



ACT
Government

Chief Minister, Treasury and
Economic Development

Ms Kris Peach
The Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007

Dear Ms Peach 

Exposure Draft (ED) 264 *Conceptual Framework for Financial Reporting*

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on the Exposure Draft: ED 264 *Conceptual Framework for Financial Reporting*.

HoTARAC is supportive of the development of the Conceptual Framework project, in particular the changes proposed in ED264 to make the framework more comprehensive, improve the conceptual underlay for other comprehensive income and address measurement uncertainty in more detail. However, HoTARAC suggests further consideration be given to the following:

- *Project timeframes.* HoTARAC supports completing the conceptual framework project in a timely manner. However, HoTARAC notes that a number of other projects are proceeding concurrently with the framework, the outcomes of which may impact on some concepts.
- *Preferred measurement base.* HoTARAC accepts that the preferred measurement base will not be appropriate in all circumstances; however, having a preferred base promotes the overall goal of improving consistency in financial reports.
- *Financial report user groups and their information needs.* A broader assessment of primary users across all types of private sector and public sector entities is essential to enable appropriate evaluation of an entity's performance, management and resource allocation decisions regardless of the entity type or its business activities.

Comments by HoTARAC on the Specific Matters for Comment, including the AASB Specific Matters, in the ED are in the Attachment.

If you have any queries regarding HoTARAC's comments please contact Peter Gibson from the Australian Department of Finance on (02) 6215 3551.

Yours sincerely



David Nicol

CHAIR

HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

10 November 2015

General Comments

Overall, HoTARAC is supportive of the development of the Conceptual Framework project and supports the proposed changes in ED264. In addition to addressing the Specific Comments below, HoTARAC notes the following:

Project completion timeframes

HoTARAC supports the IASB's goal of completing the conceptual framework project in a timely manner. However, it is noted that a number of other projects are proceeding concurrently with the conceptual framework project and are referenced in the ED, including the characteristics of equity (BCIN.25), the Disclosure Initiative (BC7.2(b)) and IAS 37 (BCE.11), cash flows (BC4.109) and, more generally, technology (BC7.23). In particular, HoTARAC believes the Disclosure Initiative and the Conceptual Framework should be considered contemporaneously. In HoTARAC's view the recent development of standards without an appropriate conceptual framework has resulted in voluminous disclosures to justify the approach taken and explain inconsistencies between standards. Reducing disclosures to a manageable level will similarly require consideration of conceptual issues. This is, for example, evident in the application of materiality to disclosure decisions.

HoTARAC is also of the view that the framework should be a living document, updated where necessary. This project has been in abeyance since 2010 and a rush to finalise without the possibility of amendment may result in conceptual weaknesses that the project was intended to address.

Language in financial reporting

HoTARAC notes the IASB's comment that the language used in the application of probability thresholds is inconsistent across standards (BC5.8). Perhaps a broader discussion of the language used in financial reporting could be considered. For example, major is used in IAS 5 Non-current assets held for sale and discontinued operations to describe discontinued operations and in exposure drafts on proposed changes to the leasing standard. Standards are in turn subject to materiality. HoTARAC considers the glossary a valuable component of the conceptual framework and suggest this could be an appropriate vehicle to explain these terms so preparers apply them consistently.

HoTARAC believes that additional guidance on the interaction of materiality with minimum disclosure requirement in accounting standards would be useful.

Not-for-profit sector

HoTARAC appreciates that the IASB current focus is on 'for profit' entities (BC 4.28). As discussed in HoTARAC's response to the IASB's discussion paper on the conceptual framework, HoTARAC believes that the language of the conceptual framework should be broad enough to encompass the not-for-profit sector, including the public sector, where this can be done without compromising this focus. For example, the discussion on fair value (from paragraph 6.21) could consider circumstances where it is appropriate to use the term 'economic benefits' in preference to cash flows, particularly as this ties in more closely to the definitions of assets and liabilities.

Specific Comments

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?

a) HoTARAC supports the decision to give greater prominence to the importance of providing information that assesses management's stewardship of the entity. However, HoTARAC considers that subsuming this concept into the current narrow objective of financial reporting of deciding whether to buy, sell or hold an investment may be overly restrictive as information on stewardship is of broader interest to a range of users.

