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Discussion Paper DP/2013/1 A Review of the Conceptual Framework for Financial Reporting

Grant Thornton International Ltd is pleased to comment on the International Accounting Standards Board's (the Board) Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the DP).

Our main comments are summarised below. Our responses to the questions in the DP's Invitation to Comment are set out in the Appendix.

General comments

We welcome the Board's decision to restart the Conceptual Framework project and to prioritise its completion. We believe that a more complete and up-to-date Framework is an important resource that will contribute significantly to the future development of high quality standards.

Although we support the prioritisation of the Framework, we would also caution that this project cannot and should not aim to address all the many difficult and sometimes controversial issues that arise in developing standards. Setting standards requires judgement and, quite properly, involves pragmatism as well as conceptual analysis.

We welcome the fact that the DP is quite comprehensive. Given the interdependencies of the various concepts it is helpful to be able to assess them collectively. We have however noted some additional matters we believe should be considered, and some areas that we consider need to be assessed in more depth. We recognise that this will take more time but would caution against setting too aggressive a timetable at the expense of a thorough exploration of the issues.

We also believe that the Framework should be a living document - in other words it should be updated and improved on a reasonably regular basis as the Board's latest thinking develops in standards-level projects.

Specific topics

Stewardship (accountability)

We continue to believe that stewardship (or accountability) should be a primary objective of financial reporting and not a by-product of a future net cash flow assessment objective. In our view Chapter 1 of the existing, revised Framework (OB2–OB4) gives insufficient prominence to the role of stewardship (or accountability) and should be reconsidered.

We acknowledge that information that is useful for assessing future cash flow prospects will usually also be useful for stewardship decisions. However, we believe that a specific focus on stewardship would have some effect on the Board's future standard-setting decisions – for example in the selection of measurement bases, and the principles for presenting different components of financial performance. We therefore believe that stewardship should be reinstated as an objective of financial reporting, even if the substantive differences between the set of information useful for assessing future cash flow prospects and for stewardship decisions are limited and/or are difficult to pinpoint.

Prudence

We are pleased that the DP includes some discussion of prudence (in paragraphs 9.15–9.22). We recognise that this has become a contentious issue and also some of the challenges and tensions of reintroducing prudence as a concept.

We agree with the description of prudence in the pre-2010 version of the Framework but note that the exercise of caution in making judgements in conditions of uncertainty is more a matter for preparers than for the standard-setter. Accordingly, the Framework is probably not the most appropriate location for a statement along those lines.

We note nonetheless that IFRSs include numerous examples of prudence in practice – both in existing standards and in new standards under development. Examples of the former include different recognition and disclosure thresholds for assets and liabilities (in IAS 37 *Provisions, Contingent Assets and Liabilities*), stricter criteria for recognising deferred tax assets than for liabilities and stricter criteria for internally-generated intangible assets than for externally purchased intangible assets. Examples of the use of prudence in standards under development include the proposed constraints on the recognition of revenue for variable consideration in the forthcoming revenue recognition standard and on profit recognition by lessors in the in the May 2013 ED *Leases*.

Given that prudence is a feature of both existing and forthcoming standards, we believe its role should be acknowledged in the Framework. Further work should be undertaken to assess the appropriate role of prudence in developing future standards, including the interaction with the neutrality characteristic.

Reliable measurement

In our responses to the Discussion Paper and Exposure Draft that preceded the publication of Chapters 1 and 3 of the existing Framework we agreed with the Board's decision to replace "reliability" with "representationally faithful" in the qualitative characteristics of useful financial information. We continue to support that decision but we also believe that reliability of measurement (by which we mean the range of uncertainty in the estimate) should have a substantive role in developing future standards.

We also note that reliability of measurement features in the Board's more recent thinking as well as in older standards (eg the constraint referred to above in the forthcoming revenue recognition standard and the proposals for variable lease payments in the *Leases* ED).

The DP and Chapter 3 of the existing Framework address reliability of measurement in the context of relevance (QC16 of the existing Framework and paragraphs 4.9(a) and 4.26(a) of the DP). We agree with this characterisation but we think both Chapter 3 and the DP understate its significance. For example, paragraph 4.26(a) refers to the range of possible outcomes being "extremely wide" and the likelihood of each outcome being "exceptionally difficult to estimate".

In addition, requiring the recognition of items (or use of measurement bases) with a high degree of estimation uncertainty will typically add costs and complexity for preparers, and result in information that is challenging to audit. Experience also suggests that recognition of items with high estimation uncertainty leads to additional disclosures – and thereby contributes to the perceived disclosure problem.

For these reasons we consider that the reliability of measurement should be given a more prominent role in the context of recognition, and also the selection of measurement bases.

Finally, we note that the reliable measurement interacts with the concept of prudence.

Business model

We welcome, and broadly agree with, the DP's discussion of how business model concepts are used in existing IFRSs. However, in our view the main relevance of an entity's business model is that it drives the transactions the entity enters into – which in turn determine the content of the financial statements. We believe this is, and should continue to be, the main way in which the financial statements reflect an entity's business model.

We think some caution is needed in considering whether the business model should have a different or broader role. We believe many of the calls for greater use of business model-type concepts are in fact demands for increased flexibility (less prescription) in certain standards and/or expressions of disagreement with certain requirements.

Asset and liability versus income and expense approach

We understand the reasons why income and expenses are defined by reference to assets and liabilities, and also why the Board generally favours this so-called asset and liability approach. However, we note that some standards are wholly or partly "income- and expense-driven" (revenue recognition being an obvious example, even if the new standard is described more in asset and liability terms). When these standards are applied, assets and liabilities (or at least debits and credits in the statement of financial position) might then be recognised by reference to income or expenses.

We think it is appropriate to sometimes focus more directly on the income statement effects and suggest that a revised Framework should at least acknowledge the role of income-and expense-driven requirements in the recognition of assets and liabilities.

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If you have any questions on our response, or wish us to amplify our comments, please contact our Global Head – IFRS, Andrew Watchman (andrew.watchman@gti.gt.com or telephone + 44 207 391 9510).

