Chief Financial Officer

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Comments on the Exposure Draft ED/2015/3 Conceptual Framework for Financial Reporting

We are pleased to provide BNP Paribas’ comments on the Exposure Draft Conceptual Framework for Financial Reporting (“ED”).

Our comments will focus on key areas where we would like to highlight the following messages:

- **Introduction of stewardship, prudence**

  We welcome the ED proposal to re-introduce the notions of prudence and stewardship, as suggested in our response to the Discussion Paper¹.

  However, we still believe that the IASB should go a step further by making the notion of stewardship even more prominent in the conceptual framework. It should indeed be explicitly considered that an objective of financial statements is to allow the assessment of how efficiently and effectively the management has actually discharged its responsibilities to use the entity’s resources.

  Furthermore we think that the notion of users should be extended to the management. Indeed, to make sure that information provided in financial reporting would be useful to depict the financial position and performance of entities, the management and their stakeholders should use a common language.

  With respect to prudence, while we agree that the exercise of prudence should not lead to a deliberately biased measurement, we consider that the conceptual framework should enable asymmetric prudence to be used by standard setters when building a standard and when deemed appropriate in some circumstances.

- **Definition of liabilities**

  Given the unintended consequences that may arise from the new definition of liabilities as proposed in the ED, in particular “present obligation”, we consider that it is premature to change the current definition without having further identified potential issues resulting from a new definition of liabilities, beyond impacts on levy’s accounting and IAS 32. In the meantime, the guidance at standard level such as IAS 37 could be enhanced to further clarify that economic compulsion may create present obligation in certain circumstances.

- **Measurement basis, P&L versus OCI and recycling, business activities, long term investments**

We regret having found no elements, neither in the Conceptual Framework ED nor in the basis for conclusion, on the relevance of the theory of market efficiency to justify the use of fair value in financial reporting, included in circumstances where this value is clearly unreliable. The conceptual framework should not introduce a bias in the analysis of the different measurement bases by suggesting a superiority of fair value measurement over other measurement bases.

Furthermore, the notions of measurement basis, P&L versus OCI and recycling, business activities and long term investments are intertwined and also closely dependent on the definition of performance. Unfortunately, definition and discussion around this core concept is lacking. Beyond the difficulty of the exercise we encourage the IASB to launch a research project thereof because most of the issues relating to the CF turn around what performance is and how it is expected to be reflected in financial statements.

One aspect of these issues is the distinction between which items must be reported in profit or loss and which must be in OCI and when to recycle. As stated in the ED, we welcome that the statement of profit or loss is the primary source of information about performance. Many investors rely on profit or loss as a first basis for predicting future operating results\(^2\). Thus, the latter should be reported consistently with the way resources are managed to generate cash flows and with business activities.

Therefore, we welcome the introduction of “business activities” as they represent the key driver in understanding the way cash flows are generated and will be generated in the future. Moreover, we consider that other notions, such as the characteristics of the instruments, should not override this concept of business activities which should be considered as a pillar of the accounting framework.

A proper reflection of the business activities in the performance of the entity would make useless to distinguish investors on the basis of their investment horizon.

Finally we consider that the evolution of some concepts or notions in the conceptual framework requires identifying the potential effects of such changes on existing standards prior to their approval. Thus, an impact study should be conducted by the IASB before the final drafting of the conceptual framework.

Our detailed answers to the questions are included below.

Should you have any questions regarding our comments, please do not hesitate to contact us.

Yours sincerely,

[Signature]

Lars Machenil

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\(^2\) As highlighted in EFRAG Research paper on the role of Business Model in Financial Statements, December 2013. EFRAG’s Report Joint Outreach Investor Event, 1 July 2015 also confirms that: “…professional investors are strongly anchored on P&L”.
Detailed comments

Chapters 1 and 2—The objective of general purpose financial reporting and the qualitative characteristics of useful financial information

Question 1—Proposed changes to Chapters 1 and 2
Do you support the proposals:
(a) to give more prominence, within the objective of financial reporting, to the importance of providing information needed to assess management’s stewardship of the entity’s resources;
(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;
(c) to state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form;
(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
(e) to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information?
Why or why not?

Stewardship

We welcome the introduction of stewardship, as suggested in our response to the Discussion Paper.

