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Ms Kris Peach

Chair

Australian Accounting Standards Board

PO BOX 204 Collins Street West

Victoria 8007

Dear Kris

Re: Exposure Draft ED 264 – Conceptual Framework for Financial Reporting

Stevenson McGregor ('SM') is pleased to provide comments on the AASB's Exposure Draft 264 Conceptual Framework for Financial Reporting (the 'ED'). Our detailed responses are set out in Appendix A to this cover letter. Appendix B sets out our responses to the AASB's Australian specific questions.

We have a deep interest in the conceptual framework project. We believe the conceptual framework (CF) is the cornerstone of high quality financial reporting. We have spent a considerable portion of our professional careers developing CFs nationally and internationally, using those frameworks in developing accounting standards nationally and internationally and advising on the practical application of those frameworks and the standards based on them. We are convinced that the quality of financial reporting is enhanced significantly if accounting standards, and ultimately decisions taken in practice, are based on an aspirational CF comprising a set of logically interrelated concepts.

We are very supportive of the IASB's decision to reactivate the CF project. The work completed previously by the IASB, together with the FASB, to update and clarify the higher levels of the framework, introduced significant improvements to the CF. However, other areas are in urgent need of updating and there continues to be significant gaps in the CF.

The reactivation of the CF project has provided the IASB and its partner standard setting bodies with the opportunity to produce a more compete and enhanced CF. Unfortunately, in our view, the exposure draft falls short of that outcome in a number of important respects.

Our overall reaction to the proposed CF is that it has become a mixture of concept and rule making, often without a clear expose of the principles behind proposals made and often addressing matters we would have expected to see debated in the development of standards. Taken as a whole, if we were in the position of an IASB board member, we would have dissented from the issuance of the exposure draft. Indeed, our most significant technical concerns parallel those of the Board members cited in the Alternative Views (AV) paragraphs of the Basis for Conclusions. We elaborate on our concerns in our detailed comments below.

We encourage the IASB to continue to strive for a more complete and enhanced conceptual framework that will have lasting benefit for those involved in and impacted by financial reporting.

If you have any questions concerning our comments please contact Warren McGregor at +61417340664 or Kevin Stevenson at +61416250008.

Signed on behalf of Warren and Kevin

Yours sincerely

K.M. Stevenson

Kevin Stevenson

Director

3 November 2015

Attached: Appendices A and B

Overall comment

1. Conceptual frameworks have traditionally been viewed by standard setters as aspirational documents, setting the direction for reform of financial reporting while acknowledging that at any point in time the ‘conceptually correct’ approach may not be achievable at a standards level. If financial reporting is to continue to evolve and meet the needs of the users of financial statements, it is important that this continues to be the case. There will always be a temptation when standard setters revisit the conceptual framework to see it as an opportunity to justify or codify previous decisions at a standard setting level that, at the time, were driven more by compromise and pragmatic solutions than underlying concepts. Such re-engineering would undermine the integrity of the conceptual framework both as a vehicle for facilitating the development of new ideas by the standard setter at a standards level and as vehicle for holding the standard setter accountable for its decisions.

Detailed comments

2. Our detailed comments are organised around the basic building blocks of the CF.

Definition of Financial Reporting

3. The existing conceptual framework does not have a section dealing with the scope of financial reporting. This is a significant omission, given the aspirational nature of the framework on the one hand and the development of potentially competing reporting models, such as integrated reporting and pro-forma reporting (including GAAP Vs Non-GAAP), on the other.

4. In our view, the conceptual framework should include an initial section that sets out a broad scope for financial reporting. This would facilitate the evolution of financial reporting as the demands of constituents’ change, as the institutional environment within which information is provided changes, and as the capacity to provide new and enhanced information changes. For example, the conceptual framework should not be a barrier to the provision of more forward-looking information in financial statements. Nor should it be a barrier to financial reporting harnessing developments in information technology that endeavour to enhance the communication process between reporting entities and those that use the information they produce.

5. In addition, articulating a broad scope for financial reporting should help clarify that other reporting models, such as integrated reporting, complement the ‘conventional’ reporting model rather than compete with it.

6. The growing interest in integrated reporting is symptomatic of growing discontent with the conventional reporting model. Preparers and users are increasingly voicing their concerns about the failure of financial statements prepared in accordance with existing accounting standards to provide

relevant information, and are responding by developing and focussing on various non-GAAP measures. Whether or not such concerns are valid, they are sincerely and passionately held. Accordingly, standard setters need to respond, and need to have the tools at their disposal to respond in an effective manner. A broad scope for financial reporting, and articulation of appropriate concepts relating to the presentation of financial position and performance (discussed below), would enable standard setters to explore alternative solutions that respond to the present concerns. However, in responding to such pressures we need to remain focussed on the objective set down in the Framework and to avoid a fragmented model. There do need to be borders to financial reporting if it is to remain meaningful.