Yours sincerely,

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Responses to invitation to comment questions

Question 1

Paragraphs 1.25–1.33 set out the proposed purpose and status of the *Conceptual Framework*. The IASB's preliminary views are that:

(a) the primary purpose of the revised *Conceptual Framework* is to assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs; and

(b) in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the *Conceptual Framework*. If this happens the IASB would describe the departure from the *Conceptual Framework*, and the reasons for that departure, in the Basis for Conclusions on that Standard.

Do you agree with these preliminary views? Why or why not?

We agree with the proposed primary purpose of the Conceptual Framework. However, the role of the Framework as a reference point for preparers and auditors in developing accounting policies in the absence of specific guidance in IFRSs is also important in a principle-based system and should be given due prominence as the project progresses.

We also agree that the IASB should retain some flexibility to diverge from the Framework in particular circumstances. This is because, in addition to the reasons provided in paragraph 1.31:

- preparing financial statements that are conceptually pure, even if possible in theory, would most likely be prohibitively expensive and complex in practice
- in developing standards, the Board does and should continue to take into consideration practical matters that are not necessarily conceptual (although might also be addressed as cost-benefit trade-offs). These include the acceptability of proposed changes to constituents and existence of well-established practices and conventions that are generally considered to result in useful information.

The number of instances of divergence will also depend on the level of detail and prescription in the updated Framework. We believe the DP is unduly prescriptive in some areas and that this is likely to lead to exceptions and conflicts in the development of future Standards. One example of this is the draft guidance on the distinction between equity instruments and liabilities (Chapter 5).

On a point of detail, we note that the DP proposes that the Framework's guidance on the presentation of items of income or expense in Other Comprehensive Income (OCI) can be used only by the IASB. It is not clear to us that this restriction is necessary given that the use of OCI is prescribed and limited by specific requirements in IFRSs.

Question 2

The definitions of an asset and a liability are discussed in paragraphs 2.6–2.16. The IASB proposes the following definitions:

(a) an asset is a present economic resource controlled by the entity as a result of past events.

(b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.

(c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.

Do you agree with these definitions? Why or why not? If you do not agree, what changes do you suggest, and why?

We do not object to the proposed definitions but note that their practical effects can be assessed only in conjunction with other aspects of the Framework – in particular the proposed recognition criteria.

We tentatively agree that the probability of an inflow or outflow of benefits is not necessary in the definitions themselves. Removing the reference to probability should also help to reduce certain anomalies whereby, in accordance with current requirements, the existence of assets or liabilities can depend on whether the unit of account is a single item or a group of items. However, we believe that this change may place more stress on the role of control over the resource, especially in the context of intangible sources of value such as customer relationships and an assembled workforce.

We also suggest the Board should consider whether the definition of an asset should include an "identifiability" condition (or similar). The current definition of intangible assets in IAS 38 includes identifiability. The DP's proposed asset definition is broader than the existing definition and could therefore capture more resources or sources of value that cannot meaningfully be distinguished from goodwill (eg market share or reputation). We also note the DP effectively argues that all assets are intangible (paragraph 3.7).

Income and expense-driven requirements

We understand the reasons why income and expenses are defined by reference to assets and liabilities, and also why the Board broadly favours this so-called asset and liability approach. However, some standards seem to be wholly or partly "income- and expense-driven" in substance – in other words, those standards are intended primarily to an appropriate amount of income or expense recognised. When such standards are applied, assets and liabilities (or at least debits and credits in the statement of financial position) might then be recognised by reference to income or expenses. Examples of these standards include IFRS 2 *Share-based Payments*, IAS 12 *Income Taxes*, IAS 19 *Employee Benefits* and aspects of the forthcoming revenue recognition standard.

We note that income- or expense-driven requirements are sometimes described in asset or liability terms – which can appear somewhat forced. We would cite the concept of performance obligations satisfied over time in the forthcoming revenue recognition standard as an example of this.

We suggest that a revised Framework should at least acknowledge the role of income- and expense-driven requirements in the recognition of assets and liabilities.

Unit of account

As noted above, we believe that the revised definitions of asset and liability could help to address some anomalies related to the unit of account. However, we think that the unit of account remains a pervasive matter that can affect whether an asset or liability exists as well as recognition and measurement. We suggest that the discussion of unit of account in paragraphs 9.35–9.41 is inadequate to be useful to the Board in setting future standards.

With respect to the proposed definition of "economic resource", we suggest it would be helpful to add wording along the lines "either individually or in combination with other resources controlled by the entity". This is in order to clarify that the capability of producing economic benefits is not necessarily limited to the individual resource.

Question 3

Whether uncertainty should play any role in the definitions of an asset and a liability, and in the recognition criteria for assets and liabilities, is discussed in paragraphs 2.17–2.36. The IASB's preliminary views are that:

(a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is 'expected'. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources.

(b) the Conceptual Framework should not set a probability threshold for the rare cases in which it is uncertain whether an asset or a liability exists. If there could be significant uncertainty about whether a particular type of asset or liability exists, the IASB would decide how to deal with that uncertainty when it develops or revises a Standard on that type of asset or liability.

(c) the recognition criteria should not retain the existing reference to probability.

Do you agree? Why or why not? If you do not agree, what do you suggest, and why?

We have commented on the proposed asset and liability definitions in our response to Question 2.

We comment on the proposed recognition criteria in our response to Question 8.

We agree that the Framework need not include detailed guidance on, or set a threshold for, cases in which it is uncertain whether an asset or a liability exists. We agree that this is a matter that can be dealt with in standards-level projects. However, we disagree with the assertion that existence uncertainty is rare. On the contrary, given that the proposed new asset and liability definitions will capture a larger population of potential assets and liabilities than the existing definitions, we think that existence uncertainty will be quite commonplace. For example, there will often be some doubt as to whether an entity has "control" over a resource. In the context of liabilities, existence uncertainty is a feature of litigation and of constructive-type obligations.

Question 4

Elements for the statement(s) of profit or loss and OCI (income and expense), statement of cash flows (cash receipts and cash payments) and statement of changes in equity (contributions to equity, distributions of equity and transfers between classes of equity) are briefly discussed in paragraphs 2.37–2.52.