Stewardship is understood as the way management has effectively discharged their responsibilities in the past and how it has positioned the entity’s resources for the future. Therefore, we agree with the ED proposal to reintroduce reference regarding stewardship.

We consider the CF should go a step further by considering stewardship as an objective of financial reporting. However financial reporting is not the only means to assess management stewardship and we think the IASB as standard setter, should limit its role to financial reporting, without covering more information related to the management report for example. As already expressed in the past, we do believe that the objective of financial statement should be to enable management to give accounts of past transactions and events of the period and their use of the resources entrusted to them. It is critical that the management and their stakeholders use a common language to report financial information and performance criteria actually used to conduct the business.

Operationally, performance objectives assigned to business managers do indeed take account of accounting conventions. The same indicators should be used both to assess the effective return of the business lines and to report to shareholders and to the market. In our view, using different sets of measurement basis and indicators for business management on the one hand and for

financial communication on the other hand would be confusing, inefficient and operationally complex. Precisely for this reason it is fundamental that accounting standards properly reflect business activities.

As highlighted by recent discussions around the Discussion Paper *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging*, it is fundamental that the conceptual framework do not preclude from reflecting faithfully actual business and risk management in financial reporting. For instance, the IASB should ensure that the equity model book or behaviouralisation should be possible, based on the revised conceptual framework.

**Users’ definition: management should be in the scope**

To reach this consistency, the conceptual framework should consider the entity’s management as part of the users of financial information, with the same priority as investors and other creditors.

**Prudence**

We strongly support the ED proposal to re-introduce prudence in the conceptual framework.

We agree with the definition proposed in paragraph 2.18 “neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty.”

It could be further explained that in exercising prudence under circumstances of measurement uncertainty, a balance should be reached with neutrality and reliability. In our view, an explicit discussion on reliability should be made in the CF, to further highlight that information should be free from material error and bias and that ultimately, reliability needs to be considered in achieving the objective of providing useful information to users.

In addition, we think that the proposed definition of prudence is rather intended to preparers when making judgements under conditions of uncertainty. We consider that it should be wider to enable standard setters to use prudence when considered appropriate in certain circumstances. Asymmetric prudence already exists at standards level currently, as highlighted in the examples below, and may be necessary for future standard developments:

- For developing an accounting policy in the absence of a specific IFRS (e.g. IAS 8.10);
- For recognition purposes (e.g. IAS37, threshold of liabilities vs assets; IFRS 15 on recognition of variable consideration);
- For measurement purposes (e.g. IAS 36 requires to ensure that the carrying amount is not greater than the recoverable amount, IFRS 5 requiring the use of lower of carrying amount and fair value less cost to sell).

**Relevance and faithful representation**

We agree with the discussion on faithful representation but as explained above, the notion of reliability is fundamental in achieving usefulness of financial information. Therefore, we would prefer that the CF use the term “reliability” which we think is more appropriate to meet the
qualitative characteristics of useful financial information instead of “faithful representation”. It is also better and widely understood than the term faithful representation.

Chapter 3—Financial statements and the reporting entity

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

We have no comments on this section.

Chapter 4—The elements of financial statements (assets, liabilities, equity, income and expenses)

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

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

Given the unintended consequences that may arise from the new definition of liabilities as proposed in the ED, in particular “present obligation”, we consider that it is premature to change the current definition.

Furthermore, the definition of liabilities and equity are closely interlinked. As the IASB has a research project on ‘Financial Instruments with Characteristics of Equity’ we believe that the IASB should not prematurely modify the definition of liabilities without considering more broadly the consequences of such changes within current standards and on this on-going research project.

Instead, the IASB should further identify other potential issues (than the one identified in IAS 32 or in IAS 37 for the levies) resulting from a new definition of liabilities and test the definition against a variety of instruments and situations.
In the meantime, the guidance at standard level such as IAS 37 could be enhanced (or IAS 34 amended) to solve the issue of IFRIC 21 and to clarify that beyond constructive obligation, economic compulsion may create a present obligation in certain circumstances, for example when there is no realistic alternative to avoid a transfer of resources.

The notion of economic compulsion, subject to the limits we mentioned above, should enable to recognise expenses as a result of past events which cannot be avoided in a going-concern situation.

The definition of a liability as proposed in the CF relies on two conditions as stated in paragraph 4.24 and 4.31: “the entity has no practical ability to avoid” a transfer of economic resources and the obligation shall result from “past events”. However, in some situations, it can be difficult to assess whether a past event has occurred or not and the condition of “past event” might not counterbalance the “no practical ability” condition, leading to potentially recognising many types of future expenditures.

