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Chair
Australian Accounting Standards Board
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Online submission: www.aasb.gov.au

Dear Kris

Submission on Exposure Draft ED 264: Conceptual Framework for Financial Reporting

CPA Australia welcomes the opportunity to respond to the above Exposure Draft. CPA Australia represents the diverse interests of more than 150,000 members in 120 countries. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders. We make this submission on behalf of our members and in the broader public interest.

CPA Australia supports the International Accounting Standards Board's (IASB) project to develop an updated conceptual framework for financial reporting. We commend the IASB for its efforts in developing a framework that includes many of the areas that have previously been identified as critical for inclusion in it.

However, we believe that the proposals set out in the Exposure Draft have not been developed sufficiently to form the basis of a sound conceptual framework that can be considered complete, clear and up-to-date, so as to form an effective basis for the development of standards. Some of the proposals in the Exposure Draft seek to address immediate problems rather than laying the foundations for future standard-setting based on well developed concepts. It is our view that further work is necessary to develop many of the proposed concepts that can form part of a framework that will effectively meet evolving financial reporting needs.

The Exposure Draft indicates that the IASB proposes to explore the issues arising with financial instruments with characteristics of both liabilities and equity as part of its "financial instruments with characteristics of equity" research project. It is our view that the conceptual framework project presents the IASB with the appropriate and timely opportunity to develop these concepts. It is also our view that the proposed approach is counterproductive to the objective of the project to improve financial reporting by providing a more complete, clear and updated set of concepts. Where significant aspects are being considered through other projects, such as the financial instruments project referred to above, we recommend prioritising these projects for completion and issuing the final conceptual framework when all significant outstanding issues have been addressed.

The IASB proposes to include guidance in the conceptual framework on the reporting of income and expenses through the statement of profit and loss and other comprehensive income (OCI), rather than developing and including definitions in the conceptual framework for profit or loss, OCI or financial performance. It is our view that conceptual clarity between the statement of profit or loss and OCI is important. We believe this could be achieved through the development of a clear definition of profit or loss that results or leads to the inclusion of income and expenses in either the statement of profit or loss or OCI. Alternatively, a "business model" approach could be explored to identify if this could form a sound basis for determining the presentation of movements in assets and liabilities in either the statement of profit and loss or OCI. If the IASB is unable to arrive at a satisfactory and clear demarcation between the statements of profit and loss and OCI, we suggest it considers restricting itself to defining financial performance within the conceptual framework and delegating the demarcation of the statements of profit and loss and OCI to the standards.

In our submission dated 21 November 2013 in response to the Discussion Paper DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting*, we identified the need for financial reporting to evolve over time to meet changing user expectations. We reiterate our belief that it is essential to consider reporting in its wider context if the needs of users are to be more fully understood, as these will then inform the decisions taken to ensure that the objectives of financial reporting are defined and achieved. One common purpose shared with the Integrated Reporting Framework <IR> developed by the International Integrated Reporting Council (IIRC) is to make reporting more user relevant and accessible. This is evidenced by the collaborative work undertaken by the IASB, the United States Financial Accounting Standards Board (FASB) and the IIRC, amongst others, to develop the Corporate Reporting Dialogue (CRD) as a mapping exercise between the major forms of corporate disclosure. As the foundation of IFRS based financial reporting, the conceptual framework presents an ideal opportunity for the IASB to both recognise and introduce concepts that enable reporting to evolve and meet user information needs. Accordingly, we recommend the IASB includes a section within the conceptual framework that discusses the role of <IR>, reporting of service performance information and similar developments.

In our view, it is unfortunate that the IASB and International Public Sector Accounting Standards Board (IPSASB) missed the opportunity to collaborate and develop a single high-level, principles-based conceptual framework that would have applied to the standards of both the Boards. Whilst we note that the IPSASB has already published its conceptual framework, we continue to support a collaborative approach with the International Public Sector Accounting Standards Board (IPSASB) in ensuring the two conceptual frameworks are as closely aligned as possible.

Our detailed responses to specific questions are included in the attached appendices. If you require further information on any of our views expressed in this submission, please contact Ram Subramanian, CPA Australia by email at ram.subramanian@cpaaustralia.com.au.

