• EFRAG welcomes the project
• Dealing with areas that have proven problematic
• Consider an entity’s business model
• Limiting the scope to financial statements
• However:
  – Should have dealt with stewardship, reliability and prudence
  – Should have been more independent of current requirements
Section 1 - Introduction
Introduction

- EFRAG generally agrees with the Discussion Paper on the purpose and status of the Conceptual Framework
- However
  - Why should some parts be for the IASB’s use only?
  - Conflicts with existing standards should be identified
  - Guidance on how to use the Conceptual Framework when interpreting existing IFRS
Section 2 – Elements of financial statements
Elements of financial statements (1/2)

- Definitions of assets and liabilities seem easier to understand – but should be tested
- Income and expenses should be defined on the basis of changes in balance sheet items
- Would be useful to define contributions to equity, distributions of equity and transfers between classes of equity
• Consider what the statement of cash flows should communicate

• Should the definition of an economic resource be:

A right, or other source of value, that is capable of producing economic benefits to the entity?
Section 3 – Additional guidance to support the asset and liability definitions
Additional guidance to support the asset and liability definitions

- Liabilities should encompass both legal and constructive obligations
- Description of a constructive obligation is too narrow
- A present obligation must have arisen from past events and be practically unconditional
- Definition of control may result in changes
- Additional guidance on the role of economic compulsion when distinguishing equity and liabilities
Section 4 – Recognition and derecognition
Recognition and derecognition (1/3)

• Relevance and faithful representation should be considered

• Should there be a probability threshold?
  – Yes: Guidance is needed in the Conceptual Framework
  – No: Would reduce flexibility in standard setting / not possible to make a threshold that is suitable for all cases
Recognition and derecognition (2/3)

Does the asset or liability represent an outcome risk?

- No
- Yes

Can the various outcomes be determined reliably/verifiably?

- Yes
- No

**Recognise**
- Recognise when probability of inflow/outflow > 50 %
- Recognise liability unless outflow is remote
- Recognise asset when inflow is virtually certain
• EFRAG supports the proposals on derecognition

• However, guidance should be included on the difference between a modification of an asset or liability and derecognition of an asset or liability and recognition of another
Section 5 – Definition of equity and distinction between liabilities and equity instruments
Equity/Liability

• Splitting the Statement of Financial Position
• Distinguishing equity instruments
• The strict obligation approach in the Discussion Paper
• Secondary equity claims
• ‘Wealth transfers’
Splitting the statement of financial position

- For the Statement of Financial Position to balance at least one item can not be directly measured
- Under current IFRS owners are defined as holders of equity instruments
- Implications for payments (including distributions) to/from holders of residual instruments
Distinguishing equity - Proprietary and Entity perspectives

<table>
<thead>
<tr>
<th>Basic Ownership Instruments as equity</th>
<th>Equity defined based on the characteristics of instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td>+ Helps solve issues such as puttable shares</td>
<td>+ Instruments are classified consistently across entities</td>
</tr>
<tr>
<td>- Equity no longer a buffer against creditor losses</td>
<td>+ Consistent with an entity perspective in the rest of IFRS</td>
</tr>
<tr>
<td>- Could be a demand deposit</td>
<td>- What characteristic?</td>
</tr>
<tr>
<td>- Reduces comparability</td>
<td></td>
</tr>
<tr>
<td>- Instruments without obligation classified as liabilities</td>
<td></td>
</tr>
</tbody>
</table>
Strict obligation approach

- Basic approach is consistent with current IFRS
- Results in identification of two types of equity:
  - Primary equity claims (a residual)
  - Secondary equity claims (directly measured)
- Presentation of changes in measurement as ‘wealth transfers’ through an expanded Statement of Changes in Equity
Secondary equity claims

• Direct measurement of an equity claim is a new concept
• Difference to assets and liabilities:
  – Shows cash leverage
  – Avoids recognising an asset for the right to receive equity
Wealth transfers

- EFRAG disagrees with the ‘wealth transfer’ notion
  - Too complex
  - Can not appropriately depict potential dilution
- Does not help solve issues with puttable shares (including ‘NCI puts’)
- Includes enforceable rights and obligations arising from trading, borrowing and investing activities, remeasurement of which should be in the statement(s) of profit or loss and OCI
Section 6 – Measurement
• EFRAG supports the proposed objective of measurement and the supportive guidance
• When selecting a measurement basis both implications for statement of financial position and statement(s) of profit or loss and OCI should be considered
• The entity’s business model should be considered
• Measurement linked with presentation
• Not a separate goal to minimise the number of different measurement bases
• Reasonable to classify assets into: using, charging for rights to use, selling and holding. However the Conceptual Framework cannot be conclusive
• Not in favour of what-if and opportunity cost measures
• Lacks discussion of current value other than market value (i.e. entity specific value)
Section 7 – Presentation and disclosure
Presentation and disclosure

• Generally agrees with the proposals and the communication principles
• However, more guidance is needed on:
  – How to provide a structured way to review the need for disclosure
  – What types of risks an entity should provide information
  – Materiality
Section 8 – Presentation in the statement(s) of comprehensive income – profit or loss and OCI
Presentation in the statement(s) of comprehensive income

- Profit or loss should be presented as it is the primary measure of an entity’s performance
- The business model should play a role in what goes to profit or loss and OCI
- EFRAG supports that OCI should include bridging items, mismatched remeasurements and transitory remeasurements
- Recycling should take place unless it would not provide relevant information in profit or loss
Section 9 – Other issues
• Information to assess stewardship may conflict with information to assess the prospects for future net cash inflows
• The objective of assessing stewardship should be as important as assessing the prospects for future net cash inflows
Reliability

• No recognition if no measure of an asset (or liability) would be reliable / result in a faithful representation
• Replace faithful representation with reliability (reintroduction of the trade-off)
• Reliability should include verifiability
Prudence

• Should be reintroduced and explained
• Clearly reflected in Standards in force today and those being developed – inclusion in Conceptual Framework to enhance consistency
• Prudence represents a degree of caution that generally recognises downside risks and questions whether upside potential inherent in uncertain future events should be recognised
The use of the business model in financial reporting

- The business model notion should be part of the Conceptual Framework
- Guidance in the Conceptual Framework should help identify whether and when the business model notion should be explicitly incorporated at the level of individual standards
- A business model should be based on observable and verifiable evidence
- There is a distinction between business model and management intent
Unit of account

- EFRAG generally agrees with the proposals of the Discussion Paper
- However, the IASB should commit itself more explicitly to consider the unit of account in relation to each Standard
• Going concern assumption is relevant when:
  – Distinguishing between liabilities and equity
  – Measuring assets and liabilities
  – Preparing disclosures
• Relationship with ‘practically unconditional’ and ‘no realistic alternative’ should be explained
Capital maintenance

• Should be developed when the IASB considers how to account for inflation
Additional issues
Reporting entity

• Would have been beneficial to debate the perspective from which financial statements are presented
• IASB should examine whether the application of a joint control approach for determining the boundaries of a group reporting entity provides decision-useful information
• Consider issues in relation to Conceptual Framework, interim reporting or another project:
  – Interim reporting may affect impairment losses reported in the annual report
  – Levies and other liabilities that relate to the entire year but only become unconditional at a specific date affect interim reporting unevenly
Thank you for your attention!

And now…
Questions?…and answers!

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