We think that the notion of “adverse economic consequences” introduced in paragraph 4.32 of the CF to illustrate the notion of “no practical ability to avoid the transfer” goes much beyond the notion of constructive obligation already existing in IAS 37 and we question the unintended consequences on the scope of liabilities to be recognised based on these concepts.

The notion of economic compulsion should also have impacts on the debt versus equity classification of instruments.

For instance, we observe that hybrid instruments with step-up clauses make unrealistic the assumption that they will not be reimbursed when the reporting entity is in a going concern situation. This should be considered in the IASB project on Financial Instrument with Characteristics of Equity.

Finally, we are not in favour of the removal of the probability criteria from the definition of a liability which we think is likely to affect the scope of elements meeting the definition of a liability. We acknowledge that the scope of liabilities to be recognised might be limited by the need to consider relevant information in recognition requirements (§5.9) but at the same time, the ED states that a liability can exist even if there is a low probability of outflow of cash. Therefore, to avoid any confusion, we consider that the notion of “expected” should remain in the definition as is today.

**Other guidance on the elements** (on executory contracts, on the unit of account…)

**Question 5—Other guidance on the elements**

Do you have any comments on the proposed guidance?

Do you believe that additional guidance is needed? If so, please specify what that guidance should include.

We do not have any comment on this section.
Chapter 5—Recognition and derecognition

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

As mentioned in our answer to question 3, we think that the new definition of assets and liabilities could inappropriately extend the elements which would meet the definition of assets and liabilities, notably with the removal of the probability threshold from the definition.

We agree with §4.26 that “a requirement for one party to recognise a liability (or asset) and measure it at a specified amount does not imply that the other party must recognise the corresponding asset (or liability) or measure it at the same amount. Applying different recognition criteria or measurement requirements to the liability (or asset) of one party and the corresponding asset (or liability) of the other party may sometimes be an outcome of decisions intended to meet the objective of financial reporting”.

Thus, recognition criteria are key to contain elements to be recognised. However, we consider these criteria are too general and paragraphs 5.17 to 5.19 relating to low probability of flow of economic benefits do not enable to limit the recognition of assets or liabilities to those presenting a probable flow of economic benefits.

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

The Conceptual framework focuses on the notion of control to assess when an asset should normally be derecognised. Indeed, §5.26 states “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.”

While the conceptual framework refers implicitly to risks and rewards in §5.29, it does not use explicitly the terms which are only included in the basis for conclusion (cf. BC 5.53 to BC 5.58).

However, the notion of risks and rewards is explicitly used in some standards (e.g. the derecognition criteria of IAS 39/IFRS 9 relies mainly on risks and rewards or IFRS 15 identifies as indicators of the transfer of control the transfer of significant risks and rewards to the customer, among other indicators). Would the lack of explicit reference to “risks and rewards” in the CF lead to potential changes in individual standards, in particular on derecognition criteria in IFRS 9/IAS 39?

If it were the intention, we would disagree with such an evolution because we consider that the notion of risks and rewards is key for the derecognition of financial instruments and it is worthwhile noting that this notion is so fundamental that it has been used in IFRS15 to assess the transfer of control.
Therefore, we think that the Conceptual Framework should be more explicit on the fact that the notion of “risks and rewards” is encompassed in the notion of “positive or negative variations in the amount of economic benefits” and that it can be a key criteria to assess whether it is relevant to derecognise an asset or not.

Chapter 6—Measurement

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

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?

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?

We agree with the discussion introduced in the conceptual framework around different possible measurement bases.

However, as further explained in our comments on to question 16 below, we believe that the role of business activities/business model in the choice of the measurement basis should be made more prominent.

Also, the CF should not introduce a bias in the analysis of the different measurement bases by suggesting a superiority of fair value measurement over other measurement bases. This superiority has been neither demonstrated nor justified and no study or reference to such study has been done on the relevance of the theory of market efficiency (cf. also our comments to question 16 and 17). In our view, it is fundamental that the selection of the measurement basis is linked to the way cash flows are generated and how the financial statements are supposed to reflect the performance of the entity.
Chapter 7—Presentation and disclosure

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?

We broadly agree with the proposal included in the ED on the objective and scope of financial statements.