Do you have any comments on these items? Would it be helpful for the Conceptual Framework to identify them as elements of financial statements?

We agree with the discussion in paragraphs 2.37–2.52.

Question 5

Constructive obligations are discussed in paragraphs 3.39–3.62. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations—and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50.

Do you agree with this preliminary view? Why or why not?

We broadly agree that obligations can be constructive as well as legal. We therefore support the direction of the discussion in paragraphs 3.39–3.62. We do not support restricting obligations to those that are enforceable by legal or equivalent means, for the reasons stated in our response to Question 6.

We are not convinced that the Framework is the appropriate vehicle for developing detailed guidance on the nature of constructive obligations. In our view this is a matter for standards-level guidance. We believe instead that the focus of the conceptual discussion should be on the avoidability or otherwise of an outflow of economic resources, which is the subject matter of Question 6.

Question 6

The meaning of 'present' in the definition of a liability is discussed in paragraphs 3.63–3.97. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains conditional on the entity's future actions. Three different views on which the IASB could develop guidance for the Conceptual Framework are put forward:

(a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions.

(b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions.

(c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity's future actions.

The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favour of View 2 or View 3.

Which of these views (or any other view on when a present obligation comes into existence) do you support? Please give reasons.

We support an approach similar to view 2 ("a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions").

We do not favour limiting the definition to legally enforceable obligations. This is because:

- the enforceability of some promises made by an entity is uncertain in the absence of relevant legal precedent from past enforcement actions or equivalent evidence
- in our view the guidance approach in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* generally works well in practice and provides useful information
- we think limiting the definition to legally enforceable obligations would be insufficiently prudent and would be more restrictive than existing requirements that work well in practice.

We do suggest that this discussion could be clarified by referring to "avoidability" instead of conditionality. In our view, a liability exists if a past event has occurred and the entity cannot avoid an outflow of resources, or can avoid an outflow only through another course of action that would have consequences more adverse than the outflow itself.

This view does place considerable emphasis on the occurrence of a "past event" and more guidance might therefore be needed in this area (although not necessarily in the Framework itself). The discussion in paragraphs 3.50–3.52, to the effect that an obligation must involve a duty or responsibility to other parties, could form part of enhanced guidance in this area. We also agree that a past event could include undertaking an activity, or receiving benefits, that will lead to or increase an outflow of resources that is practically unavoidable (in the terms discussed above). It is however important to include guidance either in the Framework or at standards-level that helps to distinguish obligations from risks and future operating costs (or losses).

We note that Chapter 3 of the DP includes examples of the implications of the three views on some potential obligations for employee benefits and government levies. We believe that an income- and expense-based approach could result in more useful information in these situations (and possibly others).

Finally, we note that existing Standards seem to take a different approach to constructive obligations in the context of financial liabilities. We do not necessarily disagree with this but suggest that a revised Framework should acknowledge and explain the reasons for this.

Question 7

Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

We have commented in our previous responses on various matters that we believe need more consideration, including:

- unit of account
- assessing control, especially in the context of intangible sources of value that would appear to meet the proposed asset definition
- the interaction between income and expense-driven requirements in standards and the recognition of assets and liabilities.

Paragraphs 3.109–112 of the DP set out a brief discussion of executory contracts. This is a critical issue and is particularly relevant to both the revenue recognition and leases projects. The discussion broadly suggests that:

- executory contracts that are enforceable give rise to assets and liabilities

- the purchaser might obtain a single net asset or liability (that is often measured at zero), or a gross asset and a gross liability (that might or might not be offset), depending on the circumstances.

We welcome the acknowledgement of the need to enhance the conceptual analysis of executory contracts but find this discussion rather vague and inconclusive given the importance and topicality of the issue. In particular we suggest that more work is needed to clarify the circumstances in which the net or the gross approach would apply. Related to this, under the gross approach the following issues merit consideration:

- classification of the assets (eg as intangible rights or based on the underlying asset) and liabilities (eg as borrowings or trade creditors) on the statement of financial position
- whether the assets and liabilities would be measured and presented gross or net (noting the different approaches taken in the leasing and revenue recognition projects)
- timing and manner of recognition in profit and loss (including whether interest income and expenses would arise).

Question 8

Paragraphs 4.1–4.27 discuss recognition criteria. In the IASB's preliminary view, an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability because:

(a) recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or

(b) no measure of the asset (or the liability) would result in a faithful representation of both the asset (or the liability) and the changes in the asset (or the liability), even if all necessary descriptions and explanations are disclosed.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

We have some concerns with these proposals. In summary:

- we are not convinced that the proposed recognition criteria are sufficiently objective or substantive to be a useful tool to the Board
- we believe that the role of prudence in the recognition of assets and liabilities should be reconsidered.

The consequence of the proposed recognition criteria would be that the Board makes a case-by-case judgement as to relevance, or sufficient relevance to justify the cost. We acknowledge that the proposed recognition criteria also include "faithful representation". However, the definition of faithful representation in the published Framework (QC12–QC16) seems almost self-fulfilling and so broad that it is difficult to envisage how this criterion would help to determine recognition in practice.

As noted in our response to Question 2, we tentatively agree that probability of an inflow or outflow of benefits should not be part of the revised asset and liability definitions. However, we believe that uncertainty does have a role to play in recognition. The role of uncertainty is acknowledged to some extent in the discussion of potential guidance on relevance (paragraph 4.26(a)). However, this discussion sets the bar high. By contrast many existing standards make less restrictive references to reliable measurement in the context of recognition.

We believe that the role of uncertainty also interacts with the prudence concept. For example, it is held to be extremely rare that a provision cannot be measured reliably in accordance with IAS 37. However, for internally generated intangible assets the onus is placed on the preparer to demonstrate that cost can be measured reliably.

We believe that prudence also has another role to play in recognition in the face of uncertainty, although perhaps indirectly. In the case of assets, it might uncertain whether an entity has "control" over the resource in question. In our view, if it is insufficiently clear that an entity has control then the presumption should generally be that it does not. This is broadly the approach taken in IFRS 10 *Consolidated Financial Statements*. By contrast, uncertainty as to whether an entity has a present obligation might be dealt with using a different and possibly lower threshold.

