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IASB
30 Cannon Street
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January 21, 2014

Dear Mr Hoogervorst,

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

We are pleased to respond to the Discussion Paper DP/2013/1 *"A Review of the Conceptual Framework for Financial Reporting"* (the DP).

First of all, we would like to thank the Board for tackling this subject of major importance which has been requested by a large number of constituents. As we mentioned in our response to the Agenda Consultation and in our comment letters on a number of other projects, it seems to us that the current body of IFRS has arrived at a point in its evolution where it has become essential to reconsider the fundamental concepts, test whether they still match the needs of the whole range of users, whether identified in the current text or not, and ascertain that they are still robust and defined in a way that achieves consensus among constituents. This would ensure that the Conceptual Framework would continue to provide a solid base for the preparation and understanding of reporting under IFRS.

Although we recognise that the DP can only represent an exploration of the potential concepts on the way towards more precise proposals, we think that it is very difficult at this stage to have a sufficiently clear understanding of the proposals, some of which are still embryonic in their development, in order to be able to assess them fully. We would therefore have liked to see more and better illustrations of the new definitions and other proposals in order to be able to evaluate more easily the potential impact they might have.

Indeed, we do not think it would be possible for us to conclude definitively on the proposals without a document analysing the impact of the proposals. Such a document should be in our view an integral part of the process for the revision of the Conceptual Framework (CF) and would provide the list of all the differences in principle identified between the proposed CF and the existing standards. The document would provide the link to the Board's agenda by specifying the following:

- The standards which would have to be amended and in what time scale, and
- Those standards that would not be amended and the justification for this.

This does not mean that we are requesting a major revision of current IFRS standards, but we anticipate that such an exercise would allow the Board to confirm the soundness of the principles adopted while providing direction for the next few years.

In addition, it should lay out guidance for the way IFRS Interpretations Committee should work in the interval between the publication of the final CF and the revision of the standards affected, in order to minimise the potential disruption that could arise in this period.

Finally, there are a number of areas which we would encourage the Board to explore further:

- We regret that there is no debate about the status of the Conceptual Framework in the body of IFRS (see our response to Question 1) and that there is no discussion of the level of detail at which the fundamental principles should be defined. The status of the CF should inform the level of detail of the principles it lays out.

- The issues around the phases of the project which were previously published, and which are still contested in some quarters, are raised only at the end of the DP. These elements seem to us to be fundamental prerequisites for the establishment of robust principles in the CF, and therefore warrant further debate. This is the case for the definition of the objectives for financial reporting and the fundamental characteristics of reporting which are derived from them (topics such as prudence, reliability and stewardship or management accountability, for example) and the role of the business model in financial reporting.

- The topics of the definition of profit or loss (or net income) and the use of OCI and recycling warrant further analysis.

- We think it would be very useful if the Board were to take into account all the “cross-cutting” issues identified in the work of the IFRS IC and in the revision of standards in order to assess whether the Conceptual Framework could help resolve some or all of these issues.

- Finally, although we agree that to commence the revision of the CF with a blank sheet of paper would be a very long-winded undertaking, we do not think that it is appropriate to use the project as an opportunity to set in stone some of the ideas that have been developed in recent projects without challenge or full debate. Examples of these are the right-of-use asset and the preference for the transfer of control over the transfer of risks and rewards. We would encourage the Board to provoke a wider debate on these topics.

Our responses to the questions posed in the DP are set out in Appendix 1.

If you have any questions or a need for further information, please do not hesitate to contact us.

Yours sincerely,

ACTEO	AFEP	MEDEF
Patrice MARTEAU Chairman	François SOULMAGNON Director General	Agnès LEPINAY Director of economic and financial affairs

Appendix 1

Section 1 Introduction

> **Question 1**
> Paragraphs 1.25–1.33 set out the proposed purpose and status of the *Conceptual Framework*. The IASB's preliminary views are that:
> (a) the primary purpose of the revised *Conceptual Framework* is to assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs; and
> (b) in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the *Conceptual Framework*. If this happens the IASB would describe the departure from the *Conceptual Framework*, and the reasons for that departure, in the Basis for Conclusions on that Standard.
>
> Do you agree with these preliminary views? Why or why not?

We think that the debate about the status of the conceptual Framework needs to be reopened, with the aim of ensuring that the body of IFRS achieves a proper balance between:

- Widely accepted robust principles which are sufficiently solid to guarantee a durable framework. This is important for all the jurisdictions which have adopted IFRS as it will ensure that, in developing or revising standards, the IASB will maintain the broad principles and direction that were often instrumental in the decision of these constituents to adopt IFRS.
- Principles which are set at a suitably high level to maintain the flexibility essential for the elaboration of individual standards which are fine-tuned in order achieve the most appropriate treatment of the specific transactions and events they are aimed at, while at the same time remaining consistent with the guiding principles of the Framework.

We think that, in a body of accounting guidance which is based firmly on principles, the Conceptual Framework should be a strong point of reference both for the standard setter and for all the interested parties. Indeed, it allows:

- The Board to develop future standards in conformity with the established principles;
- All the other parties who are interested in international accounting standards to understand the general structure within which the standard setter is working; and
- All those who apply IFRS (preparers, auditors, oversight bodies, etc.) to have readily at hand a strong body of guidance to help them when they are faced with situations which are not dealt with by a specific standard.

