Document for public consultation

Comments should be submitted by 26 October 2015 to
commentletters@efrag.org

Re: Exposure Draft *Conceptual Framework for Financial Reporting*

Given the critical role the conceptual framework should play in the effectiveness of the IASB standard-setting process in meeting European expectations in the future, the EFRAG Board has decided to:

- Issue this document for public consultation early to support European constituents in their participation in this important debate; the analysis and preliminary positions presented have been reviewed and validated by the EFRAG Board as the basis for EFRAG's due process, in the way they highlight and explain the main issues at stake and build on views expressed by a majority of European constituents in the past, in particular in 2013 when the IASB Discussion Paper was discussed or in response to the bulletins issued by EFRAG jointly with the ANC, ASCG, FRC and the OIC;
- Write to the IASB and request that the IASB extends its deadline for comments by 2 months (up to 26 December 2015). The deadline for comments indicated above would be postponed to 20 November 2015, would EFRAG be successful in its request;
- Give further consideration in an open manner to the most critical issues that should be dealt with in the conceptual framework before affirming preliminary views; and
- Update this first consultation document accordingly.

Summarised analysis

The revision of the Conceptual Framework is subject to close scrutiny by all European interests with stakes in the EU IFRS policy. In the past decade of development of IFRS, the IASB due process has repeatedly led to hot debate on the same fundamental issues, including the objectives of financial reporting, the measurement of assets and liabilities and the reporting of performance. The efficiency of the IASB standard-setting process and the confidence that Europe needs to have in the standard-setting process it has entrusted to the IASB will be significantly enhanced when these issues are resolved. Whilst the Conceptual Framework is not subject to the EU endorsement process, it needs to be of such quality that it could meet political approval.

In this context EFRAG expressed satisfaction in its response to the IASB Discussion Paper on the Conceptual Framework that the IASB had undertaken a comprehensive revision of the Conceptual Framework, decided to focus on financial statements, and adopted a pragmatic approach with the objective of providing a solution to identified problems. From EFRAG's perspective this approach continues to be the right approach. EFRAG is aware that some other constituencies have called for the Conceptual Framework to be more aspirational in nature, and have exercised influence to set aside guidance that well illustrated the accounting model that was currently implemented in IFRS. From EFRAG's point of view, the result is a set back from the approach in the Discussion Paper even though the analysis of measurement bases is significantly improved and has led EFRAG to be concerned that the Conceptual Framework as developed in the Exposure Draft will not provide the clarity that is deemed necessary.

Having said that, EFRAG is pleased to note that the IASB has been responsive to some of EFRAG's requests, in particular in its reconsideration of the objectives and qualitative characteristics of financial reporting. Good progress has been made in giving more prominence to the objective of stewardship and the re-introduction of prudence. We are nevertheless of the view that more needs to be done in those areas. EFRAG is not convinced that information that is relevant to support decisions to buy, hold and sell, and to support the assessment of stewardship are in all circumstances the same. On prudence, EFRAG agrees with most of the developments made in the Basis for Conclusions. However, EFRAG does not agree with the concluding remarks, and hence not with what the Conceptual Framework would say on prudence, were it to be finalised on the basis proposed.

Furthermore, EFRAG is opposed to having measurement uncertainty dealt with as part of relevance. The whole discussion on the concept of reliability originates, in EFRAG's view, from a lack of common understanding between the IASB and some of its constituents of what a reliable measurement is. Disagreement on this means disagreement on what faithful representation is. EFRAG is not aware of any disagreement or misunderstanding of the other components of reliability, once prudence and substance over form are re-introduced. Instead of relabelling or changing the meaning of well understood concepts such as relevance and reliability, EFRAG urges the IASB to clarify the boundary of a 'reliable estimate'. The revision of the Conceptual Framework is the ideal opportunity for this. EFRAG notes that it agrees with most of the IASB's Basis for Conclusions on this issue. Also, re-instating 'reliability' as one of the two fundamental qualitative characteristics of financial reporting would be the best option from a European perspective, to ensure proper dialog and understanding with all stakeholders involved.

Finally, the Exposure Draft does not provide the expected guidance on how to select a measurement basis or a conceptual foundation for the reporting of performance, including what should be reported in profit or loss and when. As indicated above, these are among the areas which have created the most contentious issues in the past: European expectations would not be met if the Conceptual Framework left decisions to be made by the IASB in the future solely guided by what the members of the IASB when an IFRS is issued would consider capable of bringing relevant, reliable and comparable information. To contribute to the work of the IASB on this issue, EFRAG has prepared a paper on profit or loss versus OCI in which it provides some views on how the distinction between these elements of performance could be made.

EFRAG therefore expects that the next round of deliberations will contribute to filling the need for guidance in these areas. This may require a second exposure draft. This possible outcome, and the consequent delay in concluding the project, should not prevent the IASB from satisfying the legitimate expectations of jurisdictions which have adopted IFRS. Whilst we support the IASB's ambition of issuing a revised framework without lingering, we consider that a high quality outcome is more important than a high speed outcome.

Whether the inconsistencies in current Standards on the distinction between equity and liabilities can be considered in any second exposure draft or in a later amendment to the Conceptual Framework may depend on when the separate project on this issue is finalised. EFRAG, however, notes that it is important to solve the inconsistencies within Standards and to amend the Conceptual Framework, to reflect the outcome of this project that is running in parallel with the broader Conceptual Framework revision.

Detailed analysis and responses to the questions in the ED are set out in the Appendix 1. Appendix 2 includes an assessment of the extent to which the guidance included in the ED assists in determining the unit of account.

APPENDIX 1

CONTENTS

CHAPTERS 1 AND 2 THE OBJECTIVE OF GENERAL PURPOSE FINANCIAL REPORTING AND THE QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION

Notes to constituents

1 The ED gives more prominence to the objective of assessing stewardship when describing the objective of financial reporting. This is done (in paragraph 1.3 of the ED) by explicitly mentioning that existing and potential investors assess the management's stewardship of the entity's resources when making decisions about buying, selling or holding equity and debt instruments and providing or settling loans and other forms of credit.

2 The ED does, however, not identify the provision of information to help assess management's stewardship as an additional objective of financial reporting. The reasons are (according the paragraph BC1.10 of the Basis for Conclusions) that the IASB thought that:

(a) *Information about management's stewardship is part of the information used to make decisions about whether to buy, sell or hold an investment (i.e. resource allocation decisions); and*

(b) *Introducing an addition primary objective of financial reporting could be confusing.*

3 *The ED also states that information about management's discharge of its responsibilities is useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions (paragraph 1.22 of the ED).*

4 The ED reintroduces (in paragraph 2.18) an explicit reference to the notion of prudence. Prudence is described as the exercise of caution when making judgements under conditions of uncertainty. It is explained that the exercise of prudence supports neutrality and should not allow the overstatement or understatement of assets, liabilities, income or expenses.

5 The Basis for Conclusions notes (in paragraph BC2.5) that some of the IASB's constituents argue for a reinstatement of prudence for the following reasons:

(a) *Some Standards, both existing and proposed, use accounting treatments that some view as motivated by a desire for prudence. It is therefore important to explain prudence in the Conceptual Framework so that it can be applied consistently.*

(b) *Prudence is needed to counteract management's natural bias towards optimism.*

(c) *Investors are more concerned about downside risk than upside potential. Prudence helps to address this concern.*

(d) *Academic research has suggested that some form of conservatism (a concept often regarded as similar to prudence) have a role to play in financial reporting in some cases. However, there are different views about what forms of conservatism are helpful, when and why.*

(e) *The exercise of prudence helps to align the interests of shareholders and managers and can reduce moral hazard.*

(f) *The financial crisis has demonstrated the need for prudence when making estimates.*

6 In the Basis for Conclusions, the IASB discusses two types of prudence:

(a) *Cautious prudence. This is defined as the exercise of caution when making judgements under conditions of uncertainty (paragraph BC2.9). The IASB thinks that setting out the message that cautious prudence is a factor in giving* *a faithful representation can help it develop rigorous Standards that could counteract any bias by management in applying the reporting entity's accounting policies (paragraph BC2.9(b)).*

(b) *Asymmetric prudence. This is described as the situation where losses are recognised at an earlier stage than gains (paragraph BC2.6). The IASB disagrees that asymmetric prudence is a necessary characteristic of useful financial information (paragraph BC2.11). In particular the IASB, in paragraph BC2.14, rejects the following approaches that could result from a requirement to apply asymmetric prudence in all circumstances:*

(i) *Prohibiting the recognition of all unrealised gains;*

(ii) *Prohibiting the recognition of unrealised gains not supported by observable market prices;*

(iii) *Permitting an entity to measure an asset at an amount that is less than an unbiased estimate using the measurement basis selected for that asset or to measure a liability at more than such an amount.*

However, the IASB also disagrees with the argument that 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 ED (BC2.14). The IASB notes that if it were to introduce asymmetric prudence, it would need to consider how much bias is appropriate (paragraph BC2.15).

7 *The ED states (in paragraph 2.14) that providing information only about a legal form that differs from the economic substance of the underlying economic phenomenon would not result in a faithful representation.*

8 The ED does not replace 'faithful representation' with 'reliability'. In addition, the ED does not include any reference to reliability as either an additional qualitative characteristic or an aspect of either relevance or faithful representation. However, greater prominence is given to the idea that if the level of uncertainty associated with an estimate is sufficiently large, that estimate might not provide relevant 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?

Question 1 (a) - Stewardship

EFRAG's response

EFRAG welcomes the greater prominence given to the assessment of management's stewardship of the entity's resources in the description of the objective of financial reporting in the ED. EFRAG remains concerned, however, that the objective of assessing management's stewardship remains subsumed in a general objective of providing useful information to support decisions involving buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.

9 EFRAG thinks that providing information that is useful for assessing stewardship is as important as providing information to assess the prospects for future net cash inflows to an entity. EFRAG accordingly agrees with paragraph 1.3 of the ED that existing and potential investors, lenders and other creditors need information to help them assess both the prospects for future net cash inflows to an entity and management's stewardship of the entity's resources.

10 However, the ED presents the assessment of stewardship as an element in the decision to buy, sell or hold equity and debt instruments. Although the ED in paragraph 1.22 mentions that information about management's discharge of its responsibilities is useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions, it appears to limit the provision of such information to usefulness for decisions on whether to buy, sell or hold equity and debt instruments. It also ignores the information needs of potential investors, lenders and other creditors and users of financial statements other than those identified as primary users.

11 EFRAG believes that existing investors could need information for the assessment of stewardship that would supplement the information useful to decisions on buying, selling or holding equity and debt instruments. EFRAG disagrees with the Basis for Conclusions (paragraph BC1.10) that information about management's stewardship is solely part of the information used to make decisions about whether to buy, sell or hold an investment (and perhaps improve the management). EFRAG assesses that in some circumstances, an investor would not consider selling an investment in an entity, but would only be interested in assessing the management of the entity. This includes understanding the entity's strategies in creating value in the longer term and assessing the management's effectiveness when deciding on the level of remuneration of senior management. To meet the objective of providing information for the assessment of stewardship, financial statements should report on past transactions and events and the information should focus on having confirmatory value.

12 EFRAG notes that one way of responding to its concern could be to identify the assessment of stewardship as an objective in its own right. Another way of dealing with EFRAG's concern could be to eliminate the focus in the definition of the objective of financial reporting on information useful for "decisions involving buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit". It should be replaced by a more general objective of providing useful information for different types of users. Useful information would then be described as information needed for both the assessment of management's stewardship on the one hand and for buy, sell or hold decisions on the other.

Question to constituents

Throughout the ED, 'users' refers to those existing and potential investors, lenders and other creditors who must rely on general purpose financial reports for much of the financial information they need.

Do you agree with focusing on this group of users? If not please indicate how it should be either narrowed down or widened, and why.

Question 1 (b) - Prudence

EFRAG's response

EFRAG welcomes the IASB's decision to re-introduce prudence into the Conceptual Framework, and with the judgement of the IASB in the Basis for Conclusions that prudence may lead to asymmetry in the recognition of assets/income and liability/expenses without introducing any undesirable bias in financial reporting. These conclusions should, however, be made clearer and be acknowledged in the Conceptual Framework itself. Also, prudence should not be made subservient to neutrality. Finally, when the Conceptual Framework explains prudence, the focus should be on how it affects standard-setting rather than suggesting it only affects the behaviour of preparers of financial statements.

13 EFRAG agrees that prudence should be reintroduced into the Conceptual Framework, however, EFRAG disagrees with how prudence is considered in paragraph 2.18 of the ED. The paragraphs below explain:

(a) What EFRAG thinks prudence is;

(b) What EFRAG thinks about asymmetric prudence;

(c) How EFRAG considers the relationship between prudence and neutrality;

(d) EFRAG's view of the role of prudence in the Conceptual Framework; and

(e) How EFRAG thinks prudence should be explained in the Conceptual Framework.

<u>What EFRAG thinks prudence is</u>

14 EFRAG notes that before the 2010 revision of the Conceptual Framework prudence was described as:

> [T]he inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow, for example the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses, because the financial statements would not be neutral and, therefore, not have the quality of reliability.

15 EFRAG would agree with the pre-2010 Conceptual Framework that prudence should not allow for hidden reserves, excessive provisions or deliberate understatements of assets and the deliberate overstatement of liabilities. On the other hand, in case of uncertainty, EFRAG thinks that it may sometimes in standard-setting be useful to require more certainty before recognising income than before recognising expenses.

16 As explained in its comment letter in response to the DP, EFRAG considers that prudence represents a degree of caution that generally recognises downside risks and strongly questions whether upside potential inherent in uncertain future events should be recognised. This would mean that when the IASB is setting Standards, it

could sometimes set thresholds for recognising losses lower than the thresholds for recognising gains. Currently, several Standards include such different thresholds.

