it could refer to prohibiting the trading of securities of a company in North America whereas the term may mean cease operations in Europe.

***Chapter 4***

91. Modify paragraph 4.12 to state:

    “…Conceptually, the economic resource is the set of rights, and not the physical object.”

92. Modify paragraph 4.14 to state:

“…(c) using the economic resource to produce cash inflows (or ~~save~~ <u>prevent</u> cash outflows), for example;…”

93. Relocate paragraph 4.26 because although relevant, it relates to the recognition criteria.

94. Reword paragraph 4.27 to be consistent with paragraph 4.13 as follows:

“An entity’s obligation to transfer an economic resource must have the potential to require the entity to transfer an economic resource to another party. It need not be certain, or even probable, that the entity will be required to transfer an economic resource.~~, but~~ <u>It is only necessary that</u> the obligation ~~must~~already exist<u>s</u> and <u>that</u> there ~~must be~~<u>is</u> at least one circumstance ~~in~~ which ~~it~~ will require the entity to transfer an economic resource. One example of such an obligation is an obligation to stand ready to transfer an economic resource if an uncertain future event occurs.”

95. Improve paragraph 4.28 to better align with paragraph 4.14:

“Obligations to transfer an economic resource <u>could</u> include~~, for example,~~ obligations to:”

96. Add the concept of interdependency to paragraph BC4.116(a) as the paragraph relies solely on separability when considering these concepts together is more relevant in determining the unit of account.

97. Replace the words recognition and measurement with classification in paragraph 4.57 because we think that is the intent.

98. Revise paragraph 4.63 because when there is a substantive change in the rights and obligations in a unit of account, that unit should be derecognized and the new unit should be recognized for any continuing interest:

“If an entity transfers part of an asset or part of a liability, the unit of account ~~may change~~ <u>changes</u> at that time…”

***Chapter 5***

99. Add a reference to time to paragraph 5.3:

“Recognising assets, liabilities, equity, income and expenses depicts economic resources and claims <u>at a point in time</u>, and changes in those resources and claims <u>during the period</u>, in a structured summary that is intended to be comparable and understandable. An important feature of that summary is that the amounts recognised in a statement are included in the totals and, if applicable, subtotals, that give structure to the statement.”

100. Improve paragraph 5.15:

“Some assets represent neither contractual nor other legal rights.~~, for e~~Examples include~~,~~ rights to benefit from items such as know-how and customer or supplier relationships.~~, are not contractual or other legal rights.~~ It may therefore be uncertain whether…”

101. Remove the word “claim” from paragraph 5.23(c):

“[h]ence, related disclosures can enable a recognised amount to form part of a faithful representation of an asset, liability, item of equity~~ claim~~, income or expense~~s~~.”

***Chapter 6***

102. Avoid using the words “cost” and “value” interchangeably. For example, paragraph 6.7 defines historical cost using the word “value”. We think using the word “amount” would be more appropriate and less confusing.

103. Revise paragraph 6.31 to remove the reference to “same amounts” and be consistent with paragraph 6.32 that refers to “different amounts” because measurement uncertainty almost always produces a range of reasonable amounts. Paragraph 6.31 refers to “estimation error” which is confusing because the fact that there may be a wide range of reasonable estimates generally is not an error:

“Because fair value is determined from the perspective of market participants, instead of the perspective of the entity, and is independent of when the asset or the liability was acquired or incurred, identical assets will ~~(subject to estimation error)~~ be measured using~~at~~ the same inputs~~amount~~ (subject to differences in estimates). This can enhance comparability both between reporting entities and within the same reporting entity.”

104. Remove paragraph 6.33 because it is not intuitive that for a specialized item how measurement from a market participant perspective would produce similar results to an entity’s perspective. We think the results may be dissimilar given the entity has information about the specialized item that market participants do not have.

105. Modify the last sentence in paragraph 6.44 because arriving at identical estimates would require many assumptions such as completely efficient markets and that all entities have equal access to all markets:

“Because value in use and fulfilment value are determined from the perspective of the reporting entity, those measures could differ for identical assets and liabilities in different entities, arguably reducing comparability. In contrast, because fair value uses market participant assumptions, in theory, different entities should arrive at ~~identical~~similar estimates of fair value for identical items."

106. Explain why the IASB would be unlikely to consider selecting current cost as a measurement basis when developing future Standards in paragraph BC6.23.

***Appendix B***

107. Revise the definition of general purpose financial report in the Glossary to refer to "investors, lenders and other creditors" to be consistent with similar references in the *Conceptual Framework* (for example, paragraph 1.2):

"A report that provides the reporting entity's existing and potential investors, lenders~~creditors~~ and other creditors~~lenders~~…"