7. We also believe the scope section of the conceptual framework should identify that the concepts articulated within the framework are 'transaction neutral'. In other words, the concepts should be capable of being applied by all reporting entities, irrespective of their operating structure, the sector of the economy in which they operate, i.e. private or public, and the operating objective they pursue, i.e. for-profit or not-for profit. We acknowledge that this is more of a medium-term objective and should ultimately be the product of a co-operative effort between the IASB and its public sector counterpart, the International Public Sector Accounting Standards Board, informed by the work of the FASB in addressing private sector not-for-profit entity issues. However, we think it is important for the IASB to acknowledge the desirability of having a single conceptual framework that can be applied by all reporting entities around the world.

8. In our view, if we develop a framework based in economics, and not in arcane accounting methods, transaction neutrality will come naturally to the fore, as we do not see economic concepts varying between sectors, even if some transactions occur exclusively or predominantly in one sector.

9. Having said this, we regret the lack of development in the current proposals in relation to economic decision-making, especially with so much time being expended on the endless semantical debates about prudence and stewardship.

Definition of the reporting entity

10. The coverage of this topic in the ED identifies the role of control in the identification of the borders of a reporting entity, which we support, but quickly heads into application issues (eg, the role of separate financial statements, the usefulness of combined financial statements and whether unconsolidated accounts can add value). It does not address when an entity should be considered to be a reporting entity. Thus a conceptual "hook" is not put in place for the distinction that the IASB makes between publicly accountable entities and other entities. Nor is there a hook for where the bottom reaches of IFRS for SMEs should be. This is left to the various jurisdictions without any guiding principles.

11. Does the IASB really intend that IFRS for SMEs would apply to micro entities? It seems to us that the IASB must have an implicit notion of a reporting entity when it determines the content of its standards. Indeed, we think the seeds of a definition are contained in paragraph 1.5. The wording

in this paragraph is consistent with the notion of a reporting entity as being an entity for which there exist users who are dependent on the entity's general purpose financial reports for information in making investment or credit decisions but whom are not in a position to demand such information.

12. We believe the Board should have retained the discussion of combined financial statements contained in the Reporting Entity Exposure Draft (RE12). In our view it is important for the CF to establish the conceptual basis for the preparation of financial statements when common control exists. In some jurisdictions there is demand from users for such statements, yet there is uncertainty in practice about the circumstances in which it is appropriate for combined financial statements to be prepared and whether such statements would be IFRS compliant. Establishing the conceptual basis for combined financial statements will provide the IASB with a framework within which to develop needed standard level guidance in this area.

13. We also believe this section of the CF should address explicitly the issues of whether a parent company's financial statements can be general purpose financial statements and whether reporting a portion of an entity can be considered to be a general purpose financial statement. These issues, along with the combined financial statements issue, were key concerns of respondents to the Reporting Entity ED.

14. Finally, this section omits a category of reporting entity – individual entities. The discussion implies that entities are either groups of (controlled) entities, which would typically prepare consolidated financial statements, or parent entities that may prepare unconsolidated financial statements. The circle needs to be closed by also referring to single entities that prepare individual financial statements showing resources controlled directly and claims against those resources.

Objective of Financial Reporting

(i) Stewardship

15. We disagree with the Board's decision to change the emphasis on stewardship from the existing CF. In the existing CF it is clear that information about resources of the entity, claims against the entity and how efficiently and effectively management has discharged their responsibilities to use the entity's resources, is directed to helping users assess an entity's prospects for future net cash inflows. That objective continues to be so in the ED for information about an entity's resources, claims on those resources and changes in those resources and claims, but now information about efficiency and effectiveness seems to be linked to "assessments of management's stewardship of the entity's resources". This is circular and meaningless. We think that the decision to retain economic decision-making as the objective is correct and that if stewardship has any part to play it is as a responsibility of management to foster quality in that decision-making.

(ii) Primary users

16. We do not agree with the discussion of primary and other users of financial reports. It underplays (circa paragraph 1.8) a traditional aspect of the debate about users – what common information serves the different information needs of the various user groups. For example, information about assets may be important to investors because of the opportunity it represents for future earnings. It may be important to lenders because of the security it offers. It may be important to Governments and employees from the perspective of employment opportunity. The merit in looking for the common information needs is that it establishes a border that precludes the need to look at the special needs of certain users (eg some information relevant to negotiating new employment contracts).