In our view, the revision of the Conceptual Framework provides the opportunity to reinforce the consistency between the Framework and the standards which apply it to specific cases. This will serve to ensure that any "grey areas" are as limited as possible.

To elaborate on the above, we think that this preliminary debate is important for the construction of the future Conceptual Framework, since it will inform its structure. In order to avoid contradictions with the standards, and to avoid inappropriate scope limitations in the development of specific standards, the Framework should be set at a high level of principles and not delve into excessively detailed levels of application. Indeed, the establishment of rules, which could not possibly respond to all the potential circumstances, would inevitably lead to the creation of exceptions from the Framework which would ultimately undermine it.

If the IASB develops a solid framework of high-level principles, it will be able to set in place a systematic process for the analysis and justification of departures from the Framework in current and future standards, which would also integrate a mechanism for correcting departures which are significant. In fact, if the development of a particular standard leads the Board to prefer an approach representing a major divergence from the Conceptual Framework, it would be justified in considering an adaptation of the Framework itself. Such a process would have the advantages of being rigorous and probably of limiting the number of exceptions from the Framework to the absolute minimum.

Section 2 Elements of financial statements

Question 2

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

(a) an asset is a present economic resource controlled by the entity as a result of past events.
(b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.
(c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.

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

We think that this topic is so important to the body of IFRS that the Board ought to identify and communicate the impact it anticipates the changes in definitions would potentially have on each standard, if adopted. This analysis should help constituents to better understand the impact of the whole of the new principles on the main types of transaction by combining the proposed definitions with the new recognition criteria and the measurement approaches. It is difficult for us to opine definitively on the proposals without such a study.

We have the impression that the new definitions widen the scope of what might be considered to be an asset or a liability. We do not think that it is appropriate to adopt such broad, or even theoretical, definitions, which we think will lead to very time-consuming debate about potential assets and liabilities, if in the end they are to be rejected by application of the recognition criteria. The widening of the scope of potential assets and liabilities will place more pressure not only on the recognition criteria defined in the CF, but also on the detailed application of the criteria in the context of each standard.

Under these proposals, the principal “filter” for the recognition of assets and liabilities will be the development or revision of a standard when the IASB will have a very strong power of discretion about which elements are recognised. We are uncomfortable with that. If the purpose of setting the new definitions is not to recognise more elements in the balance sheet but rather to ensure that more items will potentially be disclosed in the notes, then this objective ought to be clearly announced.

Having said that, we agree with the fundamental point that an asset is a resource and a liability is an obligation.

However, we have doubts about the use of the phrase "capable of producing economic benefits", which could give rise to the vagaries of interpretation just as the phrase "economic benefits are expected" does today. Furthermore, the replacement of "expected" by "capable" seems to us to be a step towards placing too much emphasis on the objective of "neutrality", to the detriment of an "entity-specific view". We believe that the latter provides for a more relevant representation in the financial statements reflecting more faithfully the actual management of the entity and better facilitating assessment of the quality of the management (stewardship or management accountability). In this respect please refer to our responses to questions 6 and 22. In order to mitigate this potential impact, we think the CF should specify that the asset is capable of producing economic benefits for the entity, and maintain a probability threshold for the existence of an element in the definitions. This would not preclude the use of exceptions, when duly justified, leading to the recognition of a broader range of assets in certain standards, such as in IFRS 3 Business Combinations.

In addition, the notion of "as a result of past events" merits further explanation: is it the signature of a contract or an event or the passing of a threshold identified by the contract which triggers the recognition of a liability? This aspect is not clearly explained in the discussion on the difference between an executory contract which is not accounted for and one that is.

We also wonder whether the notion of "enforceable rights", is not better suited to intangible assets than to tangible assets, for which it raises many questions, notably when it is combined with the idea of the "unbundling" of rights from an asset. It seems that for the IASB these new definitions are merely better drafting of the existing definitions, but we think that there is a risk that they will force entities to ask themselves numerous questions in order to determine or deny the existence of new assets and liabilities without any clear benefit that we can see at this stage.

Finally, in view of the increasing reliance on the notion of control in recent standards, we agree that all the definitions of this notion should be aligned into a single definition. This would not preclude the fine-tuning of the definition of control where justified in individual standards, but it should be very clear that it is the same notion.
However, we do not think that it is advisable to delete the modifier "substantially all" from the definition before having concluded the discussions on the subject of the notion of portions of assets.

Question 3
Whether uncertainty should play any role in the definitions of an asset and a liability, and in the recognition criteria for assets and liabilities, is discussed in paragraphs 2.17–2.36. The IASB's preliminary views are that:

(a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is 'expected'. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources.
(b) the *Conceptual Framework* should not set a probability threshold for the rare cases in which it is uncertain whether an asset or a liability exists. If there could be significant uncertainty about whether a particular type of asset or liability exists, the IASB would decide how to deal with that uncertainty when it develops or revises a Standard on that type of asset or liability.
(c) the recognition criteria should not retain the existing reference to probability.

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

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

We think that it is advisable to retain a probability threshold as part of the definition of assets and liabilities. This would allow the Board to:

- Simplify and make more efficient the elimination of assets and liabilities where the uncertainty about the their existence is clear;
- Define more narrowly the scope of the recognition criteria ;
- Re-introduce the notion of entity specificity in the identification of assets and liabilities.