What EFRAG thinks about asymmetric prudence

17 In its basis for conclusions (paragraphs BC2.1 to BC2.15), the IASB considers two possible aspects of prudence, 'cautious prudence' and 'asymmetric prudence'. The Basis for Conclusions mentions that the IASB disagrees that asymmetric prudence is a necessary characteristic of useful financial information. However, accounting policies that treat gains and losses asymmetrically could be selected in accordance with the proposals in the ED if their selection is intended to result in relevant information that faithfully represents what it purports to represent. EFRAG agrees with this. However, EFRAG does not think that the fact that asymmetric prudence should only be applied in some cases would call for a rejection of the term as is done in paragraph BC2.15 of the Basis for Conclusions. Instead EFRAG thinks that the Conceptual Framework should acknowledge that some asymmetric prudence may at times be necessary (as explained in paragraphs BC2.11 and BC2.14).

How EFRAG considers the relationship between prudence and neutrality

18 EFRAG also agrees with the ED that both neutrality and prudence are necessary components of reliability (faithful representation). As both need to be met and neutrality calls for the absence of any bias, prudence cannot have the effect that some describe as necessarily entangled with it, that is the intended understatement of assets or overstatement of liabilities that is contrary to transparent and faithful financial reporting. EFRAG agrees that prudence does not lead to making choices such as those described in paragraph BC2.14. When prudence applies, caution exercised by the standard setter may nevertheless result in asymmetric outcomes in how assets and liabilities are accounted for, for the reasons stated in paragraph BC2.5.

19 Prudence and neutrality contribute together – on the same footing – to reliable information and prudence cannot be said to 'support' neutrality. Rather they provide together an equilibrium. EFRAG notes that all of the above is consistent with the manner in which prudence was described in the pre-2010 Conceptual Framework.

20 The type of prudence that EFRAG accordingly thinks should be reflected in the Conceptual Framework would not support neutrality. Neither would it be inconsistent with neutrality. According to the current Conceptual Framework, a neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users.

EFRAG's view of the role of prudence in the Conceptual Framework

21 EFRAG acknowledges that in the pre-2010 Conceptual Framework, prudence was explained in a manner that was directed towards preparers of financial statements. EFRAG, however, considers that the status of the Conceptual Framework makes it a less effective tool for affecting the behaviour of preparers than guidance in Standards.

22 Accordingly, EFRAG thinks that the description of prudence in the Conceptual Framework should be directed more towards how the IASB should use it in standard-setting. Addressing prudence in standard-setting rather than leaving it to individual preparers would, in the view of EFRAG, result in a more consistent application. The Conceptual Framework should thus include directions in order for 'asymmetric prudence' to be reflected in Standards on a consistent basis. 'A consistent basis' in this regard would not mean that there should generally be different thresholds for assets/income and liabilities/expenses but it would mean that

when such thresholds are introduced they are introduced for similar circumstances and in a similar manner.

23 EFRAG therefore supports paragraph BC2.9(b) of the Basis for Conclusions that clearly identifies a role of prudence in standard-setting, that is, it does not limit prudence to having a role in how estimates are prepared. EFRAG, however, does not believe that prudence in standard-setting is necessarily limited to counteracting any bias by management in the preparation of financial statements. Prudence has a role to play in standard-setting to set requirements that consider the inter-relationship between conditions of uncertainty and reliability of information, i.e. leading to useful information.

<u>How EFRAG thinks prudence should be explained in the Conceptual Framework</u>

24 Even though the Basis for Conclusions is in its developments consistent with how EFRAG perceives the role of prudence, EFRAG disagrees with the concluding statements and with how it is finally dealt with in the ED which:

(a) Fails to acknowledge the possibility of asymmetric outcomes;

(b) Makes neutrality trump prudence; and

(c) Seems to focus on how financial statements are prepared and not on how standards are set.

25 EFRAG suggests building on the content of the Basis for Conclusions to provide for a meaningful re-introduction of prudence in the Conceptual Framework along the following lines:

> A neutral depiction is without bias in the definition and application of accounting policies and the selection and presentation of financial information. A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users. As a result neutral representation cannot allow for the deliberate understatement, or overstatement, of assets and income and liabilities and expenses.
>
> Providing relevant information that faithfully represents what it purports to represent requires the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. It helps the IASB develop rigorous standards and practitioners determine reasonable estimates. It may result under some circumstances in accounting policies that treat income and expenses asymmetrically, however only when this is intended to result in relevant information that faithfully represents what it purports to represent. Under these circumstances prudence is not contrary to neutrality, it supplements neutrality in providing useful information.

26 The Basis for Conclusions could remain virtually unchanged, except that the conclusions reached under 'cautious prudence' and 'asymmetric prudence' would have to be modified to lead to the above outcome, taking into account all of EFRAG's comments.

Question 1 (c) – Substance over form

EFRAG's response

EFRAG welcomes the IASB's decision to reintroduce 'substance over form' but considers that the IASB should revisit the drafting and explain the distinction between 'legal substance' and 'legal form'.

27 EFRAG welcomes the IASB's decision to reintroduce 'substance over form' as a necessary component of reliability (faithful representation). EFRAG agrees with the pre-2010 Conceptual Framework that if information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they

are accounted for and presented in accordance with their substance and economic reality and not merely their form or appearance.

28 EFRAG would, however, suggest that the drafting is revisited, so as to eliminate any possible misinterpretation that legal arrangements should be disregarded and the economic substance of transactions considered independently. EFRAG does not think legal arrangements should be disregarded. Legal aspects will often play an important role in assessing what rights and obligations an entity has, and hence are the basis for analysing the economic substance of arrangements, i.e. their 'legal substance'. They should thus be considered unless the legal form would not represent the economic substance.

29 Clarity on this account is necessary. Often opposition to accounting requirements arises because they would generate different outcomes in different countries for transactions in the same economic sector, the reason being that legal frameworks vary from jurisdiction to jurisdiction. What constituents may regard as the same 'economic' transactions have different economic substance, the differences in the legal requirements making the economic substance different.

Question 1 (d) – Measurement uncertainty

EFRAG's response

EFRAG disagrees that measurement uncertainty should be an element of 'relevance'. In EFRAG's view, the Conceptual Framework should provide the opportunity of gaining a better understanding of what the boundary of a reliable measurement should be. Acknowledgment of the trade-off between relevance and reliability should remain. Further, it should be clear that uncertainty plays a role in both recognition and measurement.

30 In EFRAG's view, the IASB's proposal on 'measurement uncertainty' cannot be considered as an isolated change. It is closely related to the move from reliability to faithful representation, the notion of what a reliable measurement is, the effectiveness in applying the fundamental qualitative characteristics and the elimination of the probability recognition criterion.

Move from 'reliability' to 'faithful representation'

31 In its Basis for Conclusions the IASB explains that reliability had to be removed in 2010 because people would "equate reliability solely with information being verifiable or free from material error" (paragraph BC2.22), and it was not understood in its wider meaning as described in the pre-2010 Conceptual Framework.

32 EFRAG believes that if a notion is not well understood, it requires clarification. The solution cannot be found in a change of labelling that is capable of bringing more confusion especially among those who understood what 'reliability' was intended to capture.

33 EFRAG notes that, in the pre-2010 Conceptual Framework, 'faithful representation' was a component of reliability. Where it is observed that people have a narrow meaning of a notion, using what used to be a component to bring a "wider" meaning appears at odds with elementary logic. Interestingly, table 2.1 in the Basis for Conclusions illustrates that under the influence of its constituents, including EFRAG, the ED reinstates the previous wider meaning of the notion of 'reliability', with the re-introduction of 'prudence' and 'substance over form'.

34 EFRAG believes that the issue at stake and that requires common understanding and acceptability is what constitutes 'a reliable measurement'. The objective of the Conceptual Framework should be to build this common understanding, not to de facto eliminate – or significantly reduce - the role that uncertainty should have in both recognition and measurement.

Notion of reliable measurement

35 EFRAG agrees with the statement in paragraph 2.12 of the ED that "the use of estimates is an essential part of the preparation of financial information" and that this use should not be unduly restricted by being constrained by too narrow an approach of what 'reliable' means.

36 EFRAG, however, disagrees with the idea that any number could qualify as a reliable estimate, provided that "the reporting entity has properly applied an appropriate process, properly described the estimate and explained any uncertainties that significantly affect the estimate" as is stated in paragraph 2.20 of the ED. Faithful representation cannot be limited, in EFRAG's view, to strict compliance with a computation process and disclosures. An estimate will represent what it purports to represent, provided the link between the economic reality that is considered and the estimate that is provided can be identified. EFRAG therefore believes that *in addition* to the above some link must be required between, on the one hand, the choice of inputs, assumptions, models, sources of data, on which the estimate is built and, on the other, the economic reality that the information "purports to represent". EFRAG fully accepts, for example, that a model that is acknowledged as widely used by market practice is a reliable basis for the price of a complex derivative. Clarifying that this link must exist and be identifiable would not put into question the bulk of the current IFRS practice. It may, however, have the merit of setting some boundary between what should be accepted as 'reliable', what users can 'depend upon' and what should not.

Effectiveness in applying the fundamental characteristics

37 EFRAG agrees with paragraph 2.20 of the ED that states that "information must be both relevant and reliable (faithfully represented) if it is to be useful".

38 By including measurement uncertainty in the notion of relevance, it becomes difficult for EFRAG to see any difference between 'useful' and 'relevant'. EFRAG understands that the IASB considers that if the measurement uncertainty is high, users may not find the resulting information relevant and that there is a trade-off between the level of measurement uncertainty and other factors that make information relevant (paragraph BC2.24 of the Basis for Conclusions). However, if relevance is interpreted as broadly as this, it could also be argued that information is not relevant if, for example, it does not represent faithfully what it purports to represent. It would thus be difficult to understand why 'relevance' and 'faithful representation' should be considered as different elements instead of considering whether information is useful more directly.

39 In the view of EFRAG, considering 'relevance' and 'reliability (faithful representation)' (including measurement uncertainty) as two separate and key components of 'useful' as in the pre-2010 Conceptual Framework, better describes the two-step approach and trade-off when deciding that certain items should not be recognised in the financial statements (but disclosed in the notes). In the pre-2010 Conceptual Framework, 'reliability' should not be considered when assessing whether information was relevant. For example, information about a claim for damages under a legal action that may be material to the entity is relevant information, regardless of the level of measurement uncertainty, for assessing the prospects for future net cash inflows to an entity. However, as stated in the pre-2010 Conceptual Framework, the information may be "so unreliable in nature or representation that its recognition may be potentially misleading", and therefore recognising the full amount of the claim in the statement of financial position may not result in reliable information. In such a case the relevance of the information commands that information be disclosed.

40 EFRAG also notes that completeness, faithful representation, neutrality and prudence have an important role to play in handling measurement uncertainty, and

that they all belong to reliability. It may be worth emphasising that, in EFRAG's view, promoting the trade-off between reliability and relevance is not intended to support the choice of the lowest level of uncertainty possible in the measurement, as in a great number of circumstances this would undoubtedly not lead to useful information.

Elimination of the probability recognition criterion

41 Uncertainty does not only play a role in relation to measurement. It plays a role in recognition as well.

42 Notwithstanding this, EFRAG supported at the DP stage the elimination of the probability recognition criterion for the following reasons:

(a) Current IFRS clearly demonstrate that the definition of probability recognition thresholds has to be a standards level decision. Despite the single probability threshold set in the current Conceptual Framework, IFRS reflect a great diversity in probability recognition thresholds. EFRAG has not heard anybody claim that a probability recognition threshold should govern the recognition of financial instruments, for example. In contrast, when amendments to IAS 37 were discussed a few years ago, the elimination of the probability recognition threshold was one of the very contentious issues debated; and

(b) Setting relevance and reliability (faithful representation) as recognition criteria was in EFRAG's view sufficient to determine, at standards level, whether a probability recognition threshold was needed.

43 In the ED relevance and reliability (faithful representation) continue to be proposed as recognition criteria and EFRAG's remains supportive of this. EFRAG agrees with the IASB that the existence uncertainty and the level of probability of a flow of economic benefits have a role to play in assessing whether an information would be relevant.

44 EFRAG therefore believes that a reference to uncertainty that is limited to measurement in relation to the discussion of relevance in the chapter dealing with qualitative characteristics may bring confusion about where and how uncertainty should play a role in financial reporting.

Conclusion

45 For the reasons explained above, EFRAG disagrees with the proposal to assess measurement uncertainty as part of relevance. EFRAG could fear that measurement uncertainty would not be genuinely considered by the IASB if it is to be considered in relation to 'relevance'. For example, it seems difficult to argue that, for example, information about a claim for damages under a legal action would not be capable of making a difference in a decision even if it is subject to a high level of measurement uncertainty.

46 Furthermore, reaching an appropriate trade-off between relevance and reliability to optimise the usefulness of information is a well-established and well-understood notion in Europe. In EFRAG's view it is therefore important that this trade-off is not eliminated or disguised in the IFRS Conceptual Framework.

47 It is also important, in EFRAG's view, that the IASB reaches a common understanding with its constituents of what constitutes a reliable measurement, with the revision of the Conceptual Framework being the opportunity to clarify the boundary of a reasonable, reliable estimate.

48 Finally, having regard to the European practice, EFRAG is of the view that re-instating 'reliability' as one of the two fundamental qualitative characteristics of financial reporting would be the best option from a European perspective, to ensure proper dialog and understanding with all stakeholders involved. Also, from a wider

perspective, 'being reliable' seems to be the quality of what can be depended upon, exactly what IFRS should have to deserve the trust and confidence of investors.

Question 1 (e) – Relevance and faithful representation

EFRAG supports the Conceptual Framework continuing to identify relevance and faithful representation (or reliability) as the two fundamental qualitative characteristics of useful financial information.

49 EFRAG considers that the Conceptual Framework should continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information. This is evidenced by our discussions above where EFRAG emphasises the importance of properly representing these characteristics. In EFRAG's view, the enhancing qualitative characteristics play a subordinate role and are not subject to the same need of trade-off that is integral to relevance and faithful representation.

Question to constituents

EFRAG's preliminary answer to Question 1(d) includes arguments for using the term 'reliability' instead of 'faithful representation'. EFRAG would, however, wish to assess whether constituents have become used to the term 'faithful representation' introduced in 2010, have a good understanding of it, and therefore would prefer not to revert to 'reliability'. What is your assessment of this?