Question 9

In the IASB's preliminary view, as set out in paragraphs 4.28–4.51, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria. (This is the control approach described in paragraph 4.36(a)). However, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. Possible approaches include:

(a) enhanced disclosure;

(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or

(c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

The proposed approach is to derecognise an asset or a liability when it no longer exists, meets the applicable definitions of those terms or no longer meets the recognition criteria. We think this is the right starting point: ideally, derecognition requirements should not result in continued recognition of assets and liabilities that do not meet the applicable definitions or recognition requirements. However, we suggest the DP's analysis and proposals are rather too simplistic to be useful in addressing more complex and problematic derecognition issues.

The DP acknowledges:

- that complexities arise when the entity retains a component of the rights and obligations of the asset or liability (paragraph 4.50)
- the interaction between the applicability of full versus partial derecognition and the unit of account (paragraph 4.51).

We agree that these are matters to be addressed in standards-level projects. We suggest however that a more thorough analysis of the unit of account issues would help to inform future decisions in those projects.

In practice the derecognition requirements in existing standards seem intended to deal not only with whether the asset or liability in question should remain on the balance sheet but also with the income statement and liability consequences of derecognition. In particular:

- whether or when a related gain or loss on derecognition should be recognised; and
- in the case of asset transfers, whether a liability should be recognised in respect of proceeds received.

Further examples of the interaction of derecognition and income statement consequences include:

- the derecognition of inventories (and some other nonfinancial assets) is dealt with in accordance with the revenue recognition requirements – both currently and in accordance with the forthcoming standard
- current leasing standards require a finance lessor to derecognise the underlying asset and recognise a different asset but measure that new asset such that no initial gain or loss arises. The latest leasing proposals would also constrain a lessor's profit on entering into a "Type A" lease.

The consequences of derecognition also depend on the presentation and measurement requirements for any new assets or liabilities that arise, or are deemed to arise, in a transfer. For example, if a financial asset is sold subject to a repurchase agreement the balance sheet impact of derecognition differs depending on whether the rights and obligations in the repurchase agreement are presented net (as a derivative, consistent with current requirements) or gross.

We think these consequences and interactions are legitimate considerations that should be acknowledged in the Framework. Put another way, an approach that focuses solely on the asset or liability in question may not provide the most useful information.

We suggest that the updated Framework should also consider the interaction between modifications of assets and liabilities and derecognition (ie when is a modification or exchange of assets or liabilities considered to result in a new asset or liability?). Existing financial instruments standards include somewhat rules-based requirements in this area for financial liabilities, and lack guidance for financial assets (an issue that has created some difficulties in relation to recent sovereign debt restructuring and also has broader relevance). This issue also relates to unit of account concepts.

Finally, we note this is an area in which existing requirements seem to reflect a degree of prudence. Our general comments about the future role of a prudence concept therefore apply.

Question 10

The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1–5.59. In the IASB's preliminary view:

(a) the *Conceptual Framework* should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

(b) the *Conceptual Framework* should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:

(i) obligations to issue equity instruments are not liabilities; and

(ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a)).

(c) an entity should:

(i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure, or an allocation of total equity.

(ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.

(d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

General comments

We would characterise the objectives of the DP's proposals as:

- simplifying the existing debt-equity model in IAS 32 *Financial Instruments: Presentation* and making it more principle-based
- enhancing the information provided about different classes of equity claim.

Although these are worthwhile objectives, we think that the DP's proposals are too detailed and too definitive given the complexity of the underlying issues. We doubt that a fast-track Framework project is the best vehicle for specifying detailed changes to the existing requirements.

Should equity be distinguished from liabilities?

Distinguishing debt and equity is inevitably somewhat reductionist: wherever the line is drawn some instruments classified as liabilities will have equity-like characteristics (eg obligations to pay a percentage of profits and obligations to acquire own equity instruments at fair value) and some classified as equity will have debt-like characteristics (eg obligations settled in shares equal to a specified value, which would be equity under the DP's proposals). The existing model in IAS 32 leads to binary outcomes with instruments classified as liabilities being measured at amortised cost (or fair value) through profit or loss and equity not re-measured at all. This or any other binary model will lead to outcomes that seem counter-intuitive or unhelpful for particular instruments and types of entities; this has been the main driver of the exceptions in IAS 32 referred to in the DP.

We note that a proposal to remove the distinction altogether (the claims approach) has been considered previously. We see some merits in a claims approach but agree on balance that a distinction between equity and liabilities should be retained. To some extent, this is simply a consequence of defining liabilities in a way that excludes certain claims against an entity. Moreover, at least one item on the statement of financial position cannot be directly measured, but is instead the residual (balancing figure) of all other items. A claims approach would require some measurement basis to be specified for these true residuals.

We also believe that 'equity' should serve as a form of record of amounts invested by an identified class of owners, or returned to them. This record of investment is very relevant from a stewardship perspective. This view of equity also argues strongly against re-measurement.

How should a distinction be made?

The discussion in Chapter 5 acknowledges the challenges of distinguishing liabilities from equity instruments and the concerns raised with existing requirements. It is particularly challenging to design an approach to the debt-equity distinction which is principle-based, not unduly complex to interpret or apply and results in intuitive, decision-useful outcomes for all types of entities and instruments. This is perhaps an inherent challenge or limitation of a single model that applies globally and to all types of entities. We note that several alternatives to the existing equity as a residual approach (eg basic ownership, claims and loss absorption) have been explored by the IASB, FASB and others. Each has its advantages, but also its drawbacks, and none has gained broad acceptance.

Given that no alternative general model is clearly superior to the equity as a residual model, we support the DP's proposal to retain that broad model. The challenge is then how to implement the model. The DP proposes a strict liability approach, possibly in combination with a "most subordinated class of instruments" exception for entities with no equity. This is not dissimilar to IAS 32 apart from the treatment of obligations that are settled by issuing own shares.