Broader consideration of user groups and their needs would allow the IASB to consider whether financial reports enable users to assess an entity's performance, management and resource allocation decisions. HoTARAC recommends that the stewardship of an entity be assessed by acknowledging the information needs of users of financial statements other than those currently identified as primary users, which is heavily directed towards short term investors.

In addition, HoTARAC recommends the inclusion of a reference to corporate governance around resource allocation decisions in paragraph 1.22 to give users some predictability over management's future effective and efficient use of resources.

b) HoTARAC broadly supports the reintroduction of the notion of prudence in the proposed Conceptual Framework. Prudence is an important aspect of achieving neutrality in financial reporting; however it also stands on its own as a key consideration when exercising judgments separate from considerations of neutrality. In this respect, prudence is particularly relevant given the expanded discussion on measurement uncertainty and as such has more relevance on measurement decisions. HoTARAC agrees with paragraph 2.18 that assets and liabilities should not be understated or overstated and with BC2.6 that caution should not be interpreted to mean that losses should be recognised before gains.

c) HoTARAC supports the emphasis on substance over form that has been reintroduced into the proposed Conceptual Framework. This is a key concept in ensuring that financial information presented is faithfully represented and useful to users of financial reports. HoTARAC notes that substance over form is at the core of a number of pronouncements, for example, IFRIC 4

Determining Whether an Arrangement Contains a Lease and SIC 27 Evaluating the Substance of Transactions in the Legal Form of a Lease. These pronouncements recognise the importance of looking through the legal form of an arrangement if the transactions are to be appropriately presented in financial statements.

d) HoTARAC agrees that the use of estimates is an unavoidable part of the preparation of financial information, and that estimates will always have a degree of measurement uncertainty due to their nature.

In its current form, HoTARAC believes the discussion around measurement uncertainty is too broad and may lead preparers to present financial information that is not relevant to users. Further discussion or guidance around the reasonableness of inputs and assumptions used in determining the estimate and how these link to what the estimate is representing is required, as well as an expansion of “appropriate process” as noted in Para 2.20.

Additionally, measurement uncertainty does not solely impact the fundamental characteristic of relevance; it also impacts on whether or not the financial information is faithfully representing the economic phenomena it presents (as per Para 2.14). A number of concepts discussed under the banner of faithful representation, such as neutrality, prudence and completeness, are key considerations when discussing measurement uncertainty.

e) HoTARAC agrees that faithful representation and relevance should continue to be identified as the two fundamental qualitative characteristics. However, HoTARAC believes that the enhancing qualitative characteristics, as identified in paragraph 2.22, should retain importance in decision-making about accounting policies.

Question 2—Description and boundary of a reporting entity
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Do you agree with:

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| <ul style="list-style-type: none">(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? |
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Why or why not?

HoTARAC broadly agrees with the proposed description and discussion of boundary of a reporting entity. However, HoTARAC recommends paragraph 3.18 refers more generally to users of financial statements, to accommodate a possible future broadening of the user group.

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?

HoTARAC broadly agrees with the definitions of elements in the proposed Conceptual Framework. However, we would draw attention to the following points:

- The discussion around the potential to produce economic benefits in Para 4.13 and the obligation to transfer economic benefits in Para 4.27 of the proposed Conceptual Framework is significantly broader and open to improper interpretation than that in the existing AASB Conceptual Framework. HoTARAC suggests referencing this discussion to Para 5.17 – 19 of the proposed Conceptual Framework, which discusses the usefulness to users of recognising an asset/liability where there is a low probability of an inflow/outflow of economic benefits. (under these circumstances the financial statements will include items that, on balance of probability, will never happen)
- HoTARAC cannot see a benefit from continuing to include a past event in the definition of an asset and suggests it be included as guidance rather than in the definition. While it has caused no significant problems (BC4.21), it is unclear what benefit it adds to the definition as it seems to relate primarily to portrayal and classification (BC4.21). As we are not aware of examples where an asset has not been identified due to the absence of a past event, almost any event would seem to qualify.

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?

HoTARAC agrees with the proposed definition of a present obligation and the related guidance.

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.