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

As discussed above, this question would not be an issue if a threshold of probability were introduced in the definition.

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

We think that it is essential to maintain a probability threshold for recognition in order to ensure that assets and liabilities are not recognised when their realisation and the amount at which they expect to be realised are very uncertain.

Based on the two main qualitative characteristics that we would like to promote, i.e. Relevance and Reliability, we believe that an uncertainty threshold should be used and maintained in the conceptual framework, to ensure that assets and liabilities recognised in the financial statements are those that are likely to give rise to future cash-flows.

We therefore believe that uncertainty is not only a matter of measurement. We support the use of a probability threshold in the recognition criterion because we believe that the user of financial statements is interested in the probable consumption of resources, not in financial data which report what remains highly improbable of realisation.

In our view, relaxing the recognition criterion would lead to meaningless information:

- Recognising highly improbable inflows and outflows is unlikely to provide useful information
- The measurement of such items is likely to be less reliable than that for assets and liabilities with more likely inflows/ outflows
- Using judgement to determine whether a recognition threshold has been met is simpler and more reliable than making the judgements necessary to determine a measurement based on all possible expected outcomes
- An approach that systematize tracking, collecting, processing information for recognising elements with a remote likelihood of occurrence does not pass the overall cost/ benefit objective

Question 4
Elements for the statement(s) of profit or loss and OCI (income and expense), statement of cash flows (cash receipts and cash payments) and statement of changes in equity (contributions to equity, distributions of equity and transfers between classes of equity) are briefly discussed in paragraphs 2.37–2.52.

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

We note that the definitions of these elements are unchanged from the current Conceptual Framework. However, we do not agree that expenses and income should be defined as the difference between two balance-sheet amounts. Moreover, we do not think that the distinction between net income (profit or loss) and OCI is just a matter of presentation as the IASB appears to conclude in paragraph 2.50.

We think that it is essential that the CF provide a definition of what an expense or an item of income relating to a specific period is. This would allow the Board to make individual decisions about how items should be accounted for in the profit or loss statement without having continually to decide upon the balance-sheet approach and then to apply the consequences to profit or loss. To define the elements of expense and income by reference to the balance sheet is at odds with the Board's assertion (in paragraph 7.31) that no individual statement is superior to any other.

We think that the following are needed:

- An independent definition of each of assets and liabilities;
- An independent definition of each of the elements of the profit or loss statement (we make some suggestions for a way towards definitions of the elements of the profit or loss statement in our response to Question 21); and
- Further reflection on the accounting for the variations in balance sheet items which should not, in our view, be recognised systematically in profit or loss (recognition instead as a movement in another asset or liability, if the required definitions are met, or otherwise use of OCI to reconcile the whole). This could assist in resolving the issues of NCI puts, variable consideration for assets, etc.

Section 3 Additional guidance to support the asset and liability definitions

Question 5
Constructive obligations are discussed in paragraphs 3.39–3.62. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations—and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50.

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

We are in favour of retaining the current notion of a constructive liability because it seems to us that restriction to the legal and contractual obligations would not allow one to properly represent the whole of the obligations of an entity. Moreover, we think that the current definition of a constructive liability is satisfactory and does not call for debate.

The examples given in paragraph 3.46 of the DP do not seem to be truly comparable to us:

- In the first Case (the restructuration plan) the announcement of the plan effectively commits the entity to it, whereas,
- In the second case, that of the contingent rentals, the arrangement may lead to a change in the performance of the entity and hence recognition serves only to improve the relevance of the reported interim result, but there is not a present implicit obligation to a third party. A constructive liability is a commitment that goes beyond an economic compulsion- there must be a real obligation.

We are therefore in agreement that a constructive liability exists only when there is a real commitment with regard to a third party (paragraph 3.50(a)). We wonder whether the addition of the criterion of paragraph 3.50(b) is necessary as this could be too restrictive, in that it appears to be trying to identify the third parties very specifically. This could have the effect of requiring that entities do not provide for depollution or even decommissioning where the party who would benefit from the activity is not necessarily the direct counterparty of the entity.

Having said that, in our interpretation, these criteria do not exclude the setting-up of a provision for a restructuration plan once there has been a formal public announcement has been made. Once the criteria of current IAS 37 in respect of restructuration plans have been satisfied a real commitment exists. The lack of a provision would not provide relevant information about the impacts of decisions and commitments made during the period. We do not think that, in the absence of a change in definition of a constructive liability, the addition of further guidance as discussed in paragraph 3.50 would, nor should, result in different timing of the recognition of a provision for restructuration.

Question 6

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

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

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

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

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

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

In order to be able to define appropriately what is meant by a “present” obligation, it is, in our view, essential to answer the following questions: what are the financial statements intended to represent? And, what level of confidence does one wish to have in forecasting future cash flows? Once that objective has been defined, one can then decide if the balance sheet should present the strict obligations which the entity cannot avoid or should it also depict all the potential risks of future cash outflows.

View 1 will capture only firm cash outflows for which all the conditions have been satisfied. However, we think that this approach could sometimes be too limited, particularly when there is a very high probability that the future condition will be satisfied.
View 2 may therefore be more pragmatic and provide a better tool for forecasting future cash flows as these would be recognised as soon as it becomes highly probable that a net cash outflow will occur.