While simplification of IAS 32 is a desirable outcome, we think that more work is needed to demonstrate that a strict liability approach will result in more useful information. Further, while we agree that IAS 32 is complex in some areas, we observe that much of the complexity stems from the need to define a liability with sufficient precision to be operational when applied to complex instruments. This need will still exist under a strict liability approach. Issues to consider or reconsider in defining a liability (at standards-level) include:

- the role (or otherwise) of constructive obligation concepts in identifying financial or contractual liabilities
- contingent settlements
- settlement alternatives
- contractual obligations conditional on distributable profits
- the role of statutory and other requirements (eg minimum dividend laws) that may impose obligations but lie outside the contract boundary.

We see some advantages in treating all obligations that are settled by issuing own shares as equity; these include a clearer focus on liquidity, more consistency with share-based payments and elimination of IAS 32's fixed-for-fixed rule. However, this would be a major change to current practice and we think that further analysis is needed. We believe it would be helpful to explore whether a distinction should be made between the substance of the obligation and the mechanics of settling the obligation. An obligation to issue shares to a specified value can be argued to be a financial liability in substance. Arguments can also be made for treating all instruments that meet the definition of derivatives in the same way. We think the treatment of such instruments should be addressed at standards-level.

Consistent with our comments in many other areas of the DP, we do not think it is possible to determine an optimal debt-equity model without considering the consequences of that model. Those consequences depend not only on where the line is drawn but also on the presentation and measurement requirements that apply to instruments on either side of the line. For example, classifying an obligation to purchase non-controlling interests at fair value as a liability provides useful information on an entity's financial position but, some would argue, creates counter-intuitive and unhelpful information in the income statement. If this argument is accepted then a presentational solution should be explored. A holistic approach is needed.

Enhancing the statement of changes in equity

We support the underlying objective of measuring each class of equity claim and updating those measures in the statement of changes in equity as a wealth transfer between classes. This proposal acknowledges that different types of equity claim have quite different characteristics and that the claims of one class are affected by the claims of others. Enhancing the statement of changes in equity is one potential means of addressing this information deficit.

However, preparing the proposed statement could be complex. It is also difficult to assess with confidence how useful it would be to users in practice. Any ultimate requirement needs careful design and should be subject to detailed field-testing and consideration of costs and benefits.

These matters are too detailed for the Framework project. We recommend instead that an updated Framework is limited to clarifying the underlying objectives of enhancing information about different classes of equity claims. A separate research or discussion paper would be a more feasible next step.

Question 11

How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6–6.35. The IASB's preliminary views are that:

(a) the objective of measurement is to contribute to the faithful representation of relevant information about:

(i) the resources of the entity, claims against the entity and changes in resources and claims; and

(ii) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.

(b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;

(c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI;

(d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:

(i) for a particular asset should depend on how that asset contributes to future cash flows; and

(ii) for a particular liability should depend on how the entity will settle or fulfil that liability.

(e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained; and

(f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.

Do you agree with these preliminary views? Why or why not? If you disagree, what alternative approach to deciding how to measure an asset or a liability would you

We largely agree with these preliminary views, subject to some reservations and detailed comments discussed below. We consider the analysis in Section 6 to be a good start, but in need of further development.

In particular, we agree that:

- a single measurement basis for all assets and liabilities may not provide the most relevant information
- in selecting a measurement basis the effects on both the balance sheet and reported performance should be considered (indeed we believe the effects on profit or loss and, if applicable, OCI should generally be given a higher priority)
- the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.

We also agree that the way in which an asset or a liability contributes to future cash flows should be considered in selecting a measurement basis. However, the statement in paragraph 6.73 that the measurement basis should depend on how the asset will contribute to cash flows is in our view too definitive and is too simplistic. This statement also focuses on cash flows to the possible exclusion of the second component of the proposed objective of measurement ("how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources").

It is also unclear how this exclusive focus on cash flow generation interacts with considering the effects on profit or loss and OCI. On a related point, we note that Section 6 of the DP discusses only asset and liability measurement. Consistent with our comments elsewhere in this letter, we believe that the primary focus should be on measurement of income and expense for certain categories of transaction.

We also have a concern about stating a standalone objective for measurement (or indeed for presentation and disclosure or any other Framework sub-topic). We suggest instead that the Framework should state how measurement and other sub-topics contribute to the overall objective of financial reporting.

As a practical matter we agree that a proliferation of measurement bases is undesirable. However, the statement "the number of different measurements used should be the smallest number necessary to provide relevant information" is perhaps too stark. Achieving a small number of measurement bases is not a goal in itself. Also, in accordance with existing IFRSs many assets and liabilities are measured using a blend of different attributes such that the overall measurement does not fit neatly into one of the three categories. Other measurements (such as equity accounting and deferred tax) are also difficult to classify within these broad headings.

In selecting measurement bases, the Board should also be mindful of the implications for disclosure. We observe that the greater use of measurements with a high degree of estimation uncertainty (an obvious example being level 3 fair values) has been a significant driver of disclosure volumes.

Question 12

The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73–6.96. The IASB's preliminary views are that:

(a) if assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost-based measurements normally provide information that is more relevant and understandable than current market prices.

(b) if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.

(c) if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.

(d) if an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

As noted in our response to Question 11, we believe the way in which an asset contributes to cash flows is an important consideration in selecting a measurement basis, but not the only one.

Question 13

The implications of the IASB's preliminary views for the subsequent measurement of liabilities are discussed in paragraphs 6.97–6.109. The IASB's preliminary views are that:

(a) cash-flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.

(b) a cost-based measurement will normally provide the most relevant information about:

(i) liabilities that will be settled according to their terms; and

(ii) contractual obligations for services (performance obligations).

(c) current market prices are likely to provide the most relevant information about liabilities that will be transferred.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

In the context of liabilities there is some ambiguity in the terms "cash flow-based" and "cost-based". For example, the amortised cost of a financial liability is broadly the present value of the expected future cash flows, discounted at an effective interest rate determined at inception. A liability for employee benefits will be settled in accordance with stated terms but is measured as the present value of future payments for services already received (and hence could be viewed as either a cash flow-or a cost-based measurement).

With that proviso, we broadly agree that some form of cash flow-based measurement is likely to be the only viable measurement for liabilities without stated terms. We say "some form" because the outcome of cash-flow-based measurement would or could be affected by a number of inter-related factors including:

- how uncertainty is incorporated
- the basis of discounting
- the unit of account.

