IASB's Conceptual Framework for Financial Reporting (ED/2015/3)

The FRC's Accounting Council has considered the above Exposure Draft and reached the tentative views set out below. These may be amended in the course of developing the Accounting Council's advice to the FRC for its response to the Exposure Draft.

The following issues were discussed at the Accounting Council's July meeting.

Stewardship, the business model, prudence and reliability

Although the IASB had previously proposed to make little change to the chapters of the Conceptual Framework that deal with objectives and qualitative characteristics, it now proposes changes to:

- give greater emphasis to stewardship;
- re-introduce the concept of prudence;
- include a discussion of measurement uncertainty, to respond to the view that the notion of reliability is not adequately addressed in the current Framework.

The Accounting Council welcomes these changes, but in its view further improvements to the proposals should be considered. Specifically:

(i) It is not satisfactory for stewardship to be dealt with as merely part of an overall objective of providing information that is decision useful, where decisions are often understood to be to buy, hold or sell shares. It should be recognised that investors need to rely on the financial statements in order to take an active part in corporate governance. It is often the case that investors will not or cannot sell their shares and therefore need information that enables them to assess the success of management's current strategies and to consider possible alternatives. To secure this, the Conceptual Framework should either identify the provision of information on stewardship as a primary objective of financial reporting or expand its discussion of the issue.

(ii) Stewardship information requires information on the performance of the business model. Although the Exposure Draft refers to 'how an entity conducts its business activities' in the context of specific topics, a general statement that this information is necessary to meet the objectives of financial reporting would result in a more coherent Framework.

(iii) The Exposure Draft characterises prudence as the exercise of caution when making judgements under conditions of uncertainty, but does not reflect the notion of 'asymmetric prudence'—the recognition of losses and liabilities at a lower level of likelihood (and hence often earlier) than gains and assets. The Basis for Conclusions explains that asymmetric prudence is reflected in many current accounting standards and that such accounting policies are consistent with the Exposure Draft. It is unsatisfactory for such a fundamental feature of financial reporting to be reflected merely in the Basis for Conclusions to the Conceptual Framework: it should be reflected in the Framework itself. This would not require that future standards would invariably reflect asymmetric prudence: this would be a judgement made in the development of individual standards.

(iv) As suggested in the Exposure Draft, prudence is consistent with neutrality as that term is described in the Conceptual Framework, which is 'without bias'. As this use of the term 'neutrality' is not its natural meaning, it leads to confusion that could be avoided by replacing the term 'neutrality' with 'unbiased'.

(v) The description of faithful representation given in the Exposure Draft does not include the idea, which was in the discussion of reliability in a previous version of the Conceptual Framework, that the information 'can be depended upon by users'. The idea of reliability needs to be reinstated.

(vi) The Exposure Draft proposes that measurement uncertainty will be discussed as an aspect of relevance. Consequently, the trade-off between relevance and reliability is replaced by a need to balance measurement uncertainty with other aspects of relevance. This is not conducive to clear thinking, as in the ordinary meaning of 'relevance', relevant information may be subject to a high degree of uncertainty. The discussion of measurement uncertainty needs to be repositioned within the Framework to make the trade-off with relevance clear.

The Statement of Profit or Loss and Other Comprehensive Income

The Exposure Draft provides a description of the purpose of the statement of profit or loss, and states that it is the primary source of information about an entity's financial performance of the period. It proposes rebuttable presumptions that (i) all income and expenses will be included in the statement of profit or loss; and (ii) that any income or expenses that are reported in other comprehensive income will be reclassified ('recycled') to profit or loss in some future period.

The Accounting Council noted that the description of the purpose of the statement of profit or loss is a useful first step. However, it is disappointed that the proposals are not based on a holistic and fundamental analysis of the concept of financial performance. Such an analysis would clarify terms such as 'profit', 'return' and 'performance'. In the absence of such an analysis, there is no basis for the Exposure Draft's proposals.

In particular, the presumption of recycling for all income and expenses initially reported in other comprehensive income seems to require the inclusion in profit of recycling adjustments, which are not income and expenses of the period. The presumption therefore cannot be supported without an explanation of the significance of recycling adjustments.

Whilst the proposals, with suitable modification, may provide a basis for an interim position, further work on this topic is urgently required. It is not satisfactory for the Conceptual Framework to contain unsupported assertions and presumptions.

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The FRC's Accounting Council continued its consideration of the Conceptual Framework Exposure Draft at its September meeting and reached the tentative views set out below, which may be amended in the course of developing the Accounting Council's advice to the FRC for its response to the Exposure Draft.