We have more difficulty in understanding the objective that is pursued by View 3. Is the aim that of showing the risks of all potential future cash outflows, whatever their level of probability? This appears to us to be too broad in scope and will not satisfy the requirement of reliability of financial statements, since it would cause flows to be recorded on the balance sheet which have a low level of probability of realisation in the future.

We wonder whether it is advisable to introduce a new threshold notion – “practically unconditional”. This may prove to be as open to divergent interpretation as is the notion of current IAS 37 “no realistic alternative to settling that obligation”. We think it is better to adopt a threshold that is already used and understood, such as “probable” or “reasonably” certain, and appropriate to the level of reliability or relevance required for the balance sheet.

Question 7
Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

Unbundling of assets into a collection of rights
In paragraph 3.7 and fol. the Board raises a new topic which we think calls for more debate and challenge. In these paragraphs the Board develops the idea that an asset is in fact a bundle of different rights which could therefore be subject to different recognition criteria and measurement approaches. We are aware that this new notion was initially used in the Leases project primarily to justify the recognition on the balance sheet of an element corresponding to the recognition of the lease liability. We are disappointed that this notion, which has been developed for a new standard, appears to be intended to be incorporated in the Conceptual Framework without proper debate and without thorough testing.

Economic compulsion
We agree that this notion is relevant to the assessment of contractual terms and conditions when identifying a liability. Nevertheless, we think the Board should consider the role of this notion not only in defining the distinction between debts and equity but also when it examines the alternatives proposed for the definition of a liability, in conjunction with the notion of a liability being “practically unconditional”. We think that these two notions are very closely linked and should be debated together while identifying clearly all the potential effects adoption of these notions would have on existing effective standards. In our view, these notions must be dealt with in the revision of the Conceptual Framework and not on an arbitrary basis when individual standards are developed or revised.

Section 4 Recognition and derecognition

Question 8

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

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

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

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

We agree with the arguments developed in paragraphs 4.9 and 4.10, that assets and liabilities should be recognised only when their recognition satisfies the objectives of financial statements, in particular the qualitative characteristics of relevance and reliability, and respects the requirement of a positive cost/benefit balance.

In contrast, we do not agree with the idea developed in paragraph 4.11. While we can understand that the Board may conclude in developing a particular standard that the recognition of a specific asset or liability, which would otherwise satisfy the definition of these elements, is not justified on the grounds of the indicators in paragraph 4.26, we would not expect the Board to be able to justify the recognition of an asset or liability which does not fulfil the definitions or the general principles of recognition.

We agree, however, that an entity should not be able to avoid recognising an asset or liability required specifically by a standard on the grounds that it does not comply with the Conceptual Framework.

As stated in our response to Question 2, we think that the proposed definition of assets in particular will broaden the range of qualifying elements and that the Conceptual Framework should incorporate more "filters" to ensure this scope-creep is limited in effect and relevant. In fact, our interpretation is that all elements that qualify as assets or liabilities according to the proposed definition should be recognised unless the Board has decided otherwise in a specific standard. There is therefore a risk that more assets and liabilities will be recognised than at present, if there are no specific standards dealing with them.

Finally, we are convinced that the Board should consider introducing a further criterion for recognition and derecognition – that of the transfer of risks and rewards. The notion of control is an « all or nothing » criterion which can define an asset, but, in our view, the asset should be accounted for by the entity that bears the risks and rewards inherent in it. Entities enter into transactions in most cases on the basis of the transfer of risks. If the accounting is not based on the same principles it becomes much more difficult to represent the business model appropriately and to judge management's performance.

We have noted that in the most recent projects undertaken by the Board (such as Consolidation, Leases, and Revenue) there has been a gradual abandoning of the concept of the transfer of risks and rewards in favour of the concept of the transfer of control as the trigger for the recognition of assets or liabilities and income or expense. We think that the revision of the Conceptual Framework should provide the forum for the definitive debate on this topic rather than to debate the issue during the development of each individual standard.

Question 9
In the IASB's preliminary view, as set out in paragraphs 4.28–4.51, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria.
(This is the control approach described in paragraph 4.36(a)). However, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. Possible approaches include:

(a) enhanced disclosure;
(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or
(c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

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

As with the topic of the initial recognition of assets and liabilities, we think that the transfer of risks and rewards should have a role in the criteria for derecognition.
The current IAS 39 model for derecognition is based upon the notion of the transfer risks and rewards. We do not think that this needs to be challenged. We expect that the assessment of the transfer of control will be every bit as judgemental as the assessment of the transfer of risk and rewards, the difference being that the latter is a notion that is well understood and applied at present in a manner which is consistent with the way the business is conducted.

Finally, we think that the question of the derecognition of all or part of an asset or liability should be examined in conjunction with the question of the unbundling of elements into their components, as discussed in our response to question 7.

Section 5 Definition of equity and distinction between liabilities and equity instruments

Question 10
The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1–5.59. In the IASB's preliminary view:

(a) the *Conceptual Framework* should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.
(b) the *Conceptual Framework* should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:
i. obligations to issue equity instruments are not liabilities; and
ii. obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a)).
(c) an entity should:
i. at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure, or an allocation of total equity.
ii. recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.
(d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards.