We agree that amortised cost-type measurement is normally appropriate for non-derivative financial liabilities.

For other contractual (but non-financial) liabilities, the terms cost-based and cash-flow-based are ambiguous but the key issues are again uncertainty and the basis of discounting.

For performance obligations that relate to revenue-generating activities (customer contracts), the measurement of the obligation should be driven by the measurement of the related revenue (and proceeds received from the customer). We agree this could be described as cost-based.

We agree that current market prices are likely to provide relevant information about liabilities that will be transferred while noting that true transfers of liabilities (outside of business combinations) are relatively rare. We would further qualify this support by limiting it to liabilities that are freely transferable (without the consent of the creditor or other counterparty).

We also note that the DP discusses the issue of an entity's own credit risk in the context of current market price-based measurement (paragraphs 6.128–130). The Board has of course acknowledged and sought to address some of the controversy referred to by requiring presentation in OCI of the own-credit related portion of fair value changes of financial liabilities designated as at fair value through profit or loss. We support the use of OCI in the circumstances. However, we think the underlying question of whether and how own credit risk should affect subsequent measurement of liabilities should be revisited. We believe that many of the arguments offered for including the effects of own credit are somewhat dogmatic and have generally focused more on the balance sheet than on the statement of comprehensive income.

Question 14

Paragraph 6.19 states the IASB's preliminary view that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or fulfilled, may not provide information that is useful when assessing prospects for future cash flows. For example, cost-based information about financial assets that are held for collection or financial liabilities that are settled according to their terms may not provide information that is useful when assessing prospects for future cash flows:

(a) if the ultimate cash flows are not closely linked to the original cost;

(b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets or financial liabilities; or

(c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (ie the asset or the liability is highly leveraged).

Do you agree with this preliminary view? Why or why not?

We agree that fair value is the most appropriate measurement basis for derivatives for the reasons stated.

Question 15

Do you have any further comments on the discussion of measurement in this section?

We have no other comments.

Question 16

This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the *Conceptual Framework*. In developing its preliminary views, the IASB has been influenced by two main factors:

(a) the primary purpose of the *Conceptual Framework*, which is to assist the IASB in developing and revising Standards (see Section 1); and

(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8), including:

(i) a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;

(ii) amendments to IAS 1; and

(iii) additional guidance or education material on materiality.

Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the *Conceptual Framework* on:

(a) presentation in the primary financial statements, including:

(i) what the primary financial statements are;

(ii) the objective of primary financial statements;

(iii) classification and aggregation;

(iv) offsetting; and

(v) the relationship between primary financial statements.

(b) disclosure in the notes to the financial statements, including:

(i) the objective of the notes to the financial statements; and

(ii) the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information.

Why or why not? If you think additional guidance is needed, please specify what additional guidance on presentation and disclosure should be included in the *Conceptual Framework*.

Presentation

We agree with the scope of guidance proposed.

Disclosure

We also agree with the direction of the discussion on disclosures. In particular, we welcome the proposals in paragraphs 7.35–7.42 to set a boundary (scope) for the notes to the financial statements. We believe the EFRAG discussion paper 'Towards a Disclosure Framework for the Notes' suggests the right starting point for considering both the purpose of the notes and their boundaries.

While we do not disagree with the proposed objective for disclosures, consistent with our comments elsewhere, we would prefer to avoid setting separate objectives for different areas in the Framework. We would prefer an overall objective for the financial statements; each sub-topic area should then set out how this area contributes to the overall objective (ie its purpose).

In our view the purpose of the notes is to describe and, if appropriate, disaggregate items recognised in the financial statements, to present alternative measurements when relevant, and to disclose the nature and amount of contingent assets and liabilities that have yet to be recognised, as well as forward-looking information to the extent that it is included in recognised or unrecognised amounts. In contrast, an analysis of the information in the notes to the financial statements should consider forward-looking information and integrate that information with information in the financial statements. We believe that this analysis, whether done by management or external third parties, should be separate from the audited financial statements.

Question 17

Paragraph 7.45 describes the IASB's preliminary view that the concept of materiality is clearly described in the existing *Conceptual Framework*. Consequently, the IASB does not propose to amend, or add to, the guidance in the *Conceptual Framework* on materiality. However, the IASB is considering developing additional guidance or education material on materiality outside of the *Conceptual Framework* project.

Do you agree with this approach? Why or why not?

We agree that there is no need to amend, or add to, the guidance on materiality in the Framework. At a conceptual level we believe the materiality concept is clearly described and well-understood.

We cautiously welcome the statement that the Board is considering developing additional guidance or education material on materiality. This acknowledges that it is very challenging for preparers to assess how information may influence users' decisions with any degree of confidence. Accordingly, tools or guidance to assist preparers, auditors and regulators in applying the materiality concept to disclosures would be of interest.

That said, we think there is a danger of over-emphasising the role of materiality judgements in contributing to disclosure overload and thereby over-selling the potential benefits of more guidance in solving the problem. The wording of paragraph 7.46 is a case in point ("…how the concept of materiality is applied in practice is seen by many as a major cause of the current disclosure problem in financial reporting. That problem is often identified as a failure to use professional judgement when considering materiality.")

Using professional judgement in the context of disclosure, involves preparers making item-by-item judgements about how a theoretical user's unspecified decision might be affected in a hypothetical scenario. Developing genuinely useful guidance on how to do this will be very difficult. Because the materiality or otherwise of an item is essentially unknowable, there is also a risk that guidance leads to the pendulum swinging too far towards de facto free choice (ie discretionary disclosure). While we are concerned with the volume of disclosure requirements, we are not convinced that discretionary disclosure is the ideal response. Excessive discretion comes with its own costs and risks to preparers and users alike and could degrade rather than improve the usefulness of financial reporting.

In summary we do not support a paradigm in which the standard-setter includes long "shopping lists" of disclosure requirements and then puts the onus on others to filter these using materiality.

Question 18

The form of disclosure requirements, including the IASB's preliminary view that it should consider the communication principles in paragraph 7.50 when it develops or amends disclosure guidance in IFRSs, is discussed in paragraphs 7.48–7.52.