Yours sincerely

Dr Eva Tsahuridu
Manager – Accounting Policy

APPENDIX 1

1. Whether, and to what extent, the IPSASB *Conceptual Framework* should be incorporated into the AASB *Conceptual Framework for Financial Reporting;*

An ideal outcome internationally would have been achieved if both the IASB and IPSASB had collaborated in developing a principles-based conceptual framework that applies to both the private and public sectors. Unfortunately, this has not eventuated, and given the AASB is tasked with issuing transaction neutral standards, we believe that it should refer to the IPSASB conceptual framework where appropriate in the development of its own *Conceptual Framework for Financial Reporting.* Below are some aspects of the IPSASB conceptual framework that we believe would need to be considered for incorporation into the AASB conceptual framework:

- Primary objectives of financial reporting – aligning the role of stewardship as proposed in the Exposure Draft with the accountability objective stated in the IPSASB conceptual framework
- Recognition of non-exchange transactions that occur in the public sector and private not-for-profit sector
- The role of non-financial information including service performance information.

2. Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to;
(a) Not-for-profit entities; and
(b) Public sector entities, including GAAP/GFS implications;

The IASB and IPSASB conceptual frameworks address financial reporting by listed and public sector entities respectively. The AASB's conceptual framework will also need to address financial reporting by non-listed corporate entities, private sector not-for-profit entities and others that rely on the AASB's standards for their financial reporting needs. We recommend the AASB take into account the specific financial reporting needs of such other entities in developing its *Conceptual Framework for Financial Reporting.* The "Australian financial reporting framework" project that the AASB is leading presents a suitable opportunity to address these issues.

3. Whether, overall, the proposals would result in financial statements that would be useful to users;

This submission highlights a number of concerns about the proposals set out in the Exposure Draft. Until these matters are addressed satisfactorily by the IASB, we are unable to provide any comments in response to the above question.

4. Whether the proposals are in the best interests of the Australian economy; and

For the reasons stated in our response to question 3 above, we are unable to provide any comments in response to the above question.

5. Unless already otherwise provided in your response, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

For the reasons stated in our response to question 3 above, we are unable to provide any comments in response to the above question.

APPENDIX 2

Question 1—Proposed changes to Chapters 1 and 2
Do you support the proposals: (a) to give more prominence, within the objective of financial reporting, to the importance of providing information needed to assess management's stewardship of the entity's resources; (b) to reintroduce an explicit reference to the notion of prudence (described as caution when making judgements under conditions of uncertainty) and to state that prudence is important in achieving neutrality; (c) to state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form; (d) to clarify that measurement uncertainty is one factor that can make financial information less relevant, and that there is a trade-off between the level of measurement uncertainty and other factors that make information relevant; and (e) to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information? Why or why not?

Stewardship
CPA Australia supports the proposal to give prominence to management's stewardship as part of the objective of financial reporting. Information included in financial reports about how well management has discharged its responsibilities in using the entity's resources to generate net cash-flows will assist users in their decision-making.

We believe the extent to which financial reporting can assist with demonstrating management's "efficient and effective" use of the entity's resources is limited. In our view, other reports that can accompany financial reports (e.g. directors' report), which include a more descriptive depiction of an entity's performance will also be relied upon by users for information on management's stewardship. We recommend the conceptual framework includes clarification about the role of financial reporting in providing information about the "effectiveness and efficiency" of management's stewardship.

New developments in reporting (e.g. <IR>) are also considered by many stakeholders as necessary steps in the evolution of effective reporting to provide a more comprehensive view of an entity's performance, including stewardship of the entity. As highlighted in our cover letter, we recommend the IASB includes a section within the conceptual framework that discusses Integrated Reporting, reporting of service performance information and similar developments, and their role in meeting evolving user information needs.

Prudence
CPA Australia does not support the reintroduction of the term "prudence" within the conceptual framework as proposed.

Outside accounting circles, the term "prudence" is often used as a descriptor for the exercise of good judgement. However, over the decades that the term had been part of accounting terminology, its application in practice gave rise to a degree of conservatism that diverged from the presentation of unbiased or neutral financial information. We are concerned that the reintroduction of the term into the conceptual framework will give rise to the same issues that led to its removal from the current conceptual framework issued in 2010. We believe the current set of accounting standards have been sufficiently developed to assist with judgements over matters of uncertainty, obviating the need to include the term within the conceptual framework.