HoTARAC broadly agrees with the guidance provided in the proposed Conceptual Framework around executory contracts, unit of account or reporting the substance of contractual rights and obligations. HoTARAC agrees that the unit of account is critical to the notions of recognition, capital consumption through depreciation and measurement and should be addressed, where possible, when standards are developed. Also, HoTARAC notes that the wording of the determination of unit of account could

be clearer, as currently it is unclear whether to apply the notion of recognition and measurement before or after determining the unit of account.

HoTARAC notes that paragraph 4.18 defines control of an economic resource as “the present ability to direct the use of the economic resource and obtain the economic benefits that flow from it.” This does not align to the definition of control under IFRS 10 *Consolidated Financial Statements*, which hinges on exposure to variable returns and the capacity to affect those returns. HoTARAC suggests these definitions be aligned.

Question 6—Recognition criteria
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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?

HoTARAC broadly agrees with the guidance around recognition in the proposed Conceptual Framework, noting that the guidance mostly mirrors concepts that are discussed in other areas of the proposed Conceptual Framework.

However, HoTARAC’s comments around measurement uncertainty and relevance in Question 1 are also applicable to the guidance around recognition. Further substantive guidance around measurement uncertainty of estimates, relevance, and disclosure as an alternative to recognition would be of benefit. In particular, HoTARAC recommends the inclusion of examples to assist in understanding circumstances where a ‘low probability’ of economic benefits translates to a loss of relevance of an element being considered for recognition.

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?

HoTARAC agrees with the guidance provided on derecognition.

Question 8—Measurement bases

Has the IASB:

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| (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? |

a) HoTARAC agrees with the measurement bases identified. However, to avoid confusion, HoTARAC suggests the IASB clarify that ‘current cost’ (an entry value per paragraph 6.18) is not the same as ‘current replacement cost’ (an exit value per IFRS 13 *Fair Value Measurement*).

b) HoTARAC broadly agrees with the information provided on each measurement base. However, HoTARAC does not agree with paragraph 6.30 that fair value may not be relevant where the intent of the entity is not to transfer a liability or sell an asset. The fair value is broadly indicative of the amounts that could be obtained by selling the assets or buying an equivalent set of assets.

This would be relevant when choosing between alternative investments, regardless of the intent of the entity.

HoTARAC strongly supports paragraph 6.50, that the cost of providing a particular measurement base should not exceed the benefits of the information provided.

HoTARAC notes that the focus of reporting, whether it is on the cost of services, operational capacity or financial capacity, would logically affect the selection of a measurement base.

Question 9—Factors to consider when selecting a measurement basis
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Has the IASB correctly identified the factors to consider when selecting a measurement basis? If not, what factors would you consider and why?
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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?
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HoTARAC strongly believes the conceptual framework should move towards a preferred measurement base. HoTARAC accepts that the preferred base will not be appropriate in all circumstances for reasons of relevance/usefulness or, in particular, where the costs of using the preferred base outweigh the benefits (for example, it is unlikely the benefits of measuring inventory at fair value would justify the cost in most circumstances). Nonetheless, having a preferred base accords with the overall goal of improving consistency by promoting a consistent measurement base. As the other items in the financial statements are driven by movements in assets and liabilities, consistency is important for meaningful financial aggregates.

A preferred measurement approach would also simplify the application of other comprehensive income as mixed measurement bases would be less likely.

While HoTARAC supports a preferred measurement base, as noted in the response to the previous question, this should be tempered by considerations of cost-benefit constraints. HoTARAC also agrees with paragraph 6.55 that the level of measurement uncertainty is critical to the selection of a measurement base. Where the use of fair value would produce an estimate with too wide a range of outcomes, a historical cost measurement base should be used.

Question 11—Objective and scope of financial statements and communication
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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?
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HoTARAC welcomes the consideration of entity-specific information as against standardised language (paragraph 7.18(a)) and emphasis of presentation and disclosure objectives at the level of individual standards (paragraph 7.16). These will be helpful in focusing financial statements preparers' on the proposed fundamental qualitative characteristic of 'relevance' and avoiding unnecessary disclosures.

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.

HoTARAC agrees with the proposed description of the statement of profit or loss.

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?