17. If the discussion had been more disciplined by the consideration of common information needs, there would have been no need to identify primary users. In turn, the expression of the conceptual framework would become more accessible to the users of financial reports in all sectors and not just to some of those participating in the capital markets.

Qualitative Characteristics

(i) Relevance

18. We support the inclusion of text explaining the impact of measurement uncertainty. There is a view held by some that an estimate subject to high measurement uncertainty cannot provide relevant information. We are pleased to see the new text addresses this misconception directly. However, we are concerned that the wording will be too abstract for some and so suggest that an example such as litigation liabilities be provided to assist readers understanding.

(ii) Prudence

19. We do not support the return to this arcane topic. The concept of neutrality (freedom from bias) is all that the Board's proposed wording seems to amount to, apart from trying to assuage the concerns of those who see merit in conservatism. We understand the political pressures that have been exerted on the Board in relation to this topic. However, we do not believe that the IASB will enhance its reputation by engaging in semantics that could possibly enable people with quite different views to retain their positions and to view the CF in the way they wish.

(iii) Reliability

20. We support the Board's position on retaining faithful representation as the qualitative characteristic and not reinstating 'reliability'.

Financial Position and Performance

21. We are of the view that the CF should have attempted to set down principles upon which these phrases could be based. In essence the absence of discussion of financial position, and any meaningful consideration of concepts of capital, means that we do not know what we mean by the term "financial position" in IAS 1 and elsewhere, or in director assertions and audit reports.

22. The corollary is that we do not know what we mean by performance.

23. We too readily are prepared to discuss possible components that might comprise the aggregations of financial position and performance without considering the meanings intended for them.

Other Comprehensive Income

24. Without a concept of performance, we find the discussion of other comprehensive income (OCI) largely non-conceptual and ill-placed in a proposed CF. We agree with the Board members who have dissented on this topic.

25. It seems to us that there is an unstated difference of view prevailing among board members. Some think that profit or loss is the only real measure of income and that OCI is a means of excluding "noise" from income until it is quietened. Others think that income should simply be a function of the definitions of the elements. Implicitly different concepts of income are being held.

26. We can understand presentations of income being designed to assist users in understanding the possible persistence of various components of earnings. But we do not understand how 'other income' can be measured and put aside until something else happens to convert it into 'real' income. Either the elements have changed or they have not.

27. We believe that 'recycling' of income is always going to be contrary to a CF based in economics and that any role that OCI could play must follow logically from a concept of performance.

28. We do not accept the non-articulation of the balance sheet and income statement. We see this as a playing out of conservatism on the part of the Board. In appears to us that the Board has accepted a view that volatility in reported income numbers needs to be guarded against rather than better explained.

Definitions of the Elements

(i) Assets

29. We support the refinements to the definition of an asset. However, we would suggest two further refinements – removal of 'as a result of past events' and the shifting of "control" to the recognition criteria.

30. In our view the phrase "as a result of past events" has been made redundant by inclusion of the phrase 'present economic resource'.

31. In particular, we support removal of the notion of 'expected' from the definition. From our experience, inclusion of this term in the present definition has caused a focus on the result of having a right to economic benefits rather than the right itself.

32. In our view all of the elements need to be defined in economic terms and that the recognition criteria should govern when elements are included or excluded from financial statements. For example, not all economic assets will be reported in balance sheets, either because of policy decisions by standard-setters or because of limitations in accounting methods to capture them. It is clear that over time we have come to recognise further assets as accounting has developed. So it is important conceptually not to slip into the trap of thinking that assets are only things we report in balance sheets.

33. Consistently with the above view, we would shift the term "controlled" to the recognition criteria. This means, for example, that good access to a public good (eg roadways) might be an asset of the reporting entity, but it is not admitted to financial statements because it is not an asset controlled by the entity.

34. We think it would be helpful to explain that the probabilities of receiving economic benefits relate to the measurement of an asset not its existence.

(ii) Liabilities

35. We do not support the retention of the vague idea of constructive obligations. We believe that there needs to be a right to enforceability open to the party or parties to whom the obligation is needed. We think that the elimination of the notion of economic compulsion from the definition of a financial liability at the standards level was correct and that "constructive obligation" is not sufficiently precise.

36. In our view working harder on the implications of the definition of a liability can lead to accounting which is not far from what people seek through intuitive approaches such as those that are thought to be provided by constructive obligations. For example, pension and long service leave entitlements can be argued to be written real options in which the employees hold the rights that they can control through meeting their obligations to serve.