Relevance (including measurement uncertainty and faithful representation (including substance over form))
CPA Australia supports the inclusion of relevance and faithful representation within the conceptual framework as fundamental qualitative characteristics of financial reporting.

We also support the inclusion of material uncertainty as a factor that can affect relevance, particularly as estimates are an essential feature of financial information presented within financial statements.

Similarly, we also support the inclusion of substance over form within the qualitative characteristic of faithful representation. We believe this is particularly useful where financial statement preparers rely on the conceptual framework in the absence of specific requirements or guidance in the accounting standards.

Question 2—Description and boundary of a reporting entity
Do you agree with: (a) the proposed description of a reporting entity in paragraphs 3.11–3.12; and (b) the discussion of the boundary of a reporting entity in paragraphs 3.13–3.25? Why or why not?

CPA Australia agrees with the proposed description of a reporting entity as set out in the Exposure Draft.

We also agree with the discussion of the boundary of a reporting entity based on control, including its application to consolidated financial statements for parent-subsidiary groups. The proposals indicate that the IASB does not see the need to embed the notions of joint control and significant influence in the conceptual framework (paragraph BC 3.15). However, we believe the discussion in the conceptual framework should be extended to cover equity accounting, as different interpretations continue to be made on whether equity accounting is a feature of consolidated financial statements or separate financial statements, and whether the amount of equity interest is one asset or a collection of assets and liabilities.

Question 3—Definitions of elements
Do you agree with the proposed definitions of elements (excluding issues relating to the distinction between liabilities and equity): (a) an asset, and the related definition of an economic resource; (b) a liability; (c) equity; (d) income; and (e) expenses? Why or why not? If you disagree with the proposed definitions, what alternative definitions do you suggest and why?

In our view the final conceptual framework should incorporate well developed and robust definitions of elements. Whilst we agree with the proposed definition of some elements, as set out in our comments below, other elements require further development.

CPA Australia agrees with the proposed definition of an asset and also agrees with the separate but related definition of an economic resource.

CPA Australia is of the view that the proposed definition of a liability and supporting descriptions as set out in the Exposure Draft are inadequately developed and can cause a number of interpretative issues. Our specific concerns are:

- Paragraph 4.30 states that an obligation to transfer an entity's own equity claims to another party is not an obligation to transfer an economic resource. This suggests that such transfers will not be a liability as defined in the proposed conceptual framework, irrespective of whether the transfers relate to a fixed or variable number of shares. We believe this contradicts the current distinctions drawn between liabilities and equity in AASB 132 *Presentation of Financial Instruments*. Whilst we note in paragraph BC4.47 that such issues will be addressed in the IASB's financial instruments with characteristics of equity research project, it is our view that it is fundamental to clarify the definition of a liability and draw a clear distinction between liabilities and equity in the conceptual framework before it is finalised. As stated in our cover letter above, we recommend the IASB does not finalise the conceptual framework until pending projects that have an impact on it are completed and considered. We also recommend that the IASB prioritise the financial instruments with characteristics of equity project and other projects that impact on significant pending aspects of the conceptual framework.

- The Exposure Draft proposes that a liability would arise if there is a present obligation that arises from the entity having no practical ability to avoid the transfer, and the obligation arises from past events. As set out in the paragraphs BC4.73-BC4.75, the term "no practical ability to avoid the transfer" now introduces an economic compulsion test in determining whether a liability exists. Characterising a present obligation in this manner will capture within the definition of a liability, transactions that an entity is committed to undertake due to its economic dependence on the transactions occurring, even if there is no claim against the entity in respect of these transactions at that time. We note from paragraph BC4.65 that the IASB has considered IFRIC 21 *Levies* in determining the proposed approach to describe a liability. Whilst the proposed approach might resolve IFRIC 21 related issues, it is likely to lead to unintended consequences when considering many other transactions that involve a degree of economic dependency by the entity. For example, based on the proposed criteria, it may be difficult to distinguish between a commitment which may not be recognised as a liability and an obligation which would be recognised as a liability. We urge the IASB to continue to focus on the criterion of present obligation based on past events without referring to “no practical ability to avoid the transfer”.