Do you agree that communication principles should be part of the Conceptual Framework?

Why or why not?

If you agree they should be included, do you agree with the communication principles proposed? Why or why not?

We agree that communication principles should be part of the Framework.

We also support the communication principles proposed, with the following qualification. Paragraph 7.50(f) comments on a trade-off between "optimising comparability" and "compromising usefulness". We think comparability is itself useful. The same paragraph notes the trade-off between flexibility and comparability, with which we agree.

In evaluating this trade-off, we would caution against responding to concerns about "checklist mentality" by veering too far towards flexibility and discretion. We believe that the financial statements and the related notes should be a reasonably comprehensive source of information that can be utilised by a wide range of users. The first cut at determining relevance lies with the standard-setter that decides on specific disclosure requirements. Judgements about the specific relevance of that information should normally be left to the users of the financial statements and their advisors who can select which information to incorporate into their analysis.

Better use of technology, such as standardised XBRL taxonomies, can reduce the cost of accessing and utilising that data. Transferring judgement about the relevance of information to the preparer also could increase the cost of financial reporting by increasing the amount of time and level of expertise required to make disclosure decisions and the risk of adverse regulatory or legal consequences when different judgements are made in the light of subsequent events. We note that some of the most important revelations about the quality of financial reporting come from evaluating information across entities. The ability to conduct meaningful research based on uniform disclosure rules is of value to all investors. So while it is easy to criticise a checklist approach to disclosure, standardised disclosures (in terms of the scope of information provided not the specific content) may be the lowest cost alternative for maximising the usefulness and comparability of financial statements.

Question 19

The IASB's preliminary view that the *Conceptual Framework* should require a total or subtotal for profit or loss is discussed in paragraphs 8.19–8.22.

Do you agree? Why or why not?

If you do not agree do you think that the IASB should still be able to require a total or subtotal profit or loss when developing or amending Standards?

We welcome the discussion of performance reporting in Section 8, including the discussion of the inter-related issues of profit or loss, other comprehensive income and recycling. We also welcome the material on the arguments for and against a profit or loss subtotal in paragraphs 8.20–21, which we find fair and balanced.

We agree with the DP's proposal that a revised Framework should not preclude the Board from requiring a total or subtotal of profit or loss when developing or amending standards. We concur with the comments in paragraph 8.19 to the effect that many investors, creditors, preparers and others view profit or loss as a useful performance measure, and that 'profit or loss' as a subtotal or a phrase is deeply ingrained in the economy, business and investors' minds.

That said we note that the topics considered in Section 8, including the discussion of the inter-related issues of profit or loss, other comprehensive income and recycling in the context of performance reporting, are mainly subtopics within the broader issue of financial statement presentation and performance reporting. In our view, a revised Framework should not limit the scope of the Board's future work on presentation and performance reporting by hard-wiring a requirement for a profit or loss subtotal. We expand on this comment in our response to Question 21.

Question 20

The IASB's preliminary view that the *Conceptual Framework* should permit or require at least some items of income and expense previously recognised in OCI to be recognised subsequently in profit or loss, ie recycled, is discussed in paragraphs 8.23–8.26.

Do you agree? Why or why not? If you agree, do you think that all items of income and expense presented in OCI should be recycled into profit or loss? Why or why not?

If you do not agree, how would you address cash flow hedge accounting?

We have responded in combination with Question 21.

Question 21

In this Discussion Paper, two approaches are explored that describe which items could be included in OCI: a narrow approach (Approach 2A described in paragraphs 8.40–8.78) and a broad approach (Approach 2B described in paragraphs 8.79–8.94).

Which of these approaches do you support, and why?

If you support a different approach, please describe that approach and explain why you believe it is preferable to the approaches described in this Discussion Paper

Similar to our comment in response to Question 19 on the use of a profit or loss subtotal, we believe the revised Framework should neither preclude nor entrench the continued use of OCI. OCI serves a necessary purpose, which is essentially to enhance the usefulness of the profit or loss subtotal. Any proposal to eliminate OCI is likely to be controversial.

The DP proposes using OCI to deal with:

- bridging items
- mismatched remeasurements
- transitory remeasurements.

We think this is an informative way of classifying the ways in which OCI is currently used, and will also be helpful in making decisions about its future use (including recycling). We agree that each of these three instances of OCI serves a useful purpose. We particularly welcome the discussion of the role of OCI in providing a bridge between profit or loss and the statement of financial position. We therefore support the continued use of OCI, on the basis of the broad approach, until or unless a better means of achieving the underlying objectives is developed.

The DP does not attempt to define OCI or set a clear distinction between profit or loss and OCI. However, identifying the types of items that might be presented in OCI does suggest an underlying objective of enhancing the usefulness of the profit or loss subtotal as a primary performance measure by excluding some or all such items (permanently or temporarily).

We support this objective. However, whether OCI is the best means of enhancing the usefulness of profit or loss is more questionable. Ultimately we believe there might be better ways to enhance presentation that could result in OCI becoming redundant or less widely used. The downsides of preserving OCI indefinitely include that:

- it is something of a blunt instrument that mixes different types of gain or loss
- OCI is not used consistently (eg some equity investments are measured at FVTOCI but investment properties are measured at FVTPL)
- the Board will continue to come under pressure to utilise OCI as compromise solution from time to time.

Finally, we do not think the need to accommodate the mechanics of cash flow hedge accounting is a strong argument for the continued use of OCI at the conceptual level. Hedge accounting is of course itself an exception to the general recognition and measurement rules to deal with perceived economic mismatches that stem from those general requirements – in other words, a practical matter. Notwithstanding possible conceptual objections, cash flow hedge accounting could be dealt with by deferring the effective portion of gain or loss on the hedging instrument, or not recognising that portion of the hedging instrument.

Question 22

***Chapters 1 and 3 of the existing* Conceptual Framework**

Paragraphs 9.2–9.22 address the chapters of the existing *Conceptual Framework* that were published in 2010 and how those chapters treat the concepts of stewardship, reliability and prudence. The IASB will make changes to those chapters if work on the rest of the *Conceptual Framework* highlights areas that need clarifying or

amending. However, the IASB does not intend to fundamentally reconsider the content of those chapters.