CHAPTER 3 FINANCIAL STATEMENTS AND REPORTING ENTITIES

The reporting entity

Notes to constituents

50 The ED states that:

(a) *A reporting entity is an entity that chooses, or is required, to present general purpose financial statements.*

(b) *A reporting entity is not necessarily a legal entity. It can comprise a portion of a legal entity, or two or more entities.*

(c) *In general, consolidated financial statements are more likely to provide useful information to users of financial statements than unconsolidated financial statements.*

(d) *When an entity is required to present consolidated financial statements, the entity may also choose, or be required, to present unconsolidated financial statements. Those unconsolidated financial statements should disclose how users may obtain the consolidated financial statements.*

(e) *Financial statements can be prepared for two or more entities that do not have a parent-subsidiary relationship with each other. However, the ED does not specify which combinations of entities could constitute a reporting entity that could legitimately prepare combined financial statements.*

(f) *Financial statements should be prepared from the perspective of the reporting entity as a whole, instead of from the perspective of any particular group of investors, lenders or other creditors.*

51 The ED does not discuss joint control and significant influence.

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 of the ED (replicated in paragraph 50(a) – (b) above); and

(b) the discussion of the boundary of a reporting entity in paragraphs 3.13–3.25 of the ED (summarised in paragraph 50(c) – (e) above)?

Why or why not?

EFRAG's response

EFRAG generally agrees that a reporting entity is not necessarily a legal entity and that an entity can prepare both individual and consolidated financial statements. However, EFRAG disagrees with including a statement in the Conceptual Framework that consolidated financial statements are more likely to provide useful information to users of financial statements than unconsolidated financial statements without acknowledging the circumstances where this may not be the case. Finally, EFRAG considers that it would be beneficial to have further explained in the Conceptual Framework what the implications of the entity approach are.

52 EFRAG agrees that a reporting entity is not necessarily a legal entity. It can comprise a portion of an entity, or two or more entities. EFRAG also agrees that entities can prepare both individual and consolidated financial statements.

53 It appears from the ED that 'control' would determine whether an entity is a subsidiary/parent of another entity. This is in accordance with the current requirements in IFRS 10 *Consolidated Financial Statements.* The ED does not provide further guidance on what 'control' is. Such guidance is currently provided in IFRS 10.

54 EFRAG thinks that it could have been useful to explain in the Conceptual Framework why control – exclusive control – is the underlying principle to the definition of the reporting entity. EFRAG is, however, not urging that this is done at this juncture.

Question to constituents

Do you agree that there is no urgent need to justify the choice of control as the basis for consolidation from a conceptual perspective? If no, please explain what EFRAG should recommend to the IASB.

55 EFRAG thinks that it is an improvement compared with the current Conceptual Framework that the ED acknowledges that unconsolidated financial statements can provide useful information. Different users have different needs. EFRAG, for example, considers that some lenders may be more interested in the separate financial statements of the borrowing entity (and the interest that it controls) than in the consolidated financial statements of the whole group. Similarly, non-controlling interests would probably find consolidated financial statements of the controlling interest less useful than financial statements of the one entity in which they are holding an interest (and any controlled subsidiaries). In addition, equity investors (whether or not they are non-controlling interests at a group level) are more likely to find the information about the ability to meet expectations about future dividends in separate financial statements. EFRAG therefore disagrees with including a statement in the Conceptual Framework that consolidated financial statements are more likely to provide useful information to users of financial statements than unconsolidated financial statements without acknowledging the circumstances where this may not be the case.

56 The ED states that financial statements should be prepared from the perspective of the reporting entity as a whole instead of from the perspective of any particular group of investors, lenders or other creditors. There seems to be different views on the consequences of this[1]. Accordingly, EFRAG considers that it would be beneficial to have this further explained in the Conceptual Framework. EFRAG considers that the non-controlling interest in a subsidiary of a parent entity is less interested in the group financial statements of the parent entity as this includes assets, liabilities and profits to which it has no rights or obligations. It seems, on the other hand, that the shareholders of the parent company could benefit from consolidated financial statements. EFRAG considers that the likely users of particular types of financial statements has to be taken into account when preparing Standards. Furthermore EFRAG thinks that for some types of information a proprietary approach would be more useful than the entity approach suggested. This could, for example, be the case for information to assess the management's stewardship. The IASB's equity/liability project may result in more insight of when it would be useful to provide some information from a proprietary perspective. EFRAG would expect that this project would lead to amendments to the Conceptual Framework, including guidance on when it would be useful to deviate from the entity approach in specific standards.

1 See for example Mourik, C. van. 2014. The Equity Theories and the IASB Conceptual Framework. *Accounting in Europe*. Vol. 11, Issue 2.

57 Paragraph 3.16 of the ED states:

> For financial statements to give a faithful representation of the economic activities of the reporting entity, they need to describe the set of economic activities included within the reporting entity.

58 EFRAG understands that the paragraph has been included to reflect the concept of completeness. However, the paragraph could be read as a disclosure requirement. EFRAG therefore recommends that the purpose of this paragraph is clarified.

59 EFRAG also notes that the references to 'direct control' and 'indirect control' are used differently from how the terms are often used. 'Direct control' is often used when an entity controls another entity directly whereas 'indirect control' is used when an entity controls another entity through a third entity. To avoid confusion, EFRAG would recommend the IASB to consider whether the issue could be explained differently.

60 Based on the suggested guidance provided in the ED, EFRAG is uncertain about how to deal with financial statements that are neither, consolidated nor combined or individual financial statements. An example could be the financial statements of a part of an entity ('carve-out financial statements') that would be required by local authorities. EFRAG considers that it should be clarified whether such financial statements could be considered IFRS financial statements according to the Conceptual Framework.

Definitions of elements

Notes to constituents

61 The ED defines:

(a) *An asset as a present economic resource controlled by the entity as a result of past events;*

(b) *An economic resource as a right that has the potential to produce economic benefits;*

(c) *A liability as a present obligation of the entity to transfer an economic resource as a result of past events;*

(d) *Equity as the residual interest in the assets of the entity after deducting all its liabilities;*

(e) *Income as increases in assets or decreases in liabilities that result in increases in equity, other than those relating to contributions from holders of equity claims; and*

(f) *Expenses as decreases assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to holders of equity claims.*

62 The ED does not include any description of gains, losses, revenue and ordinary activities.

63 The ED states that if one party has a liability, another party (or parties) has an asset. The party or parties could be a specific person or entity, a group of people or entities, or society at large.

64 The ED states that a physical object includes several different rights (e.g. the right to use the object, the right to sell the object, and the right to pledge the object).

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?

EFRAG's response

EFRAG tentatively agrees with defining:

(a) An asset as a present economic resource controlled by the entity as a result of past events;

(b) An economic resource as a right that has the potential to produce economic benefits;

(c) A liability as a present obligation of the entity to transfer an economic resource as a result of past events;

(d) Equity as the residual interest in the assets of the entity after deducting all its liabilities;

(e) Income as in Income as increases in assets or decreases in liabilities that result in increases in equity, other than those relating to contributions from holders of equity claims; and

(f) Expenses as decreases assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to holders of equity claims.

EFRAG disagrees with removing the description of revenue and with stating that if one party has a liability another party has an asset.

65 EFRAG tentatively agrees with the proposed definitions of assets and liabilities as they seem easier to understand than the current definitions.

Note to constituents

During the comment period of the ED, EFRAG will collect input on the proposed definitions. The input will be collected through a questionnaire where constituents are asked for their views on whether or not certain items would meet the proposed definitions of assets and liabilities.

66 EFRAG disagrees with removing the description of revenue.

67 EFRAG is concerned that removing the description of revenue could indicate that profit or loss and OCI is less important than indicated by the current version of the Conceptual Framework. EFRAG has an opposite view. EFRAG believes that the statement(s) of financial performance and the statement of financial position are equally important.

68 Although EFRAG considers that the statement(s) of financial performance and the statement of financial position are equally important, EFRAG thinks that it is reasonable to define income and expenses on the basis of changes in assets and liabilities. Defining income and expenses based on changes in assets and liabilities does, in the view of EFRAG, not conflict with the objective of producing useful performance figures. In addition, it does not mean that the statement of financial position is more important than the statement(s) of financial performance. EFRAG thinks that the asset/liability approach has some merits compared to a matching approach. First it ensures that the statement of financial position only represents rights and obligations to future in- and out-flows. In contrast a pure matching approach generates deferrals that cannot be linked to economic phenomena. Second it brings discipline - and therefore reliability - in the income statement. This is because the matching approach does not provide any reliable anchor to decide the period to which a transaction relates. For these reasons EFRAG believes that the asset and liability approach leads to more robust and consistent financial reporting.

Question to constituents

Do you agree with the view that the asset liability approach leads to more robust and consistent financial reporting than a pure matching approach? (Why/why not?)

69 In relation to the removal of the term 'ordinary activity', EFRAG notes that the term has been used in IFRS 15 *Revenue from Contracts with Customers* to define the transactions within the scope of IFRS 15. IFRS 15 deals with contracts with customers and defines a customer as a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

70 EFRAG notes that some respondents to the Exposure Draft resulting in IFRS 15, asked the IASB to clarify the meaning of ordinary activities. However, the IASB decided not to provide additional requirements, because the notion of ordinary activities was derived from the definition of revenue in the Conceptual Framework. In order to provide clarity on what is considered 'ordinary' and within the scope of IFRS 15, EFRAG thinks that the removal of the term from the Conceptual Framework should lead the IASB to consider explaining the term better on a standards level.

71 EFRAG disagrees with the proposal that the Conceptual Framework should state that if one party has a liability, another party or parties has an asset. EFRAG has considered an example where an entity (Entity A) has announced, initiated and is committed to a restructuring (for example, because it could not continue as a going concern without it). Entity A knows that as part of the restructuring, it will have expenses to some kind of legal advisors, but it has not yet decided what advisors to use.

72 In this case EFRAG believes that Entity A should recognise a liability for the costs related to the restructuring. EFRAG thinks, however, that the requirement that another party should have an asset could result in no liability being recognised for the legal costs.

73 EFRAG acknowledges that one interpretation of the requirement could be that all legal advisors in the world would jointly control the economic resource that is caused by the fact that Entity A will have expenses to legal advisors. All the legal advisors in the world would then be the party that has an asset. In that case, there would not be a problem with recognising a liability for the restructuring.

74 However, other arguments could be made against such an interpretation. For example, with an unidentifiable sub-group rather than 'society at large':

(a) The definition of an asset states that an asset is something controlled by an entity, all the legal advisors in the world is not 'an entity' – and hence they cannot have an asset.

(b) All the legal advisors in the world is not a defined group and accordingly cannot be considered as a 'party'.

75 EFRAG is therefore uncertain about what interpretation the IASB would make when setting Standards in the future.

76 EFRAG could also be concerned about implications of considering that an asset, for example, is shared by all legal advisors in the world. Would any legal advisor have a share of this asset, and accordingly another type of asset? If this is the case, would the result be that entities would have to consider possible future contracts as assets? EFRAG would not support such a development.

77 The Basis for Conclusions accompanying the ED (paragraph BC4.78) states that the IASB thinks that making the general point that if one party has a liability another party has an asset would help people to apply the definitions. EFRAG, on the other hand, is concerned that it could result in unintended consequences, and accordingly disagrees with included such a statement in the Conceptual Framework.

78 EFRAG agrees with the ED that in principle a physical object consists of different rights and that these different rights can be regarded as separate assets. EFRAG also agrees with the ED that in many cases, the set of rights arising from legal ownership of a physical object should be accounted for as a single item. As further explained in relation to the proposed guidance on the unit of account, EFRAG is, however, concerned that the guidance on the unit of account is not sufficiently clear that such an outcome would result.

79 The ED does not deal with the inconsistencies in current Standards on the distinction between equity and liabilities. EFRAG agrees with the IASB that it may be useful to deal with this issue in a project running in parallel with the broader Conceptual Framework revision. EFRAG, however, notes that it is important to solve the inconsistencies and to amend the Conceptual Framework to reflect the outcome of the separate project on this issue.

Present obligation

Notes to constituents

80 The ED explains that an entity has a present obligation to transfer an economic resource as a result of past events if both:

(a) *The entity has no practical ability to avoid the transfer; and*

(b) *The obligation has arisen from past events; in other words, the entity has received the economic benefits, or conducted the activities, that established the extent of its obligation.*

81 An event establishes the extent of an obligation if it specifies either the amount of the future transfer or the basis for determining that amount.

82 The ED explains that obligations need not be legally enforceable. They can also arise from an entity's customary practices or published policies or specific statements that require the transfer of an economic resource or where the entity has no practical ability to avoid transferring an economic resource.

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?

EFRAG's response

EFRAG generally agrees with how the ED describes a 'present obligation' and a constructive obligation. However, EFRAG is concerned that the guidance is not sufficiently clear.

83 EFRAG agrees with the ED that obligations need not be legally enforceable, but also arise when the entity has no practical ability to avoid transferring an economic resource.

84 EFRAG also agrees with paragraph 4.31 of the ED that an entity has a present obligation to transfer an economic resource if:

(a) The entity has no practical ability to avoid the transfer; and

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

85 Although EFRAG welcomes guidance on when a past event has arisen, it considers that the wording of the guidance needs to be amended, as it does not appear sufficiently clear. For example, a levy a utility will have to pay on 1 April 2x12 can be based on various parameters such as: the average number of customers over the past ten years; change in revenue from 2x10 to 2x11; the estimated increase in customers over the following ten years; and the average asset balance of the past five years. It is not apparent from the ED what factors the utility should consider in determining when to start recognising a liability, which could be from the start date of the calculation of the average number of customers (i.e. from 2x02).

Question to constituents

Although the change proposed appears appealing, EFRAG notes that it could have far-reaching consequences that need to be assessed. EFRAG will therefore during the comment period collect input on the proposed definitions.

Please provide input on this issue.