Elements

The Accounting Council agrees that the Exposure Draft's proposed definitions of an asset and a liability are an improvement on the existing definitions. It noted that the explanation of a 'present obligation' is potentially helpful, but that some further clarifications and changes of emphasis seem to be necessary. It agreed that the guidance on executory contracts was appropriate.

The Accounting Council regrets that the Exposure Draft proposes to continue to use the terms 'income' and 'expenses' for non-owner changes in assets and liabilities. In its view, wider terms such as 'gains' and 'losses' should be used, as the terms 'income' and 'expense' have specific connotations that are not appropriate for all changes in assets and liabilities. This would also allow 'income' and 'expenses' to be used in a narrower sense, which might be appropriate in further work on the reporting of performance.

The Accounting Council notes that the Chapter on elements does not retain the discussion of revenue and ordinary activities that is in the existing Conceptual Framework. In the Council's view, the concept of ordinary activities—or, perhaps, 'operating activities'—is an important factor in providing relevant information about an entity's financial performance, and should be reflected in the Conceptual Framework.

One of the main contributions of the Conceptual Framework is to secure that only items that meet the definition of an element are recognised in financial statements. In the view of the Accounting Council, it is therefore necessary that contributions and distributions of equity are defined as elements. Also, if recycling is to be permitted or required, it is necessary to define recycling adjustments as elements.

The Exposure Draft does not propose to define elements for the statement of cash flows. The Accounting Council encourages the IASB to consider whether it is necessary to define elements for the statement of cash flows as part of the current project on 'Primary Financial Statements' and to be prepared to amend the

Conceptual Framework in the light of that work. The Accounting Council believes it is important to retain the requirement to provide a cash flow statement with prominence equal to that of the other primary financial statements.

The Council noted the proposal to retain the existing definition of equity. However, it notes that the IASB will continue to explore how to distinguish liabilities from equity in its research project 'Financial Instruments with Characteristics of Equity', which might ultimately lead to proposals to amend the Conceptual Framework.

Recognition and derecognition

The Accounting Council supports the general approach of the Exposure Draft to recognition, which seeks to identify factors that are relevant to recognition, rather than setting rigid criteria. However, the tentative views reached at the Accounting Council's July meeting would have significant implications for the recognition Chapter of the Conceptual Framework. In particular:

- Reinstating the idea of reliability would secure that in the development of accounting standards, a balance needs to be struck between relevance and reliability (including measurement uncertainty).
- The Chapter should highlight, consistent with asymmetric prudence, that in certain situations early recognition of liabilities and losses may be more relevant than that of assets and gains.

The Council also considers that it would be helpful for the Conceptual Framework to note that, when considering recognition issues, alternatives, such as disclosure in the notes, should be considered.

The Accounting Council agrees with the discussion of derecognition.

Measurement

The Exposure Draft notes that, in the IASB's view, it is not necessary or appropriate to delay all or part of the Conceptual Framework to undertake more research on measurement and it does not support the issue of high-level interim guidance. However, the Accounting Council believes that further analysis and research on the development of principles that direct the selection of a measurement basis is necessary if the Conceptual Framework is to provide useful guidance for the development of accounting standards. This should include consideration of entry and exit values—in particular where an entity cannot sell an asset on the same market as it buys—and the link between measurement and capital maintenance.

The Council noted that some academic research questions the logical coherence of fair value when used for non-financial assets that are not traded on markets.

The Accounting Council welcomes the treatment of cash flow techniques as techniques for estimating the measure of an asset on a particular measurement basis rather than as a separate category of measurement basis.

Presentation

The Accounting Council discussed the distinction between the statement of profit or loss and other comprehensive income at its July meeting. The discussion at its September meeting was directed to other parts of the Chapter on Presentation and Disclosure.

The Accounting Council agreed that these parts fell short of what is required to provide a useful foundation for work on presentation, and reaffirmed its view that reporting financial performance should be a priority for the IASB.

In particular, the Council suggested that:

- The IASB should develop further communication principles.
- A distinction between ‘presentation’ and ‘disclosure’ should be considered.
- The term ‘Primary Financial Statements’ should be retained.
- The Framework should set out a clear boundary between financial statements and other financial reporting, and between the primary financial statements and the notes.

The Council noted that the division of this material between the Conceptual Framework and work underway in the Disclosure Initiative was unclear.

The Council welcomed:

- the guidance in the Exposure Draft relating to forward looking information; and
- the Exposure Draft’s acknowledgement that it may be preferable for accounting standards to identify the specific disclosure objectives rather than numerous detailed disclosure requirements.

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