However, as highlighted by EFRAG we think that the IASB should better consider how to distinguish between presentation and disclosure, through for example a high level discussion of factors to consider when deciding what information to be presented on the face of FS versus disclosed in the notes.

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

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

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

We welcome the statement in § 7.21 that income and expenses included in the statement of profit or loss (P&L) are the primary source of information about performance. As explained below, we support recycling of OCI in profit or loss and we agree with BC7.54 stating that no income and expense should be excluded from the statement of profit or loss permanently, unless there is a compelling reason to do so. However, P&L should be retained and kept separate from a total for OCI because P&L should represent the ultimate depiction of performance consistently with business activities.

While the notion of performance is mentioned in the ED, definition and discussion around this core concept is lacking. We acknowledge the difficulty on this area but we encourage the IASB to launch a research project thereof because most of the issues relating to the CF turn around what performance is and how it is supposed to be reflected in financial statements.

Typically, one aspect of these issues is the distinction between which items must be reported in profit or loss and which must be in OCI and when to recycle.
To that respect, we support the fact that all items in OCI should be recycled into profit or loss. However, this should be a principle in the CF and not a rebuttable presumption as proposed. As such, we believe that the developments in points a) and b) of paragraph 7.23 identifying the situations where the presumption cannot be rebutted are not necessary.

Consistently with the need to define performance, the underlying conceptual basis on what should be recognised in OCI should be defined (how to substantiate the current use of OCI: AFS, CFH, IAS 19 actuarial assumptions, forex reserves on conversion of financial statements...). Accordingly, we do believe that there is no rationale for not recycling gains and losses on equity instruments for equity instruments measured at FVOCI in IFRS 9.

Other questions for respondents: Effects of the proposed changes to the Conceptual Framework

**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?

We do not have any comments on this section (cf. comments provided to the other questions).

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

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

While we welcome the introduction of the notion of “business activities” in regards of the unit of account, the measurement and presentation and disclosures, we consider that it should have been more thoroughly discussed and linked with other significant concepts.

Indeed, we believe that business activities, long term investments, the choice of measurement basis, the elements to be recognised in profit or loss versus those to be recognised in OCI are intertwined and closely dependent on the definition of performance.

Consistent with the importance of management stewardship/accountability, we consider that financial statements should portray how the business has been actually conducted and how the entity has specifically operated in its environment.

To that respect, the framework should not implicitly introduce a bias towards the superiority of fair value over other measurement bases in terms of transparency, predictive value, comparability (e.g. §6.28, 6.31).

As already expressed in the past, we regret the lack of debate around measurement attributes in relation to market efficiency theory. The latter currently grounds the use of fair value measurement to represent the market value, whenever possible, either from direct prices or
derived from internal models that aim to mimic efficient markets. However, actually, financial markets are seldom efficient. Therefore, rather than trying to guess a hypothetical market value in absence of liquid markets, we believe that the framework should give more prominence to the intrinsic value. This debate could usefully take place in the context of an IASB research project on financial performance.

The CF should acknowledge that there is no single value for a given asset but several possible values depending on how the asset is actually managed, might it be by own use either alone or in combination with other resources, through rent or sale. While the CF identifies business activities as being one of the factors to be considered when selecting a measurement basis, this concept is in practice overridden by the other factor relating to the characteristics of the instruments. This is clearly demonstrated by IFRS 9 and the primacy of the SPPI criterion over the business model criterion. We regret that the fair value through profit or loss category under IFRS 9 has not been defined by reference and ring fenced to the trading business model.

In our view, business activities represent the key driver in understanding the way cash flows are generated and will be generated in the future. Therefore, financial performance reported in financial statements should be driven by the business activities, which enable users to assess properly how the entity’s management efficiently and effectively has discharged its responsibilities to use the entity’s resource and to assess entity’s prospects for future net cash inflows.

A proper reflection of the business activities in the performance of the entity would make useless to distinguish investors on the basis of their investment horizon.

**Question 18—Other comments**

Do you have comments on any other aspect of the Exposure Draft? Please indicate the specific paragraphs or group of paragraphs to which your comments relate (if applicable).

As previously noted, the IASB is not requesting comments on all parts of Chapters 1 and 2, on how to distinguish liabilities from equity claims (see Chapter 4) or on Chapter 8.

We have no comments on this section.