(iii) Equity vs Liabilities

37. The exposure draft has failed to provide any ways to resolve the distinction between liabilities and equity. We do not accept that this is a standards-level issue, though the principles involved may well need support at that level. Again we agree with the views of the dissenting board members. This is a significant missed opportunity.

38. We do not support the possibility of remeasuring equity which seems to be implicit in some of the board's thinking. Such a re-measurement would be evidence of unreconciled differences as to the concept of capital and income. It also is another example of the consequences of not pursuing in a more fulsome way, the concept of common information needs.

Measurement

39. We strongly agree with the points made by Mr Finnegan in AV 17. In both the Discussion Paper "A Review of the Conceptual framework for Financial Reporting" and the ED the Board has shown little appreciation for the literature on accounting for price changes, the alternative concepts of capital and income and how measurement should articulate with the definitions of the elements and the issues of recognition and de-recognition.

40. The poor grasp of the literature in this area is highlighted by the classification of a model based in current market buying prices (and which would use the equivalent of current fulfilment values) as a cost model and a model based in current selling prices as a current value model (to be placed alongside fulfilment values!).

41. The Board continues to use the phrase "amount, timing and uncertainty of cash flows" without really addressing what are the objectives of measurement. The Board seems to prefer to pursue a smorgasbord approach to selecting different measurement attributes in different circumstances, yielding up financial statements that are in no way capable of meaning at aggregated levels. In doing so it is far from clear that they have assisted users in their assessment of future cash flows.

42. We continue to believe that, when current and historical prices differ materially few if any economic decisions will be based on historical costs. The Board seems to rely on anecdotal evidence about which elements of financial statements can stay at historical cost and which must be restated, or may be restated, to current values. The Board is unwilling to turn insurance activity reporting back to historical cost and unwilling to move the measurement of long term loan capital from historical cost to the same basis as it requires for provisions. At the level of the CF we would like to see the Board analyse the competing measurement models in situations in which there is a presumption of material differences between historical cost and current values. At least then we could see explicitly the thinking about the relationship between the objective of financial reporting and the basis for measurement. This in turn could lead to the development of concepts of financial position and

performance. If this is not achieved the Board will achieve little progress on a framework for presentation and disclosure – simply because there will be no unifying concepts to serve.

43. We understand that considerable political pressure has been exerted on the Board in relation to the use of fair values and other current values (eg fulfilment values). In our view one of the most significant reasons for a lack of progress in the use of current values has been a failure to bed their selection in clearly expressed concepts of capital and income. It is another significant missed opportunity that the proposals contain no means for furthering the debate.

44. In turn, the inconsistency in measurement bases has eroded the ability of the board to address or develop any meaningful concepts of financial position or performance.

Unit of Account

45. This issue is another left by the CF to the standards level. In a sense this could be seen to be an intermediate aggregation issue that falls between the definition of an element and the levels of aggregation we see in financial statements. The difference is that we actually sometimes vary the recognition and measurement rules (usually through off-setting) when certain units of account are thought important. On other occasions we have recourse to the notion of unit of account simply out of the practical necessity to deal with volumes of transactions or items. We would have thought that some high level principles could be developed for at least these two broad categories of “unit of account” issues.

Appendix B

Australian Specific Questions

(i) whether, and to what extent, the IPSASB Conceptual Framework should be incorporated into the AASB Conceptual Framework for Financial Reporting

1. We support the AASB's traditional approach of retaining a transaction neutral approach to the CF and individual standards. The IPSASB conceptual framework does not, in our view, offer any superior answers to the IFRS conceptual framework and Australian reporting entities are long past worrying about issues of lexicon.

(ii) 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

2. We do not see any regulatory issues but would see that the Board will need to include some Australian specific paragraphs, as in the past, to ensure that the different sectors understand the CF in their context.

(iii) whether, overall, the proposals would result in financial statements that would be useful to users

3. Though we are broadly opposed to the ED, we do not think this question is provoked. Individual standards flowing from the proposals may well be contentious. But we do not see the proposed CF affecting financial statements in those circumstances in which the CF is in active play in the hierarchy of accounting precedents. This is, in large part, due the proposals being more like a codification of existing requirements than a development of the CF.

(iv) whether the proposals are in the best interests of the Australian economy

4. We do not support recourse to this criterion when evaluating proposals for changes in IFRS. We understand the AASB is obliged to consider it, but think that such changes should be considered

within the context of financial reporting principles and practices, not some unspecific “other” criterion.

(v) 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.

5. At the level of the proposed changes to the CF, it is hard to judge the costs and benefits other than by technical merit and logic. However, for the reason stated above, we do not see any of the proposed changes leading to undue cash costs. We are quite doubtful about the accounting merit of the changes discussed above.