HoTARAC broadly agrees and welcomes the firmer conceptual base for the use of other comprehensive income (OCI). However, further clarification of the objective of profit or loss and OCI in the Conceptual Framework would make it easier to determine which items of OCI should be recycled into profit or loss and when that recycling should take place. While HoTARAC appreciates this should not unnecessarily delay the finalisation of the framework, as noted above, HoTARAC believes this should be a living document, evolving as issues arise.

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?

HoTARAC suggests that the need for recycling may arise because items in OCI are assigned a lesser prominence and further consideration should be given to whether this can be addressed through presentation. For example, it may be necessary to add another category for items which are outside the control of the entity.

HoTARAC also notes that paragraph 7.26 implies that all income or expenses will generally be recycled from OCI into profit or loss in some future period. HoTARAC therefore questions how that relates to long-established practices for accounting for certain income/expenses through OCI, which are not currently recycled (e.g. asset revaluation increases/decreases). HoTARAC recommends high level principles be included in the Conceptual Framework to provide a consistent basis to determine whether a particular item should be recycled from OCI to Profit or Loss and when should that happen. In developing principles HoTARAC recommends give due consideration to the rationale expounded in paragraph 7.26 of recycling where this will enhance the relevance of information included in the statement of 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?

HoTARAC agrees.

Question 16—Business activities

Do you agree with the proposed approach to business activities? Why or why not?

HoTARAC view is that, for financial reporting purposes, the accounting treatment should always reflect the substance of the transaction rather than a reflection of the business activities of a particular entity. Identical transactions shall be treated in similar ways irrespective of entity type. For example, is the transaction conducted for commercial reasons or a not-for-profit reason, such as a donation? HoTARAC believes this emphasises the importance of the eventual consideration of transactions for both the for-profit and not-for-profit sectors. The comparability of financial information would dictate that recognition and measurement should primarily be determined by the nature of the transaction.

Question 17—Long-term investment

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

HoTARAC broadly agrees. However, HoTARAC views the identification of a separate investor group as an indication that the current objective of financial reporting as a decision to buy, sell or hold an investment may be too narrow. If the framework sets an appropriate base for the development of financial reports that legitimately provide relevant information to a broad user group then HoTARAC considers differentiating amongst short and long-term investment as unnecessary.

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.

Refer general comments above.

AASB Specific Matters for Comment

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

HoTARAC notes that the IPSASB conceptual framework specifically addresses public sector issues and could potentially be used by the AASB in developing public sector guidance within the AASB framework. However, it is still HoTARAC's preference that the IASB framework supports transaction neutrality. Where divergence is appropriate to better address activities and transactions unique to the public sector the framework can be modified, for example non-reciprocal arrangements and revenue recognition.

In relation to IASB Question 2, HoTARAC is concerned that there is insufficient guidance to assist preparers in determining the boundaries of non-legal reporting entities, for example, in NSW the 'Crown Finance Entity'.

In relation to IASB Question 3, HoTARAC suggests the AASB consider an Aus paragraph to include 'service potential'. The definition of 'economic resource' at paragraph 4.6 and subsequent elaboration of 'potential to produce economic benefits' under paragraph 4.14 could lead to a narrow interpretation of an economic resource/ benefit to include only measurable financial benefits and cash flows. This could mean excluding 'service potential' of assets that does not necessarily generate measurable cash flows or cash flows at all.

Question 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;

HoTARAC is not aware of any regulatory implications for public sector entities. HoTARAC has not yet assessed whether there are:

- a) any specific requirements to amend the framework for suitability to not-for-profit entities in general, and the public sector in particular; or
- b) any specific GAAP/GFS implications of the proposals, although it is noted that GFS does take a different view of some issues e.g. GFS has one preferred measurement basis (market value); GFS has established and clear distinctions between profit and OCI (transactions and other economic flows), and does not have recycling .

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

Other than those points raised in the General Comments and Specific Comments above, HoTARAC is supportive of the IASB Conceptual Framework project proposals and believes it would result in financial statements more useful to users.

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

Yes.

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.

HoTARAC notes it is difficult to assess costs and benefits until the principles are translated into accounting standards. However, it is likely that additional costs may arise from applying the 'benefit versus cost' criteria for element recognition. For example, this may be relevant for the public sector that holds large volumes of assets where no active market exists.