Do you agree with this approach? Please explain your reasons.

If you believe that the IASB should consider changes to those chapters (including how those chapters treat the concepts of stewardship, reliability and prudence), please explain those changes and the reasons for them, and please explain as precisely as possible how they would affect the rest of the *Conceptual Framework*

We believe that the IASB should reconsider certain aspects of Chapters 1 and 3, including the role of stewardship. We comment in more detail in our covering letter.

In our covering letter we also comment on reliability and prudence. We believe that further work is needed in both of these areas. However, this would not necessarily lead to reconsideration of Chapters 1 and 3. In summary:

- we consider that the reliability of measurement should be given a more prominent role in the context of recognition, and also the selection of measurement bases.
- given that prudence is a feature of both existing and forthcoming standards, we believe its role should be acknowledged in the Framework. Further work should be undertaken to assess the appropriate role of prudence in developing future standards, including the interaction with the neutrality characteristic.

Question 23

Business model

The business model concept is discussed in paragraphs 9.23–9.34. This Discussion Paper does not define the business model concept. However, the IASB's preliminary view is that financial statements can be made more relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities.

Do you think that the IASB should use the business model concept when it develops or revises particular Standards? Why or why not? If you agree, in which areas do you think that the business model concept would be helpful?

Should the IASB define 'business model'? Why or why not?

If you think that 'business model' should be defined, how would you define it?

We welcome the discussion in paragraphs 9.23–9.34 and broadly agree with its description of how business model-type concepts are used in existing IFRSs. We note that an approach that could be loosely-described as business model-based is well established in the classification and measurement of financial instruments (particularly which instruments are measured at fair value).

However, an entity's business model also has a more basic and pervasive role: the business model (put simply, how the entity does business) drives the transactions an entity enters into. The financial statements are in turn driven primarily by those transactions. We believe this is, and should continue to be, the main way in which an entity's financial statements reflect its business model.

We think some caution is needed in considering whether the business model should have a different and/or broader role. We believe some of the calls for greater use of business model-type concepts are in reality demands for increased flexibility (less prescription) in certain standards and/or expressions of disagreement with particular requirements.

It is also difficult to comment on whether the IASB should use the business model concept when it develops standards in the absence of a definition of "business model" and a fuller analysis of how it might affect the IASB's decisions.

We note that the use of the term business model in the classification and measurement section of IFRS 9 *Financial Instruments* has proved somewhat problematic (while nonetheless being broadly welcomed by many commentators, including ourselves). Recent re-deliberations suggest that the assessment should reflect the expected outcome of the business model (ie whether financial assets are held for collection of contractual cash flows, held for sale or some combination of both) and not the business model itself. We think this is a subtle but important distinction that points to the difficulty of making direct reference to business models. On a similar note we suggest that, before committing to a broader role for the business model, the Board should articulate how this is similar or different to management intent and the discussion of measurement in paragraphs 6.73-6.96.

In our view, the only clear-cut example of an accounting requirement based on an entity's business model in existing IFRSs is the Investment Entity consolidation exception (although even this could instead be characterised as an industry-specific standard).

Question 24

Unit of account

The unit of account is discussed in paragraphs 9.35–9.41. The IASB's preliminary view is that the unit of account will normally be decided when the IASB develops or revises particular Standards and that, in selecting a unit of account, the IASB should consider the qualitative characteristics of useful financial information.

Do you agree? Why or why not?

We welcome the DP's acknowledgment of the importance of the unit of account. In fact we believe that the brief discussion paragraphs 9.35–9.41 understates the significance and pervasiveness of this concept. We would note that the unit of account also affects existence and recognition under existing standards (for example in the context of warranty obligations).

As noted in our response to Question 3, we think that removing the probability thresholds from the asset and liability definitions will partly address one of the anomalies with unit of account. However, unit of account would remain an issue in relation to constructive obligations, and may also affect whether assets and liabilities meet the recognition criteria (depending on how they are finalised). The requirement in IFRS 13 *Fair Value Measurement* to fair value an item consistent with its unit of account has created additional questions in this area.

That said, we agree that detailed specification of the unit of account should be addressed at standards-level. Future standards should however be more explicit on the unit of account (where applicable) that has been selected and the reasons for its selection.

At Framework-level we suggest the Board should:

- acknowledge the issue
- describe the different roles of unit of account and possible options for its selection

- commit the Board to consider, and preferably prescribe, the selected unit of account more explicitly in setting standards
- include some high level indicators for the Board to consider in making those decisions.

We believe it is particularly important in the context of the Framework that proper consideration is given to the unit of account as it might affect the existence and recognition of assets and liabilities.

Question 25

Going concern

Going concern is discussed in paragraphs 9.42–9.44. The IASB has identified three situations in which the going concern assumption is relevant (when measuring assets and liabilities, when identifying liabilities and when disclosing information about the entity).

Are there any other situations where the going concern assumption might be relevant?

We agree that the three situations identified are probably the most significant if an entity is no longer a 'going concern'. However, there may be detailed matters such as the presentation of assets and liabilities as current or non-current.

More generally, we are not quite clear what the Board has in mind for the Framework in this area. We are aware of occasional requests for more guidance on the basis of preparation of financial statements when an entity is not a going concern, and whether financial statements prepared on a different basis can or should be described as complying with IFRSs. The reference in paragraph 4.1 of the existing Framework to "prepared on a different basis", and the lack of guidance as to what that basis might be, has caused some confusion. However, the issues are not widespread in our experience and we would not see this area as a high priority.

Question 26

Capital maintenance

Capital maintenance is discussed in paragraphs 9.45–9.54. The IASB plans to include the existing descriptions and the discussion of capital maintenance concepts in the revised *Conceptual Framework* largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change.

Do you agree? Why or why not? Please explain your reasons.

We agree. The discussion of capital maintenance concepts in paragraphs 4.57–65 of the existing Framework is perhaps not particularly useful as a practical tool for developing standards. This material would therefore benefit from updating and improvement in due course. However, we are not aware that this is causing significant practical difficulties at present and would not view it as a high priority topic.