Whilst CPA Australia supports the definition of equity as proposed, due to the concerns about the definition of a liability we have raised above, we believe the boundaries between liabilities and equity need to be clarified further.

We note that the definitions of income and expenses exclude contributions from and distributions to holders of equity claims. In practice, owners of an entity can also include those that control the entity, even if the exercise is not through equity claims. We suggest the definitions of income and expenses should also exclude transactions with such owners who may not necessarily be holders of equity claims.

Paragraph BC4.105 highlights the IASB’s decision not to emphasise the subclasses of income as including revenue and gains. We believe this distinction is important in many jurisdictions including Australia where revenue (or income) is used as a determinant for regulatory reporting thresholds. We therefore recommend the IASB considers including emphasis on the broad income subclasses of revenue and gains within the conceptual framework.

Question 4—Present obligation
Do you agree with the proposed description of a present obligation and the proposed guidance to support that description? Why or why not?

Please see our response to question 3 above.

Question 5—Other guidance on the elements
Do you have any comments on the proposed guidance? Do you believe that additional guidance is needed? If so, please specify what that guidance should include.

We have no further comments.

Question 6—Recognition criteria
Do you agree with the proposed approach to recognition? Why or why not? If you do not agree, what changes do you suggest and why?

A phenomenon identified in recent times is the growth of “clutter” or unnecessary information in financial statements. Many stakeholders, including the IASB, are undertaking projects to address this issue. Paragraph BC2.30 notes that the IASB will further examine the role of materiality and the possibility of providing further guidance on the application of the concept, as part of its Disclosure Initiative. We believe the conceptual framework provides a suitable opportunity to introduce concepts that seek to address the problem of clutter in financial statements. Therefore, we suggest including guidance on materiality that seeks to address the issue of immaterial and irrelevant information in the financial statements.

We support the IASB's decision to remove the probability thresholds and instead include in the conceptual framework, recognition criteria based on the qualitative characteristics. This provides a conceptual approach to recognition, delegating probability criteria to the standards.

Question 7—Derecognition
Do you agree with the proposed discussion of derecognition? Why or why not? If you do not agree, what changes do you suggest and why?

CPA Australia broadly agrees with the proposed discussion of derecognition.

Question 8—Measurement bases
Has the IASB: (a) correctly identified the measurement bases that should be described in the *Conceptual Framework*? If not, which measurement bases would you include and why? (b) properly described the information provided by each of the measurement bases, and their advantages and disadvantages? If not, how would you describe the information provided by each measurement basis, and its advantages and disadvantages?

CPA Australia supports the mixed measurement basis that includes discussion about both historical cost and current value. We acknowledge that current value is an aspirational goal as a single measurement basis and arguably, in the case of many assets and liabilities, the most faithfully representative measurement basis. However, a mixed measurement basis presents a more pragmatic approach that accommodates alternative measurement bases that can be effective in providing information that is more relevant to users whilst not necessarily being faithfully representative.

If a standard does not specify the applicable measurement basis, the conceptual framework appears to allow the preparer with a choice over which measurement basis to apply. It is not clear whether this was intended, and if not, we recommend the IASB considers including guidance on the appropriate choice in such circumstances.

Paragraph 6.30 suggests fair value may not be a relevant measurement basis where an entity does not intend to sell an asset or transfer a liability. Whilst this may be true in some cases (e.g. some financial liabilities such as loans) we do not believe this will always be the case. There can be some instances where fair value still provides relevant information to users in making informed economic resource allocation decisions.

Many developing countries that have recently adopted IFRS or those that are on the path to adopt IFRS will find it challenging to implement an accounting standards framework that is entirely based on current values. In many such countries, there is a short supply of expertise and resources required to establish reliable estimates of current values for items recognised in the financial statements. For the IFRS framework to be a truly global framework, a mixed measurement model is necessary to ensure acceptance by both developed and developing countries.

Question 9—Factors to consider when selecting a measurement basis
Has the IASB correctly identified the factors to consider when selecting a measurement basis? If not, what factors would you consider and why?