Other guidance on the elements

Notes to constituents

86 The ED states that an executory contract contains a right and an obligation to exchange economic resources. Entering into the contract is the activity that establishes the extent of the entity's right and obligation to exchange economic resources. That 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. The entity has an asset if the terms of the exchange are favourable; it has a liability if the terms of the exchange are unfavourable. Whether the asset or the liability is included in the financial statements depends on both the recognition criteria and the measurement basis adopted for the contract. The ED does not address the measurement of executory contract assets and liabilities. Instead the IASB should apply the general measurement concepts in the Conceptual Framework when specifying requirements for particular types of executory contracts within the applicable Standard.

87 The Basis for Conclusions accompanying the ED (paragraph BC4.115) states that selecting a unit of account is a standards level decision. However, the ED describes possible units of account and includes a list of factors to consider when determining the unit of account. The ED (paragraph 4.59) states that in some circumstances, it may be appropriate to select one unit of account for recognition and a different unit of account for measurement.

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.

EFRAG's response

EFRAG disagrees with how the ED deals with executory contracts. EFRAG is uncertain about whether the discussion on the unit of account provides sufficient guidance for the IASB and EFRAG finally thinks that the unit of account for measurement decisions and recognition decisions should generally be the same.

Executory contracts

88 Under current practice, executory contracts are normally not recognised when the rights and obligations have equal value, or the rights have a value greater than that of the obligations. EFRAG considers this approach provides useful information. EFRAG is uncertain whether this would be the outcome of the guidance proposed in the ED, and accordingly disagrees with the proposed guidance.

89 The guidance included in the ED states that an executory contract is either an asset or a liability. Whether the asset or the liability is included in the financial statements depends on both:

(a) The recognition criteria; and

(b) The measurement basis adopted for the contract.

90 EFRAG is unsure about what the outcome of the recognition criteria would be for executory contracts. From paragraph BC4.92 of the Basis for Conclusions, it seems as if measurement at cost at both initial recognition and subsequently is the way to avoid executory contracts being recognised. EFRAG, however, considers that selecting a measurement basis for the purpose of avoiding recognition is a way to escape from a problem. It is not a solution to the problem.

91 EFRAG believes that it is necessary for the Conceptual Framework to include guidance on when it is useful to recognise an executory contract and when it is not useful. Considering whether entering into a contract is a core transaction (compared to fulfilling the contract) could be an element in such guidance. If entering into the contract is a core transaction, this would suggest that recognition of the executory contract should be considered. This would, for example, be the case for contracts such as those involving financial instruments (e.g. an interest rate swap). On the other hand, entering into a contract is unlikely to be a core transaction for an entity producing goods or services.

92 EFRAG does not support different measurement bases for executory contracts at initial recognition and subsequently. Different measurement bases may be appropriate when the contract ceases to be executory and the underlying assets and liabilities are recognised separately. However, in EFRAG's view, confusion will arise from using different measurement bases during the executory phase. If the IASB retains this possibility in the final Conceptual Framework, it would also need to establish whether the different bases are applied to the contract as a whole or the assets and liabilities incorporated in the contract.

The unit of account

93 In the view of EFRAG, the Conceptual Framework should specify that the unit of account when considering recognition should be the same as when considering measurement. This does not mean that EFRAG considers that the unit of account for measurement should always be the same as for recognition. However, if the IASB when setting Standards were to depart from this principle, the basis for conclusions accompanying the Standard has to explain why different units of accounts were chosen.

94 In order to examine whether the guidance on unit of account proposed in the ED is likely to be useful for standard-setting, EFRAG has applied the proposed guidance to selected items. EFRAG has then assessed whether the guidance is helpful when deciding on the unit of account. The tentative results of EFRAG's initial assessment

are published in Appendix 2 to this comment letter. They indicate that the guidance included in the ED does not seem to provide clear directions on how to determine the unit of account.

CHAPTER 5 RECOGNITION AND DERECOGNITION

Recognition

Notes to constituents

95 *The ED does not include criteria that will govern the recognition of an asset or a liability in all circumstances. Instead, the ED states that assets and liabilities should be recognised when they provide users of financial statements with:*

(a) *Relevant information about the asset or liability, and about any income, expenses or changes in equity;*

(b) *A faithful representation of the asset or liability and of any income, expenses or changes in equity; and*

(c) *Information that results in benefits exceeding the cost of providing that information.*

96 *The ED states that recognition may not provide relevant information when one or more of the following applies:*

(a) *If it is uncertain whether an asset exists, or is separable from goodwill, or whether a liability exists;*

(b) *If an asset or a liability exists, but there is only a low probability that an inflow or outflow of economic benefits will result; or*

(c) *If a measurement of an asset or a liability is available (or can be obtained), but the level of measurement uncertainty is so high that the resulting information has little relevance and no other relevant measure is available or can be obtained.*

97 *If an item meeting the definition of an element is not recognised, disclosures may be needed.*

98 *The ED states than when determining how to represent faithfully assets, liabilities, equity, income and expenses, it is necessary to consider not only recognition, but also which measurement to use and how to present and disclose information about the recognised assets, liabilities, equity, income and expenses.*

99 *Hence, when assessing whether it is possible for recognition of an asset or liability to provide a faithful representation of the asset or liability and of any resulting income or expenses, it is necessary to consider not just its description and measurement on the face of the statement of financial position, but also:*

(a) *The depiction of the resulting income, expenses or equity.*

(b) *Whether related assets and liabilities are recognised.*

(c) *Related disclosures.*

100 *In some cases, two or more assets, liabilities or both, are affected by the same transaction or other event. Recognising all the changes in assets and liabilities may not be possible because some affected assets or liabilities may not have been recognised in the past, or may not currently meet the criteria for recognition. In some such cases, recognising only some of the changes in assets and liabilities, and hence only some of the income and expenses, might not provide an understandable or faithful representation of the overall effect of the transaction or other event, even if extra disclosure is provided. Hence, if recognising all changes in assets and liabilities is not possible, it may be necessary not to recognise other changes, even if they provide relevant information about the individual asset or liability affected and resulting income or expenses, to avoid an accounting mismatch.*

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?

EFRAG's response

EFRAG broadly agrees with the guidance on recognition. However, in some areas EFRAG is concerned that the guidance proposed is insufficient to ensure consistent standard-setting in the future.

101 EFRAG broadly agrees with the guidance on recognition. However, it considers that the guidance could be improved in some areas.

102 EFRAG considers that it should appear clearer that the alternative to recognition is disclosure rather than completely omitting assets and liabilities from the financial statements.

103 As noted in relation to Question 1, EFRAG thinks that measurement uncertainty relates to whether information is reliable (or a faithful representation) rather than whether it is relevant. It seems from the ED, that recognising assets and liabilities would be relevant unless:

(a) It is unclear whether the asset or liability exists (existence uncertainty) or is separable from goodwill;

(b) There is a low probability of an inflow or outflow of economic benefits; or

(c) The level of measurement uncertainty is so high that the resulting information has little relevance and no other relevant measure is available or can be obtained.

104 The ED does, however, not provide any substantive guidance on when recognising an asset where there is existence uncertainty or a low probability of an inflow or an outflow would not result in relevant information. EFRAG considers that it is difficult to assess the impact of the guidance if it were to be used for standard-setting. EFRAG accordingly believes that future IASB members may place emphasis on different parts of the guidance. Accordingly, consistency in future standard-setting may be impaired.

105 Although EFRAG considers that the Conceptual Framework should include more substantive guidance on how uncertainty affects recognition, it would not necessarily have to include this guidance in the chapter on recognition. Uncertainty is dealt with in several parts of the ED, and it might be clearer if the issue is addressed in a single place.

106 EFRAG is supportive of stating in the Conceptual Framework that, if recognising all changes in assets and liabilities is not possible, it may be necessary not to recognise any changes, even if they provide relevant information about the individual asset or liability affected. This would avoid an accounting mismatch, rather than requiring further remeasurements to ameliorate the accounting mismatch. However, EFRAG considers that it would be helpful if the Conceptual Framework would provide guidance on when different assets and liabilities should be considered together. In this regard, EFRAG thinks that the entity's business model would have a role to play.

Derecognition

Notes to constituents

107 *The ED defines derecognition as the removal of all or part of a previously recognised asset or liability from an entity's statement of financial position.*

108 The accounting requirements for derecognition aim to represent faithfully both:

(a) *The assets and liabilities retained after the transaction or other event that led to the recognition; and*

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

109 The ED states that the aims mentioned above are normally achieved by:

(a) *Derecognising any assets or liabilities that have been transferred, consumed, collected or fulfilled, or have expired and recognising any resulting income or expense; and*

(b) *Continuing to recognise the 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 component as a result of the derecognition of the transferred component.*

110 The ED acknowledges, however, that it may sometimes be difficult to achieve both aims. In some cases, derecognition may achieve the two aims if supported by separate presentation, or explanatory disclosure in the notes to the financial statements. However, if this is not sufficient, there may be a need to continue to recognise not only the retained component, but also the transferred component.

111 The ED notes that one case in which questions about derecognition arise is when a contract is modified.

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?

EFRAG's response

EFRAG agrees with the guidance on derecognition.

112 EFRAG agrees with the ED that the aim of derecognition is both to depict faithfully an entity's financial position resulting from a transaction or event and income or expenses resulting from that transaction or event.

113 As the ED acknowledges, it may sometimes be difficult to achieve this aim and lists alternative ways to achieve the aims. Although the ED does not provide any directions on when a different alternative should be considered, EFRAG considers that the guidance is sufficient for the Conceptual Framework.

CHAPTER 6 MEASUREMENT

Measurement bases

Notes to constituents

114 The ED categorises measurement bases as:

(a) *Historical cost; or*

(b) *Current value:*

(i) *Fair value; and*

(ii) *Value in use for assets and fulfilment value for liabilities.*

115 Amortised cost is a historical cost measure. Fair value and value to the entity are current value measures.

116 Appendix A to the ED explains that the purpose of cash-flow-based measurement techniques is normally to customise one of the measurement bases that is described in the Conceptual Framework. However, as customised measurement bases may be more difficult to understand, if the IASB decides in a particular Standard to use a customised measurement basis, the Basis for Conclusions on the relevant Standard should explain the reasons for that customisation.

117 The ED also states, that at initial recognition, cost and fair value are the same if transaction costs are excluded from cost or are negligible.

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?

EFRAG's response

EFRAG broadly agrees with the categorisation proposed in the ED. EFRAG also broadly agrees with the ED's description of the information provided by each of the measurement bases. EFRAG welcomes the descriptions as their inclusion would improve the Conceptual Framework. However, the ED does not consider the possible use of market-consistent measurement bases other than fair value. Such measurement bases could be useful in circumstances where an entry market, and not an exit market is relevant or when own credit risk changes are deemed irrelevant.

118 EFRAG welcomes the proposal in the ED to include a description in the Conceptual Framework of the information provided by each measurement basis. The guidance on measurement in the current Conceptual Framework is clearly insufficient.

Identification of measurement bases

119 The Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* grouped measurements into three categories:

(a) Cost-based measurements;

(b) Current market prices including fair value; and

(c) Other cash-flow-based measurements.

120 EFRAG considered that cash-flow-based measurements could be used to estimate a current value or cost. EFRAG accordingly thought that it was unclear which measurement attribute cash-flow-based measurements were aiming to achieve.

121 EFRAG therefore agrees with the ED that cash-flow-based measurement techniques are normally used to implement a historical cost, a current value measurement basis or a partly updated measurement basis (a customised measurement basis). EFRAG accordingly agrees that cash-flow-based measurement techniques should not be considered as a separate measurement category.

122 EFRAG also agrees that, in principle, it makes sense to categorise measurement bases as either historical cost or current value. EFRAG acknowledges that the IASB may choose to customise measurement bases by updating only some of the factors that could be updated when measuring at fair value or value in use and fulfilment value. EFRAG agrees with the ED, that when this is done, the IASB should explain the reasons for the customisation in the Basis for Conclusions accompanying the Standard. In addition, EFRAG considers that the IASB would need to determine whether the customised measurement basis should be considered as representing historical cost or current value in order to 'fit' with the categorisation suggested.

123 Sometimes it may be difficult to categorise a customised measurement basis as either 'historical cost' or 'current value', for example, when a measurement basis is partly updated as a result of applying hedge accounting. EFRAG could accordingly see the benefits of creating a third category of measurement bases for these partly updated measurements. A benefit of introducing a third category for partly updated measurements would be that the Conceptual Framework in that case would have to provide guidance on how to decide what part of a measurement basis should be updated, and when[2].

124 EFRAG disagrees with the statement included in the ED that initially cost and fair value of a financial asset are the same if transaction costs are excluded from cost. EFRAG notes that that an entity, for various reasons, may want to sell or acquire an asset at a price that is different from fair value. Further, as noted below, fair value may be market-specific and the cost of an asset may not represent the fair value of that asset in the market in which it will be deployed.

Description of the information provided by each of the measurement bases

125 EFRAG broadly agrees with the description in the ED (paragraphs 6.4 – 6.47) of the information provided by each of the measurement bases: historical cost; fair value; value in use and fulfilment value. EFRAG, however, notes that 'current value' in the ED is only represented by exit-market-based measurements: fair value; value in use and fulfilment value. EFRAG thinks that the ED should also have described current input-market measures.

126 The Basis for Conclusions (paragraph BC6.18) notes that the IASB thinks that there is often little difference between entry and exit values in the same market, except for transaction costs.

127 While EFRAG perhaps could agree that there is often little difference between entry and exit values in the same market, EFRAG thinks that it is important to consider that the same market may not always be relevant from the perspective of an entity. A retailer will frequently buy its products in a wholesale with professional participants and sell the products in a retail market on an 'item by item' basis with final

[2] Such an approach has been suggested by the Accounting Standards Board of Japan and described in the paper *Identification, Description and Classification of Measurement Bases* presented at the March 2015 meeting of the Accounting Standards Advisory Forum (ASAF).

consumers. If there were identical prices in these two markets, the retailer would not make any profit.

128 For a particular asset, it could be argued that the most useful measurement would be one that reflects how much an entity should pay to acquire the asset at the balance sheet date as it was when it was originally acquired. This could provide information about the costs of replacing the asset. Although such a measure should be categorised as a current value, it does not seem possible to categorise it as neither fair value nor value in use according to the ED.

