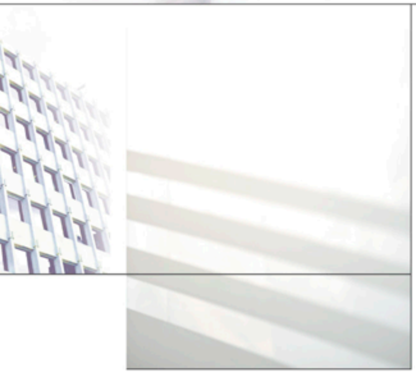

European Financial Reporting Advisory Group

A Review of the Conceptual Framework for Financial Reporting

General (1/2)

- EFRAG welcomes the project
- Dealing with areas that have proven problematic
- Consider an entity’s business model
- Limiting the scope to financial statements

General (2/2)

- 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

Elements of financial statements (2/2)

- 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

Recognise

Can the various outcomes be determined reliably/verifiably?

Yes

No

Recognise when probability of inflow/outflow > 50 %

Recognise liability unless outflow is remote
Recognise asset when inflow is virtually certain

Recognition and derecognition (3/3)

- 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

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

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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

Measurement (1/2)

- 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 (2/2)

- 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

Stewardship

- 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

- 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

Reporting period

- 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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