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

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

We agree that equity should remain a category defined as a residual.

b) *the Conceptual Framework should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:*
(i) obligations to issue equity instruments are not liabilities; and
(ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a) of the DP).

We are not sure that we have fully understood the intentions of the Board in this instance. The DP seems to be proposing to maintain the status quo in respect of the distinction between debt and equity, whereas we understand from our exchanges with the IASB that the Board members wish to explore an alternative model. We accept that the provisions of current IAS 32 are complex but, taking into account the time that has already been spent on the "FICE" project, we think that it may be too ambitious to deal with this subject thoroughly in the Conceptual Framework project.
We note that in the « narrow equity" alternative the Board considers that the NCI is an element of debt. Such a reclassification would bring into question all the methods of accounting for minority interests currently required by IFRS 3 and IFRS 10. We think that it is also advisable for the Board to complete its work on the notion of the reporting entity in order to establish definitively whether NCI is an element of debt or equity.
Moreover, we think it would be very helpful to this debate to understand the impact of each of the three "Views" on the identification of a liability on the classification between debt and equity. Clearly, any evolution in the notion of a liability towards a wider or narrower definition of an obligation is likely to have consequences on the line between debt and equity.
Finally, we think that the Board cannot solve all the problems of IAS 32 in the Conceptual Framework. The CF should be limited to the establishing of major principles:

- The definition of the reporting entity (encompassing or excluding the minority interests);
- The principle that equity is defined as a residual;
- The definition of debt (the obligation to transfer resources to a third party).

IAS 32 should provide guidance to allow one to assess each instrument to determine whether there is an element of debt which should lead to the classification of the instrument wholly or partially as a liability.

c) *an entity should:*
(i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure or an allocation of total equity.
(ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.

We are not convinced by the Board's proposals in this domain, partly because it is unclear what the objective of the wealth-transfer model is. We wonder what the needs as formulated by users really are in this area.
We are not convinced that the table of wealth-transfer as proposed actually facilitates the understanding of the dilution of equity. At best it might depict dilution at a single moment (At a value

which may not ultimately be the realised value) but it will not show the dilution that is expected to occur upon the exercising of the options.

Moreover, we wonder how one can reconcile the definition of equity as a residual with the idea of revaluing its components.
We note that the measurement method to be used for each element has not yet been decided but all the examples given are based on measurement at fair value. This raises the following questions:

- The satisfaction of the cost/benefit requirement: if one takes the example of schemes valued under IFRS 2 (which is not a true fair value measure), one has to perform a fair-value calculation which gives rise to the risk of making the financial statements more confusing without proof of a real benefit;
- Equity will be made up of elements which are valued using a variety of measurement techniques;
- There is a risk that there will be a propagation of variations in value shown in equity that will sometimes have only a very low probability of realisation;
- Is there a risk of the creeping spread of the use of fair value? Once several elements of equity are measured at fair value is there a risk of a requirement that the whole of equity be valued at fair value?
- Although we acknowledge that the IASB is not responsible for the supervision of financial markets, we think that it is important that any potential impact on the "prudential ratios" be taken into account in its deliberations.

d) *(d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards.*
Do you agree? Why or why not? If you do not agree, what changes do you suggest and why?

We agree with this proposal.

Section 6 Measurement

Question 11
How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6–6.35. The IASB's preliminary views are that:
(a) the objective of measurement is to contribute to the faithful representation of relevant information about:
i. the resources of the entity, claims against the entity and changes in resources and claims; and
ii. how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.
(b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;
(c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI;
(d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:
i. for a particular asset should depend on how that asset contributes to future cash flows; and
ii. for a particular liability should depend on how the entity will settle or fulfil that liability.

(e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained; and
(f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.

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

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

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

As we explained in our response to Question 8, we think the IASB ought to reopen the question of the qualitative characteristics of useful financial information, as we are still not convinced that the amendments made to Chapter 3 of the Conceptual Framework have made the characteristics more relevant than before.

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

We fully agree with this objective. This is why we think that the CF should reintroduce the objective of providing information to allow the user to judge the stewardship of management of the entity as an explicit objective of financial reporting. We discuss this further in our response to Question 22.

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

We agree with this view, all the more so since we think that the financial statements must be capable of representing the particularities of the entities and their different business models. A single measurement model cannot therefore be envisaged as it would not be able to reflect the differences in utilisation and settlement of assets and liabilities.

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

We agree with this principle, but with the following provisos:

- The distinct objectives of the balance sheet and the statement of profit or loss must be clearly established in order to explain the need for multiple measurement bases and to facilitate the choice of the base which best meets these objectives.

- In determining the most relevant measurement base the IASB must not lend priority any one statement and must demonstrate that the use of a dual measure is justified and satisfies the requirement for a positive cost/benefit balance. The use of OCI should not be regarded as a facilitator for the use of a dual measurement, but should be taken as a trigger for the Board to re-examine and confirm that the measurements selected are really the most relevant. It should also verify whether it would not be better to provide information in the notes rather than to use two different valuations on the balance sheet and in profit or loss.

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

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

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

We agree with the proposal that the measurement model should reflect the way the asset will contribute to cash flows or the way the liability will be settled or fulfilled. We do not, however, agree with the suggestion that it is the investor or creditor who should determine how the asset or liability will contribute to the cash flows. It is the entity's business model which is the key driver for this.