129 The ED describes fair value as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The fair value would in the case of a retailer depend on whether the retailer would sell the asset in the market it was bought or in the market where it is going to be sold. The selling price in the market in which it is sold would not reflect the price the entity would pay to acquire the asset. However, paragraph 6.26 of the ED states that fair value does not include transaction costs. The current value for the particular asset mentioned above would include transaction costs. In addition, if the entity has further developed the asset, the selling price of the asset would not reflect the current price of the asset in its original condition. Accordingly, even if the fair value in the input market (and not the exit market) was considered, 'fair value' could not capture the most useful measurement in the particular example. In addition, the ED describes that fair value reflects estimates of future cash flows (paragraph 6.23(a)) and has predictive value, because it reflects expectations about the amount, timing and uncertainty of the cash flows. The fair value (the selling price) of the particular asset in the input market would in the case of the retailer not be an estimate of future cash flows of the retailer, as the retailer would not sell the asset in the input market.

130 EFRAG would thus consider that the Conceptual Framework should include market-consistent measurement bases for the cases where an entry market would be relevant. Currently, the only market-consistent measurement basis that is described is fair value, which is based on an exit market.

131 EFRAG notes that current cost is very briefly presented in paragraph 6.18 under 'historical cost'. In EFRAG's view, 'current cost' does not meet the description of 'historical cost'.

132 In addition to providing guidance on the use of entry-market based measurements, EFRAG thinks that the Conceptual Framework should provide guidance on when own credit risk changes are relevant. This issue seems to be the subject of some debate.

Selection of a measurement basis

Notes to constituents

133 The ED states that when the IASB selects a measurement basis, it should consider the resulting information produced in both the statement of financial position and the statement(s) of profit or loss and other comprehensive income (OCI).

134 The ED states that information in the financial statements can be made more relevant by considering:

(a) *How the asset or liability will contribute to future cash flows. This will depend in part on the nature of the business activities being conducted by the entity; and*

(b) *The characteristics of the asset or liability (e.g. the nature or extent of the variability in the item's cash flows, the sensitivity of the value of the item to changes in market factors or other risks inherent in the item).*

135 The level of measurement uncertainty associated with the measurement of an item is another factor that affects the relevance provided by a measurement basis.

136 A perfectly faithful representation is free from error. However, this does not mean that measurements must be perfectly accurate in all respects. An estimate of an unobservable price can be faithfully represented if it is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained and no errors have been made in selecting and applying an appropriate process for developing the estimate.

137 When assets and liabilities are related in some way, using different measurement bases for those assets and liabilities can create a measurement inconsistency (sometimes called an 'accounting mismatch'). Measurement inconsistencies can result in financial statements that do not faithfully represent the reporting entity's financial position and performance. Consequently, in some circumstances the same measurement approach for related assets or liabilities may provide more useful information for users of financial statements than using dissimilar measurement bases. This may be particularly likely when the cash flows from one item are contractually linked to the cash flows from another item.

138 The ED also considers the enhancing qualitative characteristics for the selection of a measurement basis. In this regard it notes that users of financial statements need to be able to understand the measurements used. In general, if the number of measurement bases used in a set of financial statements increases, the resulting information becomes more complex, and the totals and subtotals in the statement of financial position and the statement(s) of financial performance become less meaningful.

139 Verifiability implies using measurements that can be independently corroborated either directly (such as by observing prices in transactions in which the entity participated) or indirectly (such as by checking inputs to a model). If a particular measurement cannot be verified, disclosures may be needed in the notes to the financial statements. In some such cases, it may be necessary to select a different measurement basis.

140 Comparability implies using measurements that are the same between periods and between entities. Using the smallest number of measurement bases contributes to comparability.

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?

EFRAG's response

In EFRAG's view the Conceptual Framework should include guidance on:

(a) How to select measurement bases that are useful for reporting both the financial position and the performance of the entity;

(b) When to select between market-consistent and entity-specific measurement bases; and

(c) When customisation of measurement bases could be useful.

In the view of EFRAG, the mere mention in the ED of factors to be taken into account when selecting a measurement basis without much other sense of direction is insufficient. However, the IASB could usefully build on the description of different measurement bases to determine the necessary guidance, distinguishing clearly between what is useful to the statement of financial position on the one hand and to the statement(s) of financial performance on the other.

141 The ED seems to state that the factors to consider when determining a measurement basis are the qualitative characteristics of useful financial information. To the extent that EFRAG agrees with the qualitative characteristics of useful financial information (see paragraphs 9 – 49 above), EFRAG does not disagree with such a statement. On the other hand, EFRAG does not think that such a statement is sufficient to ensure discipline and consistency in future standard-setting.

142 EFRAG acknowledges that the ED does more than just stating that the qualitative characteristics of useful financial information should be considered when determining a measurement basis. The ED includes a discussion of factors that can affect the various qualitative characteristics. However, the ED is deficient in the following ways:

(a) The ED does not describe how different measurement bases are linked with the factors to be considered when deciding on a measurement basis.

(b) The ED states that when selecting a measurement basis, it is important to consider what information that measurement basis will provide in both the statement of financial position and the statement(s) of financial performance. EFRAG agrees with this, but it notes that the ED does not further describe what information meets the qualitative characteristics from the perspectives of the statement of financial position and the statement(s) financial performance. In the view of EFRAG, the discussion in the ED seems to be focused on how to meet the qualitative characteristics for the statement of financial position, as the references in the ED are to assets and liabilities rather than to income and expenses. EFRAG disagrees with this primary focus. EFRAG further notes that:

(i) The ED proposes that circumstances in which different measurement bases for the measurement in the financial position and in the statement(s) of financial performance would be rare (paragraph 6.75); and

(ii) The Basis for Conclusions notes that the statement of profit or loss should be as inclusive as possible (paragraph BC7.42).

When the statement of profit or loss should be as inclusive as possible, assets and liabilities cannot be measured at a current value without including the changes in the current value in profit or loss. The latter statement (ii) thus reinforces what is said in (i) that different measurement bases for the measurement in the financial position and in the statement(s) of financial performance would be rare. EFRAG could envisage that there could be situations where it would provide the most useful information about an entity's financial position to measure assets and liabilities at a current value in the statement of financial position, but where the profit or loss would be most useful if these changes were excluded and reflected in OCI instead.

These statements (i) and (ii) above thus seem to reinforce a sole focus on the statement of financial position.

(c) The factors the ED considers may point in different directions. The ED states that the relative importance of each of the factors will depend upon facts and circumstances. However, the ED does not provide any guidance on what circumstances would mean that one factor is more important than another factor – for example, when an entity specific or a market-based measurement would be more useful. There is also no guidance on how to customise measurement bases. It follows that the discussion in the ED does not seem to guide the selection of a measurement basis other than in specific situations.

(d) EFRAG disagrees with the guidance on internally constructed assets. EFRAG disagrees with the statement in paragraph 6.73 of the ED that the information provided could be useful for assessing the cost-effectiveness of the construction, as EFRAG does not believe it is relevant to suggest that an entity earns money from 'transacting' with itself. In addition, EFRAG agrees that for unique or custom-made assets it could be difficult to find a fair value, the potential for any income recognised lacking reliability, in such circumstances.

143 EFRAG assesses that the issues mentioned above in (a) – (c) could be dealt with by:

(a) Distinguishing between the statement of financial position and the statement of profit or loss;

(b) Incorporating some of the guidance included in the description of measurement bases into the guidance on factors to consider when selecting a measurement basis; and

(c) Including some directions in the guidance, as is done for specific cases in paragraphs 6.64 - 6.71 of the ED.

Question to constituents

The ED includes different factors to consider when selecting a measurement basis. For example, the ED mentions in paragraph 6.54 that to produce relevant information it is important to consider both how an asset or liability contributes to future cash flows and the characteristics of the asset or the liability. Sometimes these factors could conflict and different conclusions could thus be reached by giving priority to some factors rather than to others. In the paper *Profit or loss versus OCI* prepared for the July 2015 ASAF meeting, EFRAG examines an approach where the business model will be used when selecting a measurement basis and thus when selecting among different factors.

What aspects do you think should help the IASB select a measurement basis when the factors listed in the ED would conflict? Do you think that some factors are more important than others?

Multiple measurement bases

Notes to constituents

144 The ED states that it may be appropriate to use one measurement basis for the statement of financial position and a different measurement basis for the statement of profit or loss.

145 In such cases the ED states that the total income or total expenses should be split into a component that is recognised in the statement of profit or loss and a component that is recognised in other comprehensive income.

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?

EFRAG's response

EFRAG believes that in some cases reflecting the business model in measurement will lead to different measurement bases used for the statement of financial position and the statement of profit or loss. EFRAG accordingly disagrees with considering the use of different measurement bases as an exception.

146 EFRAG agrees that in some cases the relevance of the information provided in the statement of financial position and the statement of profit or loss is enhanced by using different measurement bases for the statement of financial position and the statement of profit or loss. EFRAG also agrees with paragraph 6.76 of the ED that the cases where it would enhance relevance would depend on the business model of the entity. However, EFRAG considers that the statements in the ED should be supplemented by guidance on selecting measurement bases relevant for the statement of profit or loss and for the statement of financial position. As noted above, the section in the ED that includes factors to consider when selecting a measurement basis does not distinguish between the statement of profit or loss and the statement of financial position.

147 In the paper *Profit or loss versus OCI* presented at the July 2015 ASAF meeting, EFRAG provides some basis to consider how the business model could be reflected in measurement and how this could lead to two different measurement bases being used in the statement of profit or loss and the statement of financial position.

148 EFRAG further observes that the choice of measurement bases is not only relevant from the perspective of the statement of financial position and the statement of profit or loss. It could also be relevant in some circumstances to provide information using a second measurement basis in the notes to the financial statements.

Question to constituents

Do you support the use of different measurement bases for the statement of financial position and the statement of profit or loss? If so, when do you think it would be appropriate?

CHAPTER 7 PRESENTATION AND DISCLOSURE

Scope of financial statements

Notes to constituents

149 The ED states that the objective of financial statements is to provide information about an entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources.

150 That information is provided in the statement of financial position and in the statement(s) of financial performance by recognising items that meet the definition of an element. In other parts of the financial statements including the notes, information is provided about:

(a) *Recognised items that meet the definition of an element;*

(b) *Items that meet the definition of an element but that have not been recognised;*

(c) *Cash flows; and*

(d) *Contributions from, or distributions to, holders of equity claims.*

151 Forward-looking information is information about the future. Such information should only be included in the notes if it provides relevant information about an entity's assets, liabilities and equity that existed at the end of, or during, the reporting period (even if they are unrecognised) or income or expenses for the period.

152 Information about transactions or events that have occurred after the end of the reporting period is included in the financial statements if such information is necessary to meet the objectives of financial statements.

153 Information in financial statements is communicated efficiently and effectively if similar items are presented together, unnecessary detail is avoided, and presentation and disclosure objectives and principles are used instead of rules.

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?

EFRAG's response

EFRAG agrees with the proposals included in the ED on the objective and scope of financial statements and communication, which are consistent with its past proposals on the 'Disclosure Framework'. However, the IASB should consider how to distinguish between presentation and disclosure.

154 EFRAG agrees with the proposals included in the ED on the scope of financial statements.

155 It was suggested in the DP that the term 'presentation' attracts different meanings. It was also suggested in the DP that the term meant the disclosure of financial information on the face of an entity's primary financial statements.

156 EFRAG notes, that contrary to the DP, the ED does not try to define primary financial statements. It is therefore unclear what the difference is between presentation and disclosure.

Description of the statement of profit or loss

Notes to constituents

157 The ED states that the purpose of the statement of profit or loss is to:

(a) *Depict the return that an entity has made on its economic resources during the period; and*

(b) *Provide information that is helpful in assessing prospects for future cash flows and in assessing management's stewardship of the entity's resources.*

158 Hence, income and expenses included in the statement of profit or loss are the primary source of information about an entity's performance for the period.

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.

EFRAG's response

EFRAG supports the description of the statement of profit or loss proposed in the ED. It however recommends that the IASB provide some basis to ensure that all constituents have a common understanding of the 'return on an entity's economic resources' that should be depicted.

159 EFRAG agrees with the ED that the purpose of the statement of profit or loss is to:

(a) Depict the return that an entity has made on its economic resources during the period; and

(b) Provide information that is helpful in assessing prospects for future cash flows and in assessing management's stewardship of the entity's resources.

160 EFRAG also agrees that income and expenses included in the statement of profit or loss are the primary source of information about an entity's performance for the period.

161 EFRAG, however, notes that people will likely have different interpretations of what 'return that an entity has made on its economic resources' would mean. Some may, for example, consider that it mean that profit can only be recognised after capital has been maintained. Others may consider that it refers to a return on investment measure.

162 EFRAG accordingly considers that it is necessary to provide further clarity on what is meant. EFRAG notes that profit or loss is very commonly relied on, and it is necessary to have robust guidance on which income and expenses are reported in profit or loss and which income and expenses are reported in OCI.

163 EFRAG believes that to meet the objective of general purpose financial reporting it is useful to consider how to measure assets and liabilities for the purpose of depicting an entity's performance and financial position in accordance with its business model. If it would be useful to measure assets and liabilities differently for the purpose of depicting the financial position, the difference should be reported in OCI.

Question to constituents

The alternative view of Stephen Cooper and Patrick Finnegan presented in paragraphs AV2 – AV7 of the Basis for Conclusions accompanying the ED, notes that identifying the statement of profit or loss as the primary source of information about financial performance, but without actually defining financial performance or specifying the characteristics of income and expenses that require their presentation in OCI, will leave the IASB in effectively the same position that it is now. In addition, the approach to recycling provides little guidance, because there are no specific reasons presented that would rebut the presumption that recycling takes place (other than the reference to relevance).

Mr Cooper and Mr Finnegan think that the conceptual foundation for performance reporting should be based on principles of separate presentation of income and expenses with different characteristics, including, for example, different degrees of persistence and different predictive values, and principles of disaggregation or splitting of items of income and expenses to highlight components that have different characteristics. In general, such disaggregation should be done within profit or loss, either on the face of the statement or in the notes. However, Mr Cooper and Mr Finnegan acknowledge that there may be some circumstances in which disaggregation may be best done by recognising some components of income and expenses in OCI and not in profit or loss. Nevertheless, they believe that the Conceptual Framework should restrict the use of this approach (unless the IASB chooses to depart from the Conceptual Framework) more than the Exposure Draft proposes.

