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Berlin, 24 November 2015

Dear Roger,

EFRAG Bulletin Getting a Better Framework – *Profit or Loss versus OCI*

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the EFRAG Discussion Paper EFRAG Bulletin Getting a Better Framework – *Profit or Loss versus OCI* (herein referred to as 'bulletin').

We concur with EFRAG's view that robust guidance about the distinction between profit or loss and OCI is necessary. Since the IASB did not make the expected progress in defining tangible indicators for using OCI, we welcome EFRAG's effort as a means of contributing to this debate. Nonetheless, we are not convinced by the bulletin's main proposal that a set of four identified business models should be used as a basis for deciding upon whether or not to use OCI. Especially, we are not convinced by the conclusion that the type of business model was the sole factor upon which the measurement of elements and the recognition of income and expense in OCI for specific transactions or events should be based. We think that the nature of the business activities is but one factor amongst other criteria that have to be taken into account. In addition, we do not concur with the view that the statement of profit or loss should have a primary role for selecting the relevant measurement basis.

For further details of our view we refer to our response to the bulletin questions in the appendix of this letter. If you would like to discuss our comments further, please do not hesitate to contact Holger Obst, Thomas Schmotz or me.

Yours sincerely,

Andreas Barckow
President

Appendix – Answers to the bulletin questions

Question 1 Different measurement bases
Do you agree that different measurement bases may be needed to provide relevant information in both the statement of financial position and in the statement of profit or loss? Do you agree that the first step in the process should be to identify the most relevant measurement basis for the statement of profit or loss? Do you agree that the choice of both measurement bases be driven by the business model?

More than one measurement basis

Generally, we are of the view that different measurement bases are needed to account for different types of transactions or other events. However, we are of a different view as to whether more than one measurement basis should be used to account for a specific transaction or event in both, the statement of financial position and in the statement of profit or loss. In our view, using more than one measurement basis for a specific transaction or event in the statement of financial position and the statement(s) of financial performance should be considered an exception if income or expense would not reflect the entity's performance of the period. To evaluate whether specific changes in assets or liabilities do not reflect performance of the period, the nature of the business transaction could have a role to play.

In addition, we do not agree with the proposal that the statement of profit or loss should be considered as the starting point for selecting the measurement basis. By definition, the measurement of assets and liabilities and the recognition of income and expense should go hand in hand. We do not believe that information about the entity's financial position is less relevant than information about the entity's financial performance that could justify such a stepped process, i.e. making the selection of the measurement basis for the statement of profit or loss as the first step.

Selection of measurement basis based on the business model

As acknowledged in our previous comment letter on EFRAG's research paper *about The Role of the Business Model in Financial Statements*[1], we believe that financial statements can be made more relevant if standard setters take into account how entities conduct their business activities when developing or revising standards. However, we do not support the bulletin's proposal that the 'business model' should be the sole driver for selecting the measurement basis and decisions whether more than one measurement basis is appropriate to account for specific transaction or event. We believe that other factors, for example the entity's risk profile, the nature of the asset

[1] www.drsc.de/service/docs/index.php?ixdox_do=show_docs&type_id=2&cat_id=57&base_doc_id=1714

etc, should not be neglected. We see our view confirmed by the Summary Report of the Joint Outreach Investor Event – *Could profit or loss (P&L) become more useful* that was published by EFRAG in July of this year.

Furthermore, we think that the business models as described in the bulletin lack robust definitions and further descriptions. For example, the notion of the 'same market' used in the description of the price change business models is not clear to us. We also consider that these business models would not be easy to identify in practice, because an entity may take a strategy that could reflect a combination of two or more business models described in the bulletin. Especially when transaction costs are low and the assets are highly fungible, it would be difficult to identify one business model.

Finally, EFRAG acknowledges in the bulletin that the business model would not provide the answer for all measurement questions. For example, in paragraph 23(b) of the bulletin EFRAG states that for transformation business models a standards-level decision as to whether finished goods available for sale should be measured at current value would still be needed. Thus, key questions regarding the selection of a measurement basis and recognition of corresponding income in the statement of profit or loss would not be answered. Similarly, the rather descriptive business model approach does not seem to deliver answers on the important question about accounting for changes in interest rates.

Question 2 Considering the business model

Do you agree with the descriptions of the various business models? Do you agree with the suggestions in the paper in how they would be portrayed in the profit or loss and financial position of entities? Are there other business models that it would be necessary to identify for financial reporting perspectives? If so what are they? What measurement bases would they require and why?

We refer to our response on question 1. In our view, the descriptions of the various business models are not clear and without further descriptions the identification of a business model does not appear feasible. We would also like to note that, in our view, granting defined pension benefits as part of employees' compensation packages should not be considered as a 'business model' of the entity.

We prefer not to respond to the subset of questions regarding other, additional business models that would be necessary to identify for financial reporting perspectives, which is owing to our objection to the identification of the business model as the sole driver for selecting the measurement basis.

Question 3 OCI items
What are your views on the proposal to include differences resulting from applying different measurement bases and incomplete transactions in OCI?

We think that the description of the proposals reflect the cases where OCI is used in current IFRSs and what was described as potential components of OCI in the IASB's Discussion Paper *A Review of the Conceptual Framework for Financial Reporting,* i.e. the use of OCI in cases of mismatched remeasurements, bridging items and transitory remeasurements. Generally, we agree that those components would be typical candidates of income and expense that do not reflect the performance of the period.

Question 4 Recycling
What are your views on the proposal to recycle amounts included in OCI as a result of applying different measurement bases under long-term investment business models?

We agree with this proposal. Generally, all income and expenses that are recognised in OCI should be recycled through profit or loss when presenting the performance of the period. Omission from recycling should be considered an exception only and should be based on cost constraints that could be identified at a standards-level. Alternatively, recycling could be made mandatory in all cases provided practical simplifications were in place. However, with respect to the wording of question 4, we want to highlight that recycling may apply to liability-driven business models as well, as described on page 11 of the bulletin.

Question 5 Current value measurements in the statement of financial position
For the purpose of the statement of the financial position (not the statement of profit or loss), would you be in favour of greater use of current value measurements than required today? What are the reasons for your views?

We observed that the bulletin primarily focuses on the question whether income and expenses from using a certain measurement basis should be recorded in the statement of profit or loss or OCI. In our view, EFRAG also needs to demonstrate how the business model relates to the selection of a measurement basis in the statement of financial position, as this question is not addressed in the bulletin. As long as the relevant measurement basis for the statement of financial position remains undefined, we are not in the position to definitely answer question 5. However, we think that, based on a principle that involves the business model amongst other notions, a greater use of current value measurements might appear relevant in certain circumstances.

Question 6 Changes in interest rates

Do you think the discount rate should be updated, and if so, should the effect of the changes be included in OCI or in profit or loss? What are the reasons for your views?

Conceptually speaking, it seems to be generally accepted to consider updating all observable market parameters when measuring items at fair value, and changes in interest rates are one of these observable market parameters. That being said, we are not aware of any theoretical basis for answering the question whether changes in such parameters should be deemed income or expense and, as such, relevant drivers of financial performance, and to what extent. The problem is even bigger when assets or liabilities are measured at cost. Equally, we are not aware of any theoretical basis for determining what parameters, other than time value of money, comprise the discount rate at initial recognition. We refer to the recent discussions at ASAF in this regard. Therefore, the question raised above cannot be answered.