Following on from this, in our view it is not appropriate for the IASB to pre-judge the use that will be made of assets or the way liabilities will be settled. Thus, for example, it should not decide that a certain type of liability should always be measured at the lower of two alternative methods of settlement, instead it, should rather require that the liability be measured at the value that reflects the probable amount of the cash flows.

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

We agree.

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

We agree. We would add, however, that it is necessary to have full knowledge of the user's needs and to have criteria to guide the Board when it has to decide among the divergent requirements of different users (please see our response to Question 22).

Question 12

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

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

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

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

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

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

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

We agree that in this instance a cost-based measure will be more relevant, both for the balance sheet and the profit or loss account.

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

We note that the DP considers that most inventory is to be assimilated to an asset used in the business rather than one which is sold, and therefore is to be measured using a cost-based measurement. We agree with this conclusion.

We also agree that if assets contribute directly to future cash flows by being sold in the short term, a current exit price is likely to be relevant, with the following proviso: that the entity must have an observable price or reliable information readily available to enable it to reconstitute a reliable current exit price. In this respect, contrary to the implication of paragraph 6.21, we not agree that an estimate of an unobservable can be a faithful representation as long as the notes provide sufficient information about the limitations and uncertainty surrounding the estimation process. We do not think that such information will always be sufficient to achieve the objective of reliable and relevant financial statements, particularly where there is no market or a market which is not sufficiently liquid. [Information of this nature may faithfully represent the nature of the estimate but that does not necessarily mean that the estimate is a faithful representation of the transaction or element. It is the latter which is important.]

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

In our opinion, all assets which are used in a "held for collection" business model should be valued at amortised cost, irrespective of the degree of variability in their market value. In this way, only probable future cash flows would be accounted for. We recognise that information about the fair value can help users to gauge the variability associated with the contractual cash flows, but if there is little or no possibility of the variability to be transformed into actual flows, then the information should be disclosed only in the notes, or, if judged absolutely necessary, OCI should be used to link the amortised cost amount in profit or loss with the balance sheet amount.

As expressed in our response to the limited amendment proposed to IFRS 9, we believe that the key driver for the "P&L measurement" should be the business model and the way the asset will be used. Instrument's characteristics such as variability should be considered only for financial position measurement (or disclosures). Furthermore, impact of variability should be assessed for each specific items at a standard's level not within the framework which should only provide main principle for valuation for both P&L and balance sheet.

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

We have not yet been able to debate this topic in sufficient depth to be able to establish a definitive position. However, we do think that this question encompasses a number of issues covering a range of different asset types which deserve to be dealt with individually and in depth. The following are examples of issues that need to be dealt with:

- the breaking down of an individual asset into its constituent rights – such as, for example, the current contract and a right to future cash flows arising from a sale or a new contract – which could be measured in different ways;
- the impact of the unit of account on the measurement model; and

- the impact on the selection of the measurement method of the availability or paucity of relevant information.

Question 13

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

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

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

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

ii. contractual obligations for services (performance obligations).

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

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

As an opening remark, although we are generally in agreement with the notions which are presented here (that is, with the notion of measurement according to the way in which the liability will be extinguished and depending upon the existence or otherwise of defined contractual terms), we find the overall discussion somewhat confused, particularly in respect of the overlap between those paragraphs dealing with cash-flow-based measurements and those dealing with the other subsequent measurement approaches.

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

We agree with this assertion, but the articulation of the discussion of measures based on projections of cash flow sis not very clear. We understand that a method utilising discounted cash flows can be used to arrive at a cost-based measurement (paragraph 6.119) or a current market value (paragraph 6.120).

The measurement of liabilities thus requires classification into one of three categories: cost (historic value), current value (seen from the perspective of the entity) or fair value (from the market perspective). Cash-flow projection is merely a method used to determine one of these values when it is not directly available. In this context, we note that paragraphs 6.99 and 6.100 state that for liabilities without stated terms or for insurance or post-employment liabilities, measurement based on cash-flow projections is relevant. We think that a vital element is missing from this discussion: what measurement base one is trying to achieve in this case. Without defining this objective, one cannot identify the factors that need to be taken into account in the cash-flow projection. Of course, these details will have to be specified in the individual standards, but we think that the concepts which underlie the measurement approach must be clearly articulated in the Conceptual Framework.

Moreover, in the absence of defined terms and objectives, it will always be difficult to make cash-flow projections, whether it be the gross cash flows or the timing of flows for discounting.

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

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

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

We agree.

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

We agree.

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

Question 14

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

(a) if the ultimate cash flows are not closely linked to the original cost;
(b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets or financial liabilities; or
(c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (ie the asset or the liability is highly leveraged).

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

In our responses to the various proposals on hedge accounting we have emphasised that the systematic valuation of all derivatives at fair value, regardless of the business model in which they are used, is a major cause of mismatched accounting which has necessary led to the development of hedge accounting.
This is another area where we think the consideration of the business model to ensure that the econ omic substance of the elements is appropriately represented is key.