What is your opinion about this alternative view?

Items in profit or loss

Notes to constituents

164 The ED requires profit or loss as a total or subtotal.

165 *The ED includes a presumption that all items of income and expense will be included in profit or loss. The presumption cannot be rebutted for:*

(a) *Income or expenses related to assets and liabilities measured at historical cost; and*

(b) *Components of income or expenses related to assets and liabilities measured at current values if the components are separately identified and are of the type that would arise if the related assets and liabilities were measured at historical cost.*

166 One example of when income and expenses will be included in other comprehensive income is when a current value measurement basis is selected for an asset or a liability for the statement of financial position and a different measurement basis is selected for determining the related income and expenses in the statement of profit or loss.

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?

EFRAG's response

EFRAG disagrees with the IASB's proposal that profit or loss should be "as inclusive as possible". The proposal can be expected to gradually label 'profit or loss' what is labelled today 'comprehensive income', i.e. include (almost) all current value adjustments. As European stakeholders have been vocal in the past requesting that "profit or loss" be retained as a primary measure of performance, the IASB's proposals are likely not to meet their expectations.

167 EFRAG notes that paragraph BC7.42 of the Basis for Conclusions states that excluding income and expenses from the statement of profit or loss without compelling reasons could undermine the usefulness of that statement. That is, the statement of profit or loss should be as inclusive as possible.

168 Based on paragraph BC7.42 of the ED, it seems as if the IASB is proposing that changes in the current value of assets and liabilities should be reported in profit or loss. This would mean that profit or loss should include those items that are currently reported in OCI (including current value adjustments) unless there are compelling reasons for including them in OCI (or the measurement of the items are changed).

169 EFRAG disagrees with this. EFRAG considers that there could be situations where, for the purpose of the statement of financial position, it could be useful to measure certain assets or liabilities at a current value (e.g. fair value changes). However, for the purpose of the statement of profit or loss, measurement based on historical cost could in some of these cases provide the most useful information. The changes in the current value of assets and liabilities should accordingly be reported in OCI.

170 For example, it may be worthwhile to consider whether fair value changes for long-term investments (e.g. some investment properties) should be reflected in profit or loss (before the investment is sold) even when the most useful information will result from measuring the investment at fair value in the statement of financial position. As the accumulated fair value changes are reported in profit or loss when the investment is sold, there would not be any amount related to the investment that would be 'stuck' in OCI in that case.

Question to constituents

The alternative view of Stephen Cooper and Patrick Finnegan presented in paragraphs AV2 – AV7 of the Basis for Conclusions accompanying the ED, notes that amounts could be recognised outside profit or loss, but only if doing so enhances the relevance of the information in the statement of profit or loss in that reporting period. Moreover, they think that this must also hold true for all other periods that may be affected, including periods covered by any potential recycling, and also in aggregate over several periods, including the life of the transaction concerned. To achieve this, the basis of disaggregation should result in a net zero accumulated amount in OCI over the life of a transaction or in aggregate over the life of economically linked transactions. If the cumulative amount in OCI is not zero, then the relevance of the information in the statement of profit or loss is reduced on a cumulative basis, because some items of income and expenses would be entirely omitted from the statement of profit or loss and so the depiction of financial performance in that statement would not be complete. They also believe that the principle they outline would obviate the need to consider explicit reclassification of OCI items (because the disaggregation should naturally result in zero cumulative OCI over the life of the relevant transactions) and would therefore remove a source of complexity and confusion for users of financial statements.

Mr Cooper and Mr Finnegan consider that this principle would, in effect, restrict the use of OCI to a limited number of cases in which either (1) a different measurement basis (which, as noted in paragraph BC7.49, should be a meaningful measure and not just an accumulation of amounts recognised in the statement of profit or loss) is judged appropriate for measuring income and expenses in profit or loss, compared with that best suited to the measurement of the asset or the liability in the statement of financial position; or (2) there is a mismatch in the recognition basis for different but economically related transactions.

The Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* presented three concepts to be used when considering whether an item could be reported in OCI. The three items were 'bridging items'; 'mismatched remeasurements' and 'transitory remeasurements'.

Mr. Cooper and Mr Finnegan thus supports two of the three situations for use of OCI envisaged in the Discussion Paper. Mr Cooper and Mr Finnegan believe that further work to develop a conceptual basis for OCI should have built on these.

What is your opinion about this alternative view?

Do you think the discussion about the three concepts from the Discussion Paper ('bridging items'; 'mismatched remeasurements' and 'transitory remeasurements') should be included in the Conceptual Framework?

Recycling

Notes to constituents

171 *The ED includes a presumption that all items of income and expense recognised in other comprehensive income should be recycled to profit or loss. The presumption could be rebutted, for example, if there is not clear basis for identifying the period in which reclassification would enhance the relevance of the information in the statement of profit or loss.*

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?

EFRAG's response

EFRAG believes that the principle (rather than a rebuttable presumption) should be set that no income and expense should be permanently excluded from the statement of profit or loss. As with other principles, the IASB could choose to depart from it when setting a specific Standard if the rationale for doing so is explained.

172 EFRAG thinks that income and expenses reported in other comprehensive incomes should be recycled to profit or loss if it would be in accordance with what profit or loss should represent. That is, these income and expenses are included in profit or

loss at a later date than when the changes in the measurement of related assets and liabilities are reflected in the statement of financial position.

173 EFRAG believes that profit or loss should reflect how an entity is generating profit based on its business model(s). In the view of EFRAG, income and expenses should generally be recognised in profit or loss. However, income and expenses could be reported in the statement of profit or loss at different points in time than at the time value changes are reported in the statement of financial position. Accordingly, some changes reported in the statement of financial position are initially reported in OCI.

174 Based on how EFRAG considers profit or loss, items reported in OCI should in principle be recycled. EFRAG thus agrees with paragraph BC7.54 that

> [i]f the amounts included in the statement of profit or loss are the primary source of information about an entity's financial performance for the period, it follows that the cumulative amounts included over time in that statement should also be as complete as possible. Hence, not income and expense should be excluded from the statement of profit or loss permanently, unless there is a compelling reason to do so.

175 EFRAG, however, thinks that the principle based explanation provided in the Basis for Conclusions is much better than what could be considered to be a rules based rebuttable presumption in the ED. EFRAG therefore thinks that the explanation provided in the Basis for Conclusions should be included in the Conceptual Framework instead of the rebuttable presumption.

176 In the paper *Profit or loss versus OCI* prepared for the July 2015 ASAF meeting EFRAG is contributing further to the discussion on recycling.

CHAPTER 8 CONCEPTS OF CAPITAL AND CAPITAL MAINTENANCE

Capital maintenance

Notes to constituents

177 *The ED includes the current guidance on the concepts of capital and capital maintenance in the ED with minor changes for consistency of terminology. For that reason no questions were included in the ED.*

Question to constituents

The IASB has carried forward the material in the chapter on capital maintenance unchanged from the existing Conceptual Framework, except for a limited number of editorial changes. The Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* preceding the ED noted that the IASB does not plan to consider the chapter on capital maintenance until such time as a new or revised Standard on accounting for high inflation indicates a need for change.

EFRAG notes that an argument for removing the chapter until the issue can be further considered could be that the chapter is not well linked with other parts of the proposed new Conceptual Framework (e.g. it is not linked with the objective of general purpose financial reporting including the role of stewardship).

Do you think the existing chapter on capital maintenance should be kept in the Conceptual Framework?

OTHER ISSUES

Effects of the proposed changes to the Conceptual Framework

Notes to constituents

178 The Conceptual Framework does not override any Standard. The proposed changes to the Conceptual Framework will therefore not have any immediate effects on the financial statements of most reporting entities. However, some entities may have used the Conceptual Framework to develop accounting policies in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors in the absence of an IFRS that specifically applies to a transaction, other event or condition. It may happen that such accounting policies developed under the current Conceptual Framework will be in conflict with the guidance in the revised Conceptual Framework.

179 The IASB will not automatically change existing Standards as a result of the changes that it makes to the Conceptual Framework. Any decision to amend an existing Standard would have to go through the IASB's normal due process for adding a project to its agenda.

180 The IASB has identified the following existing Standards and Interpretations that it thinks would be inconsistent with the proposed new concepts:

(a) *Some of the classification requirements of IAS 32 Financial Instruments—Presentation;*

(b) *The requirements of IFRIC 21 Levies (an interpretation of IAS 37 Provisions, Continent Liabilities and Contingent Assets);*

181 The proposed changes to the Conceptual Framework would create some more minor inconsistencies between existing Standards and the Conceptual Framework:

(a) *Some existing Standards directly quote existing Conceptual Framework definitions which are proposed amended;*

(b) *Some Standards do not provide an objective for disclosure requirements and some require forward-looking information that is not necessarily related to assets and liabilities existing at the end of, or during, the reporting period;*

(c) *In existing Standards the term 'reliability' is used in two different ways. In some places it refers to what is termed 'faithful representation' in the ED.*

Question 15 - Effects of the proposed changes to the Conceptual Framework

Do you agree with the analysis in paragraphs BCE.1–BCE.31 of the ED (summarised in paragraphs 178 - 181 above)? Should the IASB consider any other effects of the proposals in the Exposure Draft?

EFRAG's response

EFRAG agrees with the proposed status of the Conceptual Framework. As the Conceptual Framework does not provide clear directions for future standard-setting activity, the effect analysis is not very helpful.

Question to constituents

Do you agree with the status of the Conceptual Framework (see paragraphs 178 - 179 above) and that the review should not automatically result in any changes to Standards?

182 As EFRAG observes above, the guidance included in the ED is insufficient to provide clear directions for future standard-setting on important issues. EFRAG is, accordingly, not surprised to see that the only a few effects of the proposals have been identified.

Business activities

Notes to constituents

183 The ED does not provide a single overarching description of how the nature of an entity's business activities would affect standard-setting. Instead, it notes that the nature of an entity's business activities is likely to affect:

(a) *Measurement;*

(b) *The unit of account;*

(c) *The distinction between profit or loss and OCI; and*

(d) *Presentation and disclosure.*

Question 16 – Business activities

Do you agree with the proposed approach to business activities? Why or why not?

EFRAG's response

EFRAG welcomes the acknowledgement of the role the business model should play in measurement, in identifying different measurement bases for the statement of financial position and the statement of profit or loss, and in selecting the unit of account. However, in EFRAG's view the proposed Conceptual Framework would limit the role of the business model in measurement without stating why and how it would be limited, and does not consider the role it could play in recognition. Furthermore EFRAG thinks that the term 'business model' that has been introduced with IFRS 9 should be retained and described for financial reporting purposes.

184 EFRAG thinks that the term 'business model' that has been introduced with IFRS 9 *Financial Instruments* should be retained and described for financial reporting purposes. Paragraph BCIN.31 of the Basis for Conclusions notes that the term 'business activities' has been used in the ED as the term 'business model' is used with different meanings by various organisations. Instead of replacing the term, EFRAG thinks that the Conceptual Framework should describe the term the IASB introduced with IFRS 9 for financial reporting purposes.

185 In the Bulletin *The role of the business model in financial reporting*, EFRAG and its partners[3], EFRAG presented the view that the business model should play a role in financial reporting. EFRAG was not convinced by the arguments of those who oppose that view, as EFRAG believes that financial statements that are consistent with other parts of corporate financial reporting are likely to support the most effective communication between management and investors and provide more useful information.

[3] The Bulletin was prepared in cooperation with the French Autorité des Normes Comptables (ANC), the Accounting Standards Committee of Germany (ASCG), the Organismo Italiano di Contabilità (OIC) and the UK Financial Reporting Council (FRC).

186 Accordingly, EFRAG agrees that the business model should affect the selection of a measurement basis, the unit of account, what items should be reported in profit or loss and presentation and disclosure. EFRAG, however, believes that the relationship between the business model and the decisions made in relation to these topics should be developed into guidance in the Conceptual Framework. The ED does little more than stating that when making decisions related to the topics mentioned, the business model should be considered.

187 In addition to playing a role in relation to measurement, the unit of account, the distinction between profit or loss and OCI, and presentation and disclosure, EFRAG thinks that the business model plays a role in relation to recognition. In current Standards some executory contracts are recognised while others are not. For example, a contract to buy or sell a non-financial item that can be settled net in cash should be recognised except if it is entered into and continues to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. EFRAG therefore thinks that the business model should also be discussed in relation to relevance in the guidance for recognition to be included in the Conceptual Framework.

Long-term investment

Notes to constituents

188 The Basis for Conclusions accompanying the ED discusses the implications of long-term investment and long-term financing for the Conceptual Framework.

189 The IASB concludes that:

(a) *The proposals in this ED provide sufficient tools for the IASB to make appropriate standard-setting decisions if future projects consider:*

  (i) *How to measure the long-term investments (or liabilities) of entities whose business activities include long-term investment; or*

  (ii) *Whether such entities should report changes in the carrying amount of those investments (or liabilities) in the statement of profit or loss or other comprehensive income.*

(b) *The Conceptual Framework contains sufficient and appropriate discussion of primary users and their information needs, and the objective of general purpose financial reporting, to address appropriately the needs of long-term investors.*

Question 17 – Long-term investment

Do you agree with the IASB's conclusions on long-term investment? Why or why not?

EFRAG's response

As indicated in many of its above responses, EFRAG requests that the *Conceptual Framework* include additional guidance on the unit of account, measurement and presentation. In the absence of such guidance at present, EFRAG disagrees that the *Conceptual Framework* provides sufficient guidance on how to reflect long-term investment business models.

Where financial reports genuinely provide information that is necessary to make decisions to buy, hold and sell and to assess the stewardship of management, EFRAG believes that it is not necessary to differentiate among investors on the basis of their investment horizon.

190 In the view of EFRAG, the *Conceptual Framework* would contain sufficient guidance to define at standards level requirements taking into account the specificities of a long term investment business model, if the IASB developed more guidance as requested by EFRAG in the above answers.