CPA Australia notes the inclusion of cost constraints as a factor when choosing a suitable measurement basis. We support the inclusion of the cost constraint and suggest expanding the discussion further on this factor, particularly as costs can play a significant part when determining an appropriate measurement basis. Also refer to our response to question 8 above.

Question 10—More than one relevant measurement basis
Do you agree with the approach discussed in paragraphs 6.74–6.77 and BC6.68? Why or why not?

CPA Australia supports the approach of adopting more than one relevant measurement basis in some cases. The reasons for our support are set out in our responses to questions 8 and 9 above.

Question 11—Objective and scope of financial statements and communication
Do you have any comments on the discussion of the objective and scope of financial statements, and on the use of presentation and disclosure as communication tools?

Subject to our other comments expressed in this submission, we have no further comments.

Question 12—Description of the statement of profit or loss
Do you support the proposed description of the statement of profit or loss? Why or why not? If you think that the *Conceptual Framework* should provide a definition of profit or loss, please explain why it is necessary and provide your suggestion for that definition.

CPA Australia is of the view that further work is required by the IASB to adequately define and characterising the two primary financial statements that present financial performance. We do not believe the current approach to provide "conceptual guidance" on reporting financial performance is sufficient to achieve the necessary outcomes. It is also our view that the IASB should address this matter before finalising the conceptual framework. We suggest that the IASB could achieve this through defining profit or loss, and build on this definition to describe the conceptual basis for the content of the statements of profit and loss and OCI.

If the IASB is unable to arrive at a satisfactory and clear demarcation between the statements of profit and loss and OCI, we suggest the conceptual framework restricts itself to defining financial performance and delegating the demarcation of the statements of profit and loss and OCI to the standards.

Some stakeholders have identified the business model approach to describe the statements of profit and loss and OCI in the conceptual framework. As this proposes introducing a new approach to the concepts of financial reporting, we recommend the IASB conducts further research into the merits and demerits of adopting a business model approach. Our preference, in the short term at least, would be for the IASB to address the issue as proposed in the previous paragraphs.

Question 13—Reporting items of income or expenses in other comprehensive income
Do you agree with the proposals on the use of other comprehensive income? Do you think that they provide useful guidance to the IASB for future decisions about the use of other comprehensive income? Why or why not? If you disagree, what alternative do you suggest and why?

Please see our response to question 12 above.

Question 14—Recycling
Do you agree that the *Conceptual Framework* should include the rebuttable presumption described above? Why or why not? If you disagree, what do you propose instead and why?

In light of the views we have expressed in our response to question 12 above, we are unable to provide any further comments at this stage on the question of recycling. However, if the IASB does address the issues highlighted in our response to question 12 in a meaningful way, we would support the presumption that all items in the statement of OCI should be recycled to statement of profit and loss. We however recommend that the IASB develops and includes high level principles to provide a consistent basis for determination of recycling from the statement of OCI to profit and loss.

Question 15—Effects of the proposed changes to the Conceptual Framework
Do you agree with the analysis in paragraphs BCE.1–BCE.31? Should the IASB consider any other effects of the proposals in the Exposure Draft?

CPA Australia broadly agrees with the analysis in paragraphs BCE.1-BCE.31. Whilst we note the highlighted inconsistencies between the proposed conceptual framework and existing standards, we believe it is essential to establish a robust and aspirational conceptual framework that forms the bedrock for future standard setting.

Question 16—Business activities
Do you agree with the proposed approach to business activities? Why or why not?

CPA Australia broadly agrees with the proposed approach to business activities. We have also provided our views on the business model approach in our response to question 12.

Question 17—Long-term investment
Do you agree with the IASB's conclusions on long-term investment? Why or why not?

Subject to our comments relating to the business model approach in response to question 12, we agree with the IASB's conclusions on long term investment.

Question 18—Other comments
Do you have comments on any other aspect of the Exposure Draft? Please indicate the specific paragraphs or group of paragraphs to which your comments relate (if applicable). As previously noted, the IASB is not requesting comments on all parts of Chapters 1 and 2, on how to distinguish liabilities from equity claims (see Chapter 4) or on Chapter 8.

We have no further comments.