Question 15

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

Discount rate

- We understand that the Board does not intend to deal with the issue of discounting here but rather to examine it in a separate project. That being the case, we are unsure how, or if at all, the discussion in paragraph 6.112 and following will be incorporated in the final Conceptual Framework. In a similar vein, we do not see clearly what is the purpose of the discussion on own credit risk here, as the DP does not appear to conclude on the matter.
- We agree with the principle of the « freezing » of the discount rate for the impairment testing of non-financial assets, as this allows one to remain consistent with the initial measurement approach, i.e., at amortised cost. The difficulty in practice will be that of

identifying which "historical" rate is relevant in cases such as that of a cash-generating unit whose composition has changed over time.

Best estimate vs. Expected value

We regret that there is no substantial discussion of the notions of expected value or best estimate since these are notions which are redebated in each new standard. We think that if one takes as the starting-point the objectives of financial statements and their characteristics, one should be able to conclude on the most appropriate route to achieving these objectives and decide upon which of the expected value and the most likely value/best estimate is the most useful and relevant measure for the balance sheet.

Perspective

Finally, in respect of the ideas developed in paragraphs 6.125 and following on the issue of whether to use the "market perspective" or the "entity perspective", we agree that the choice must be made in each instance with regard to improving the relevance of the measurements used according to the usage made of each asset or liability within the business model of the entity.

Section 7 Presentation and disclosure

Question 16

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

(a) the primary purpose of the *Conceptual Framework*, which is to assist the IASB in developing and revising Standards (see Section 1); and
(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8), including:
i. a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;
ii. amendments to IAS 1; and
iii. additional guidance or education material on materiality.
iv. Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the *Conceptual Framework* on:
(a) presentation in the primary financial statements, including:
i. what the primary financial statements are;
ii. the objective of primary financial statements;
iii. classification and aggregation;
iv. offsetting; and
i. (v) the relationship between primary financial statements.
(b) disclosure in the notes to the financial statements, including:
i. the objective of the notes to the financial statements; and
ii. the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information.

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

The objectives of presentation

We think that it is fundamental that the Conceptual Framework (CF) defines the objectives of each primary financial statement as well as the link between these different statements. This is not just a simple question of presentation but is an essential prerequisite to any consideration of the criteria for recognition and measurement. Thus the CF should first of all define the objective of each statement in order to allow one to decide upon what items are relevant and should be recognized, and which is the relevant measurement approach. In respect of the relationship between the statements, we fully agree with the statement in paragraph 7.31 of the DP that no single statement should have precedence over any other. However, we believe that this approach is not applied in all cases. In our view, in its development of standards, particularly those developed recently, the Board has concentrated first on what should be recognised in the balance sheet before asking the question of the relevance of such a measure to the profit or loss account. As an illustration of this, revenue, which is a key element of the profit or loss account, will henceforth be determined as a consequence of balance-sheet variations and no longer as a flow which is relevant for the profit or loss of the period.
Finally, we suggest that the principles of classification, aggregation and netting should be dealt with at the level of individual standards, rather than in the CF, in order to permit the Board to give greater flexibility to entities to allow them to best represent individual transactions and specific items.

The objectives of the Notes to the financial statements

In the context of what is seen to be an ever-expanding requirement for disclosure, in our view this is an important subject which the Board should deal with comprehensively and definitively. To do this, the Board can define objectives for the notes in the Conceptual Framework as it does for the other financial statements which make up the set of financial reports. However, the effectiveness of this approach will to a large extent depend upon the status of the CF. We would suggest, therefore, that the Board develop a specific standard to establish the needs of the users and the objectives of the notes which derive logically from these. Following on from this, each specific standard could provide illustrations of how the objectives could be applied in the case of specific transactions or elements. This guidance should not, in our opinion, be an integral part of the standard and therefore not represent mandatory disclosure. This would help avoid falling back into the trap of the "checklist" approach which can be detrimental to the relevance and clarity of the financial statements.

We believe that preparers should remain fully accountable for the content of the notes and thus apply judgment in selecting information which is relevant to the entity and its economic environment. Some may think that the absence of a definitive "checklist" of disclosures is too liberal an approach, but we think that allowing the entity this discretion is in fact far more of a constraint than complying with a "check list" approach, and we believe that this model fits better with the idea of the principle-based standards that IFRSs are intended to be. Preparers should be accountable for their financial reporting, and adjustments will subsequently be made by the market (users' specific demands, sector benchmarks, etc.).
As far as the definition of the objectives in the CF and their elaboration in a dedicated standard are concerned, we are in full agreement with the proposal of paragraph 7.33 that the notes should complement the primary financial statements. In this regard, we think it is important to specify that the information should relate to elements which existed at the balance sheet date, whether they are recognised or not, and include information which allows the user to understand the items that have been recognised. The information required should not be aimed at the reconstitution by the user of alternative methods for recognition, presentation or measurement. In our opinion, the idea of an

alternative measure typically illustrates the tendency of the IASB to compensate for perceived shortcomings in the measurement / recognition principles by requiring disclosures. As examples of this we would cite the requirements of IFRS 7 in relation to the offsetting of financial assets and liabilities, and the proposals for leases.