191 As explained above, EFRAG considers that the Conceptual Framework should reflect more on the business model when considering measurement and what changes in current value should be reported in OCI. For this purpose, it will likely be useful to group different business models into some general categories (like in the paper *Profit or loss versus OCI* presented by EFRAG at the July 2015 ASAF meeting). EFRAG tentatively believes that it would be useful to group the business models of long-term investors into such a category. As further explained in the paper *Profit or loss versus OCI*, EFRAG believes that fluctuations in the current value of long-term investors' investments are not particular relevant for the assessment of periodic financial performance. On the other hand, these fluctuations would be relevant when assessing the periodic financial performance of an entity that tries to profit from short term fluctuations in the market price of certain financial instruments or goods.

192 As EFRAG believes that business models should be reflected in Standards, EFRAG considers it useful if the Conceptual Framework identified the main categories of business models – including those of long-term investors – and described how these business models should affect the reporting of events and transactions.

193 Whether the Conceptual Framework includes sufficient guidance to ensure that IFRS provide useful information to investors having a long-term objective is a different question. EFRAG believes that if financial statements provide useful information to make decisions to buy, hold and sell and to assess stewardship of management, all investors' needs are fulfilled, without the need to differentiate them by their horizon of investment.

Question to constituents

Do you agree that:

- The ED provides sufficient guidance on how to reflect long-term investment business models;
- The ED contains sufficient and appropriate discussion of primary users and their information needs, and the objective of general purpose financial reporting, to address appropriately the needs of long-term investors?

Ideas included in the Discussion Paper

Question to constituents

Are there any of the discussions, ideas and reflections included in the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (issued by the IASB in July 2013), that are not reflected in the ED, you think should be included in the Conceptual Framework?

Appendix 2

Unit of Account

1 This Appendix on the unit of account has been prepared to support EFRAG's assessment of whether the guidance included in the Exposure Draft *Conceptual Framework for Financial Reporting* (the ED) is sufficient to provide directions for future Standards on what the unit of account should be.

Applying the IASB proposals to specific situations

Situations analysed

2 To examine whether the guidance provided in the ED provides sufficient directions for future standard-setting, EFRAG has considered the outcome of applying the proposal to some issues where the unit of account has raised concerns, and sometimes been heavily debated, in the past.

3 The issues have been grouped into the following categories:

(a) Situations where a bundle of rights and obligations has been acquired in one transaction but the rights and obligations would have to be accounted for as smaller groups of rights and obligations. An example is when an entity acquires an asset in one transaction (e.g. nuclear power plant or building), but for accounting purposes would have to unbundle this asset and account for rights and obligations related to each of the unbundled items separately. This situation will be illustrated by an **item of property, plant and equipment (PPE) held for use** (Case A).

(b) Situations where one unit of account is used for recognition, but the fact that the item is part of a portfolio is taken into account when measuring it (and when assessing whether any probability thresholds are met in relation to recognition). This situation will be illustrated by **warranties related to products sold** (Case B).

(c) Situations where one unit of account is used for recognition but a smaller unit of account is used for measurement. This situation will be illustrated by **investments in subsidiaries, associates and joint ventures** (Case C).

(d) Situations where rights and obligations are unbundled and bundled based on the activity they relate to. This situation will be illustrated by a **subsidiary of an investment entity** (Case D).

4 Paragraphs 4.57 – 4.63 of the ED includes guidance on the unit of account. When examining the outcome of the guidance only paragraphs 4.62 – 4.63 have been considered.

5 Paragraphs 4.57 – 4.60 note that:

(a) The unit of account is the group of rights, the group of obligations or the group of rights and obligations, to which recognition and measurement requirements are applied;

(b) A unit of account is selected after considering how recognition and measurement will apply to the asset or liability and the related income and expenses;

(c) One unit of account may be appropriate for recognition while another unit of account may be appropriate for measurement;

(d) Separable rights and obligations may be included in a single unit of account.

6 Paragraph 4.61 provides a list of possible units of account and paragraphs 4.62 – 4.63 set out the objective in selecting a unit of account and provide list of factors to

consider when determining the unit of account. More specifically, the factors that drive the identification of the unit of account are:

(a) The information provided about the resulting asset, liability, income and expenses must be relevant;

(b) The asset, liability, income and expenses recognised must faithfully represent the substance of the transaction from which they have arisen; and

(c) The cost of providing the information for that unit of account must not exceed the benefits.

7 When examining the outcome of the guidance, EFRAG has only considered paragraphs 4.62 – 4.63 of the ED, which focus on the factors to consider when determining the unit of account.

Summary of findings

8 The situations analysed below indicate that the guidance included in the ED does not clearly point in a specific direction when considering significant unit of account issues in standard-setting.

9 Although the ED acknowledges that it may be appropriate in some cases to select one unit of account for recognition and one other for measurement, the guidance provided in the ED is similar for recognition and measurement. It is therefore unclear how the unit of account could be different for recognition and measurement.

10 The ED notes that the unit of account is the group of rights and/or obligations, to which recognition and measurement requirements are applied. Thus, before deciding on recognition and measurement requirements an entity needs to decide the unit of account to be used. However, according to the ED, when determining the unit of account, the measurement of assets and liabilities should be taken into consideration. The guidance could thus seem circular.

Case A: An item of PPE held for use

The issue

11 Different parts of an item of PPE may need to be replaced over time. The choice of the unit of account could influence how the replacement of parts should be accounted for and the length of the depreciation period(s) of the asset(s).

12 Currently IAS 16 *Property, Plant and Equipment* requires each part of an item of PPE with a cost that is significant in relation to the total cost of the item to be depreciated separately (paragraph 43 of IAS 16).

Possible units of account

13 When considering how to account for a piece of PPE (e.g. a nuclear power plant or a building) possible unit of accounts include, but are not limited to:

(a) Each single right that could be identified (e.g. a right to use (a part of) a physical asset);

(b) The combination of a set of rights over an equipment or a single part of the equipment (and treat them as a single unit of account) that:

  (i) Could be purchased separately;

  (ii) Was purchased separately by the entity;

  (iii) Is capable of producing a usable output;

  (iv) Is capable of producing an output the entity is selling; and

(c) Group of single parts with similar useful lives and usage patterns.

Guidance in the ED when considering an item of PPE

14 The left column in the table below presents the guidance provided in the ED on how to determine the unit of account. The right column includes an assessment of what unit of account the guidance would result in for the accounting for a PPE, more specifically a nuclear power plant and building.

15 The text of the ED refers to 'a group of rights and obligations'. In the analysis below, it is assumed that the guidance also applies to 'a group of rights' only.

Relevance	
Treating a group of rights and obligations as a single unit of account may provide relevant information to users if, for example, those rights and obligations:	
▪ cannot (or are unlikely to) be the subject of separate transactions;	The rights related to a nuclear reactor constructed for a particular acquirer are usually not subject of separate transactions. Similarly, the different rights over a building are unlikely to be the subject of separate transactions. Therefore, it seems that **the unit of account would be each equipment that could be purchased separately such as a nuclear reactor or building** (**i.e. combining a set of rights into a single asset that can be subject of a separate transaction could provide relevant information).** Perhaps, an exception could be said to occur when an asset is leased. In these cases the rights to use an asset for a given period may be transferred directly from a seller to the lessee, but other rights may simultaneously be transferred directly to the lessor. In this case, there is also the question of whether the unit of account of the obligation to pay rentals in a lease and unit of account of the right-of-use asset should be, to some extent, related as the rights and obligations arise in the same contract and do not normally exist independently of each other. Another exception might be if a piece of PPE acquired could be divided into several physical parts. In the case of the building, it could, for example, be considered that all the rights related to the central heating and all the rights related to main building could be acquired separately. Thus, **the unit of account would be each single part of the equipment that could be purchased separately** (**i.e. the combination of rights over a single part of an asset that can be subject of a separate transaction).** Finally, the rights over an elevator can be subject of a separate transaction if sold as

	a spare part. In this case, **the unit of account would be each single part of the equipment that could be purchased separately** (**i.e. the combination of rights over a single part of an asset that can be subject of a separate transaction).**
▪ cannot (or are unlikely to) expire in different patterns;	In many cases, the rights related to an acquired physical item of PPE would not expire at different points in time (an exception may be a lease agreement). For example, the right to use a building would usually expire at the same time as the right to sell the building. This example would accordingly result in the **unit of account would be each equipment over which there is legal ownership (i.e. unit of account being the combination of rights and/or obligations embodied in the physical asset).** However, the depreciation pattern of the different rights related to a physical asset such as a building may differ (e.g. roof and central heating). The example would, accordingly, suggest that the **unit of account should be the physical parts of the physical assets expire in similar patterns (i.e. the unit of account is the group of single parts with similar useful lives and usage patterns).**
▪ are used together in the context of the business activities conducted by the entity to produce cash flows and are measured by reference to the estimates of their interdependent future cash flows;	In many cases, the different rights over an item of PPE that is capable of producing an output that the entity is selling are used together in the business activities conducted by the entity to produce cash flows. Whether this group of rights will be measured together (e.g. entire nuclear power plant or a building) depends on the unit of account chosen in Standards. Currently, the requirements in IAS 36 *Impairment of Assets* may result in the rights related to an entire nuclear power plant or building being measured by reference to the estimate of the interdependent future cash flows. Depending on measurement requirements, the **unit of account could therefore be each equipment or single part that is capable of producing an output the entity is selling (i.e. the combination of rights over a nuclear power plant or a building)**.
▪ have similar economic characteristics and risks. Rights and obligations with	The rights related to a physical piece of PPE may often have similar economic

different characteristics and risks are likely to have different implications for the prospects for future net cash inflows to an entity and so may need to be separated.	characteristics and risks. This may apply to the rights related to a nuclear power plant or a building.
Faithful representation	
To achieve a faithful representation it may be necessary to: ▪ treat the rights or obligations arising from different sources as a single unit of account or ▪ to separate the rights or obligations arising from a single source. Moreover, to provide a faithful representation of unrelated rights and obligations, it may be necessary to recognise and measure them separately.	Generally, accounting for a group of rights over an item of PPE as a single unit of account would result in a faithful representation. That is, an entity would group the different rights arising from a single source (e.g. contract) and treat them as a single unit of account. However, the examples do not seem to provide indicators of when it may be necessary to separate or group the rights or obligations arising from a single source.
The cost constraint	
Costs of providing the information for that unit of account must not exceed the benefits. In general, the costs associated with recognising and measuring assets, liabilities, income and expenses increase as the size of the unit of account decreases.	Generally, the cost constraint would push towards considering the highest group level of rights – or big groups of physical objects as the unit of account. It would, however, not necessarily prohibit that physical objects that expires in similar patterns could be considered the unit of account **(i.e. group of single parts with similar useful lives and usage patterns).**
Transfer part of an asset	
If an entity transfers part of an asset or part of a liability, the unit of account may change at that time so that the transferred component and the retained component become separate units of account.	It can happen that part of a physical object is replaced. When this happens, if the unit of account is the combination of a set of rights over an asset (e.g. a car) the replacement parts (e.g. tyres) may become a separate unit of account and the retained component becomes a separate unit of account.

16 Based on the assessment above, it appears as if each single right that could be identified in relation to a physical item of PPE would not be identified as the unit of account under the proposed guidance.

17 The list of factors included in the ED seems to indicate that a possible unit of account could be the following, as described in paragraph 13 above:

(a) the combination of a set of rights over an equipment or a single part of the equipment that:

(i) is capable of being subject to a separate transaction (see paragraph 19 (a) below);

(ii) was purchased separately by the entity (see paragraph 19 (a) below);

(iii) is capable of producing an output the entity is selling (a cash generating unit in accordance with IAS 36) (see paragraph 19 (b) below); or

(b) A subgroup of rights over an item of PPE embodied in a physical part of a piece of PPE, that is parts with similar useful lives and usage patterns.

18 However, if the unit of account is the combination of all rights over an asset (e.g. a car), then over time as parts of the asset are replaced (e.g. tyres), the replacing parts would be considered as separate units of account and the retained component becomes a separate unit of account.

19 In addition to indicating that the directions included in the ED would not point in only one direction, this example on PPE also showed that:

(a) Whether rights and obligations are unlikely to be the subject of separate transactions depends on which type of transactions one has to consider. One could consider all types of transactions, where every screw could sold separately; or one could consider transactions with the similar purpose to that being considered (i.e. acquire a fully operative asset and not its individual components).

(b) How the unit of account would be determined would depend on how an asset or liability is measured. However, how an asset or liability is measured seem also to depend on the unit of account chosen for measurement.

Case B: Warranties for products sold

The issue

20 An entity may sell some products and provide a related guarantee. Each time the entity sells a product it also incurs a liability related to the guarantee. It is unlikely that a particular guarantee will result in an outflow. However, it is also unlikely that none of the guarantees will result in an outflow. When measuring the liability (and when considering any recognition thresholds related to the probability of an outflow) it may therefore matter whether each guarantee is considered separately or it is taken into account that the entity has a portfolio of guarantees.

21 Currently, in accordance with IFRS 15 *Revenue from Contracts with Customers*, if a customer has the option to purchase a warranty separately, the warranty is a distinct service as the entity promises to provide the service to the customer in addition to the product. In those circumstances, an entity accounts for the promised warranty as a performance obligation (that is the warranty is measured based on the stand-alone selling price).

22 However, if a customer does not have the option to purchase a warranty separately and it only provides the customer with assurance that the related product will function as the parties intended because it complies with agreed-upon specifications, an entity shall account for the warranty in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The amount should accordingly reflect the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

Possible units of account

23 When considering how to measure guarantee liabilities possible unit of accounts include, but are not limited to:

(a) Each single obligation that could be identified; and

(b) Groups or subgroups of similar obligations.

Guidance in the ED when considering warranties for products sold that are not considered separate performance obligations

24 The left column in the table below presents the guidance provided in the ED on how to determine the unit of account. The right column includes an assessment of what unit of account the guidance would result in relation to the accounting for warranties for products sold.

25 The text of the ED refers to 'a group of rights and obligations'. In the analysis below, it is assumed that the guidance also applies to 'a group of obligations' only.

Relevance	
Treating a group of rights and obligations as a single unit of account may provide relevant information to users if, for example, those rights and obligations:	
▪ cannot (or are unlikely to) be the subject of a separate transaction;	Each warranty is likely to be the subject of a separate transaction. Each warranty is 'sold' when the entity sells a product and the entity is likely to settle its obligations with each individual customer. This example would accordingly point in the direction that **each warranty should be considered separately for measurement and recognition (i.e. the unit of account is each single obligation that could be identified)**.
▪ cannot (or are unlikely to) expire in different patterns;	In this specific case, each obligation to repair a product so that it will function in accordance with the agreed-upon specifications may expire at different points in time (i.e. the entity may have to settle each obligation at various points in time). This example would accordingly result in **each warranty being different considered as a single unit of account for measurement and recognition (i.e. the unit of account is each single obligation that could be identified).**
▪ are used together in the context of the business activities conducted by the entity to produce cash flows and are measured by reference to the estimates of their interdependent future cash flows;	This example does not seem to provide directions for what the unit of account for warranties should be.
▪ have similar economic characteristics and risks. Rights and obligations with different characteristics and risks are likely to have different implications for the prospects for future net cash inflows to an entity and so may need to be separated.	Warranties related to the same product would have similar economic characteristics and risks. Warranties related to very different types of products could have very different risks. This example would thus result in **warranties being grouped according to economic characteristics and risks and these groups are considered the unit of account for measurement and recognition (i.e. the unit of account is a group or a subgroup of similar obligations).**
Faithful representation	
To achieve a faithful representation it may be necessary to:	It is assessed that it would not result in a faithful representation to measure warranty

▪ treat the rights or obligations arising from different sources as a single unit of account or ▪ to separate the rights or obligations arising from a single source. Moreover, to provide a faithful representation of unrelated rights and obligations, it may be necessary to recognise and measure them separately.	liabilities at zero (not recognising the liability) if it is unlikely that a particular guarantee will result in an outflow but, at the same time, it is unlikely that none of the guarantees will result in an outflow. On the one hand, it could be argued that it would result in a faithful representation to recognise and measure each warranty individually as long as each warranty (if there are many of them) are measured at an expected value **(thus, the unit of account is each single obligation that could be identified)**. On the other hand it could be argued that if the choice of measurement basis should depend on how many warranties an entity has, recognition and measurement would de facto be carried out on a portfolio level. (**i.e. the unit of account is a group or a subgroup of similar obligations).**
The cost constraint	
Costs of providing the information for that unit of account must not exceed the benefits. In general, the costs associated with recognising and measuring assets, liabilities, income and expenses increase as the size of the unit of account decreases.	Generally, the cost constraint would push towards considering the highest group level of obligations as the unit of account. It would, however, not necessarily prohibit that each warranty could be considered the unit of account.
Transfer part of an asset	
If an entity transfers part of an asset or part of a liability, the unit of account may change at that time so that the transferred component and the retained component become separate units of account.	For the particular examination, this guidance is assessed not to be relevant.

26 Based on the assessment above, it appears as if the ED could both indicate that a possible unit of account could be (a) or (b) in paragraph 23 above.

27 In addition to indicating that the directions included in the ED would not point in only one direction, the example on warranties also showed that:

(a) Although the ED mentions that it in some cases may be appropriate to select one unit of account for recognition and a different unit of account for measurement, the ED includes no further guidance on this.

(b) When the selection of a measurement basis has to be based on the number of similar items to be measured, it is not clear what the unit of account is. On the one hand, it could be argued that each single item is the unit of account measured at, for example, expected value. On the other hand, it could be argued that the group of similar items is the unit of account measured at, for example, the most likely amount.

Case C: Investments in subsidiaries, associates and joint ventures

The issue

28 An entity may acquire a considerable number of equity instruments in another entity. In these cases, the price of the total number of equity instruments may be higher than the fair value of a single equity instrument in the other entity as the entity would

have to pay some type of a control premium. For measurement and recognition, the issue could be whether the unit of account is each equity instrument the entity has purchased or the group of equity instruments the entity has purchased. This could affect whether a control premium would have to be recognised as an expense immediately.

29 Currently, IAS 28 *Investments in Associates and Joint Ventures* (as amended in 2011) prescribes the accounting for investments in associates and joint ventures. IAS 27 *Separate Financial Statements* also prescribes the accounting for investments in subsidiaries, jointly ventures and associates, but taking into account the perspective of the users of separate financial statements (the focus is upon the performance of the assets as investments). Although both IAS 27 and IAS 28 relate the accounting to an "investment", neither IAS 27 nor IAS 28 make a reference to the unit of account. When measuring investments at fair value, IFRS 13 states that a control premium when measuring the fair value of a controlling interest is not permitted in a fair value measurement. On the other hand IFRS 3 *Business Combinations* requires the control premium to be taken into account when determining the fair value of a non-controlling interest in an acquiree.

Possible units of account

30 When considering how to account for an interest in an subsidiary (in separate financial statements), joint venture and associate (in separate and consolidated financial statements) possible units of account include:

(a) Combination of rights over all the individual financial instruments that are included within the investments (i.e. there is only one investment and account for the investment as a single unit of account);

(b) A subgroup of rights over the individual financial instruments that are included within the investment (i.e. different portions of an investment);

(c) Each individual financial instrument that are included within the investment (i.e. combination of rights over a single financial instrument); or

(d) Each right included in each individual financial instrument.

Guidance in the ED on the unit of account for investments

31 The left column in the table below presents the guidance provided in the ED on how to determine the unit of account. The right column includes an assessment of what unit of account the guidance would result in relation to the accounting for a listed subsidiary that is being measured at fair value in separate financial statements.

32 The text of the ED refers to 'a group of rights and obligations'. In the analysis below, it is assumed that the guidance also applies to 'a group of rights' only.

Relevance	
Treating a group of rights and obligations as a single unit of account may provide relevant information to users if, for example, those rights and obligations:	
▪ cannot (or are unlikely to) be the subject of a separate transaction;	The rights related to the individual financial instruments that make up the investment in a subsidiary can be subject of separate transactions (i.e. the parent may sell part of its investment in a subsidiary). In some cases, the different rights related to an equity instrument (e.g. right to receive dividend and right to vote at the general assembly) could also be the subject of a

	separate transaction. The example would accordingly point in the direction that the **unit of account should be each individual financial instrument that could be identified or each right within such a financial instrument**.
▪ cannot (or are unlikely to) expire in different patterns;	The rights related to an interest in another entity do normally not expire in different patterns (but some could). **The example would accordingly point in the direction that the unit of account should be the entire investment.**
▪ are used together in the context of the business activities conducted by the entity to produce cash flows and are measured by reference to the estimates of their interdependent future cash flows;	In most cases, the different rights over an investment in a subsidiary, that is capable of generating cash flows to the parent, are used together in the business activities conducted by the parent (e.g. decisions about dividends or other distributions). Therefore, this example would **point in the direction that all the individual financial instruments that are included within the investment should be considered as a single unit of account.**
▪ have similar economic characteristics and risks. Rights and obligations with different characteristics and risks are likely to have different implications for the prospects for future net cash inflows to an entity and so may need to be separated.	A parent may own different types of financial instruments in a subsidiary (e.g. ordinary shares, preference shares). There may be different economic characteristics and risks related to these. **Thus, the example would point in the directions that similar types of financial instruments in a subsidiary should be considered as a single unit of account (i.e. a subgroup of rights over the individual financial instruments that are included within the investment for which there are similar economic characteristics and risks).**
Faithful representation	
To achieve a faithful representation it may be necessary to: ▪ treat the rights or obligations arising from different sources as a single unit of account or ▪ to separate the rights or obligations arising from a single source. Moreover, to provide a faithful representation of unrelated rights and obligations, it may be necessary to recognise and measure them separately.	Current IFRS indicates that both considering the entire investment in another entity as the unit of account and considering each financial instrument as the unit of account would result in a faithful representation.
The cost constraint	
Costs of providing the information for that unit of account must not exceed the benefits. In general, the costs associated	Generally, the cost constraint would push towards considering the highest group level of rights. However, in this specific case, the

with recognising and measuring assets, liabilities, income and expenses increase as the size of the unit of account decreases.	mathematical product P x Q (i.e. sum of the individual financial instruments) to measure the fair value of an investment in a subsidiary, quoted in an active may be the simplest and less costly method to measure the investment. Considering each right related to a financial instrument will likely be the most costly, but the **guidance would not point in a specific direction on whether individual financial instruments or groups of financial instruments should be considered as the unit of account**.
Transfer part of an asset	
If an entity transfers part of an asset or part of a liability, the unit of account may change at that time so that the transferred component and the retained component become separate units of account.	A parent may decide to sell part of its investment in a subsidiary. The guidance suggests that if the unit of account has been the group of financial instruments in the subsidiary, this would continue to be the case even if the investment should no longer be considered a subsidiary or an associate.

33 Based on the assessment above, it appears as if the ED could provide arguments in favour of all the possibilities listed above in paragraph 30.

Case D: A subsidiary meeting the definition of an investment entity and additionally providing investment-related services

The issue

34 A subsidiary can have different activities. How to account for a subsidiary may depend on its activities. The question is whether the subsidiary is the unit of account or different activities of the subsidiary can be considered the unit of account. The choice of the unit of account could impact whether, for example, part of a subsidiary could be measured at fair value while another part is consolidated.

35 Currently, the issue is relevant for investment entities. In December 2014 the IASB issued an amendment to IFRS 10, IFRS 12 and IAS 28: *Investment Entities: Applying the Consolidation Exception* where it clarified that an investment entity shall measure at fair value through profit or loss all its subsidiaries that are themselves investment entities and provide services that relate to the parent's investment activities.

36 If the subsidiary is not an investment entity, the investment entity parent assesses whether the main activities undertaken by the subsidiary support the core investment activities of the parent. If so, the subsidiary's activities are considered to be an extension of the parent's core investing activities and the subsidiary would be consolidated.

Possible units of account

37 When considering how an investment entity should account for subsidiaries that have investing activities and provide services that relate to the parent's investment entities, possible units of account include, but are not limited to:

(a) A combination of all the rights and obligations related to the subsidiary; or

(b) A subgroup of rights and obligations that are related to a particular activity of a subsidiary.

Guidance in the ED on the unit of account for subsidiaries

38 The left column in the table below presents the guidance provided in the ED on how to determine the unit of account. The right column includes an assessment of whether the guidance would points towards (a) or (b) of paragraph 37. In the examination, the focus is not on the rights held by a parent entity that provides control of a subsidiary. These rights are considered above in paragraphs 28 - 33. The focus of this examination is whether the rights and obligations of a subsidiary should be considered as one unit of account or more unit of accounts.

Relevance	
Treating a group of rights and obligations as a single unit of account may provide relevant information to users if, for example, those rights and obligations:	
▪ cannot (or are unlikely to) be the subject of a separate transaction;	A subsidiary, in consolidated financial statements, consists of many rights and obligations. Many of these can be subject to a separate transaction. For example, it is common practice for a group to change its structure by making, for example, a spin-off or selling a part of a subsidiary (e.g. a business within a subsidiary). This example would accordingly mean that an **entity should not treat all its rights over a subsidiary as a single unit of account**. **Instead, the unit of account should be a subgroup of rights and obligations that are related to a particular activity of a subsidiary.**
▪ cannot (or are unlikely to) expire in different patterns;	Whereas the rights that gives control of a subsidiary would generally expire in similar patterns, the rights and obligations of a subsidiary will generally expire at different points in time. Thus, the example seems to suggest that **the rights and obligations of a subsidiary should not be treated as a single unit of account**. **Instead, the unit of account should be a subgroup of rights and obligations that are related to a particular activity of a subsidiary.**
▪ are used together in the context of the business activities conducted by the entity to produce cash flows and are measured by reference to the estimates of their interdependent future cash flows;	In this example, it is difficult to assess whether the different components of the subsidiary that are capable of engaging different business activities are in fact used together in the context of the business activities. It would depend on facts and circumstances. Nonetheless, different business components (e.g. core investing activities and investment-related services) may be mutually dependent and benefit from synergies between them. If so, this example would suggest that **an**

	entity should treat all its rights over a subsidiary as a single unit of account.
▪ have similar economic characteristics and risks. Rights and obligations with different characteristics and risks are likely to have different implications for the prospects for future net cash inflows to an entity and so may need to be separated.	Although the different business components may be mutually dependent and benefit from synergies between them, 'core investing activities' and 'investment related services' have different economic characteristics and risks. Thus, this example seems to suggest that **an entity should not treat all its rights over a subsidiary as a single unit of account (i.e. the unit of account is the combination of all the rights and obligations related to the subsidiary)**
Faithful representation	
To achieve a faithful representation it may be necessary to: ▪ treat the rights or obligations arising from different sources as a single unit of account or ▪ to separate the rights or obligations arising from a single source. Moreover, to provide a faithful representation of unrelated rights and obligations, it may be necessary to recognise and measure them separately.	While this guidance might not explicitly point in the direction that all rights and obligations of a subsidiary should be considered separately for presenting them in the consolidated financial statements, the guidance would not seem to require that the rights and obligations should all be bundled.
The cost constraint	
Costs of providing the information for that unit of account must not exceed the benefits. In general, the costs associated with recognising and measuring assets, liabilities, income and expenses increase as the size of the unit of account decreases.	Generally, the cost constraint would push towards considering the highest group level of rights – or big groups of physical objects as the unit of account. It would, however, not necessarily prohibit an entity to consider each component of the subsidiary that is capable of engaging different business activities as a different unit of account.
Transfer part of an asset	
If an entity transfers part of an asset or part of a liability, the unit of account may change at that time so that the transferred component and the retained component become separate units of account.	An investment entity may decide to sell part of its investment in a subsidiary. Still, the unit of account after the sale would depend on the unit of account chosen by the entity before the sale and the retained interest in the subsidiary.

39 Although one of the examples above would suggest that the **subsidiary should be considered as one unit of account**, the proposed guidance seems generally to suggest that groups of rights and obligations within a subsidiary can be considered the unit of account. This is not reflected in the December 2014 amendment, but is reflected in the normal consolidation guidance.