In respect of “forward-looking” information, we agree that these should be strictly limited to the explanation of elements which exist at the balance-sheet date. Moreover, we think that the IASB should be very cautious in defining the requirements and should be aware that any information about the future can be detrimental to entities, particularly when their major competitors are not subject to the same constraints. As an illustration of this point, we think that today there is a substantial imbalance between the information that has to be given by entities which report under IFRS about impairment testing and that which has to be provided by their competitors under US GAAP. We think that the Board should be very cautious with requirements such as this, as some may interpret them in a very particular way, and infer that complete and detailed information about future results may be required in this context. Finally, such information should not be viewed as the provision of data for those who would like to recalculate or verify the measurements: notes are not and should not become an auditing tool.

Question 17

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

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

We believe that materiality is already appropriately defined in IAS 1 and, as it should remain an entity-specific notion, it does not need additional guidance.

Materiality should be assessed in the context of the specific circumstances and therefore it should not be standardized, but rather only explained and defined on the basis of principles.

Question 18

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

Do you agree that communication principles should be part of the *Conceptual Framework*?
Why or why not?
If you agree they should be included, do you agree with the communication principles proposed? Why or why not?

We agree with the principles for communication proposed in paragraph 7.50, which we think should lead to increased relevance and clarity in the financial statements. Nevertheless, we are undecided about which is the most appropriate place for the definition of these requirements – in the Conceptual Framework or in a specific standard. We think that the final decision will depend upon the status accorded to the CF.

Section 8 Presentation in the statement of comprehensive income—profit or loss and other comprehensive income

> **Question 19**
> The IASB's preliminary view that the *Conceptual Framework* should require a total or subtotal for profit or loss is discussed in paragraphs 8.19–8.22.
>
> Do you agree? Why or why not?
>
> If you do not agree do you think that the IASB should still be able to require a total or subtotal profit or loss when developing or amending Standards?

We fully agree with the arguments laid out in paragraph 8.20 about the usefulness of presenting the total for profit or loss; this is an essential performance indicator for financial communication.

As far as the presentation of this indicator is concerned, we think that it should not be a sub-total as it cannot and must not be aggregated with other changes in equity other than transactions with owners (commonly referred to as OCI). Indeed, even though we agree that items falling at present within "other comprehensive income" should not be ignored and that they can be very relevant to the understanding of the whole financial position of some entities, these other changes in net assets have neither the same nature, nor the same utility for users as those items recognised in net income and thus should not be aggregated in a single statement. We think that, in order to ensure that financial statements remain meaningful and clear for users, it is absolutely necessary to preserve a statement of performance which ends with profit or loss (net income) and earnings per share. Our discussions with users of all types indicate that this is the essential "anchor" point from which different analyses of the performance of the entity begin.

All other changes in net assets should also be presented in a principal statement, either in a separate statement or as an element of the statement of change in equity, in order to provide not only changes of the current period but also the cumulative amounts. It appears to us that, in contrast to the flows which pass in profit or loss, those elements recognised in OCI are of higher informational value when they are presented as a cumulative total than when they are presented only as changes of the period. We think that the most useful information is to know the "stock" of flows accounted for in the balance sheet which could potentially affect the income statement and future cash flows. If one takes the example of the category of assets accounted for at FVOCI, users may be interested in the unrealised gains or losses (and thus in the cumulative value) and not in the changes in this value in a single period. Such variations can by no means be predictive of the variations that will occur in future periods.

For further discussion on the potential definition of profit or loss, please refer to our response to Question 21.

> **Question 20**

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

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

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

We think that all cash flows should ultimately be recognised in the profit and loss account as an element of cost or income. This is the test of the relevance of the profit and loss account. We are therefore in favour of the Conceptual Framework establishing the principle of the systematic recycling of all the elements recognised in OCI and of each individual standard setting the principles for recycling for each type of element. The difficulty experienced by the Board in finding a suitable recycling principle for each type of element of OCI should not be allowed to prevent the principle of systematic recycling from being established.

Question 21

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

Which of these approaches do you support, and why?

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

We think that neither 2A nor 2B represents the best approach from a conceptual point of view, since both of these approaches result in the definition of the profit and loss account by default. In view of the generally accepted importance of this performance indicator, we think that the Board should renew its reflection and endeavour to find a positive definition of profit or loss, or, at the very least, arrive at a clear description of what the objective of the profit or loss total is intended to portray.

The analysis of the potential criteria for distinguishing between profit or loss and OCI and the conclusions drawn from it, as summarized in table 8.1, appear somewhat lightweight and merit further work. We note that the Board has looked at the criteria individually and does not appear to have considered whether a combination of several of the criteria might provide a route to a satisfactory solution.

Moreover, it seems to us that the objectives for each recycling category have been defined in a circular manner by reference to a profit or loss total which has not been defined. Indeed, principle 2, which is common to both recycling approaches, states that all elements of expense or income must be recognised in profit or loss unless recognition on OCI would enhance the relevance of the profit or loss total. It seems to us, therefore, that it is necessary to define clearly profit or loss in order to judge how accounting for a particular element in OCI might enhance profit or loss.

Paragraph 8.46 provides an embryonic response but is insufficient given the importance of the subject. The IASB might find it helpful to take up the various arguments heard in favour of profit or loss as laid out in paragraph 8.20. We think it is important that the Conceptual Framework gives due recognition to the principle that cash flows recognised in profit or loss should be able to be forecast and correspond to the business model of the entity. If one conforms to the principal qualitative characteristics of relevance and reliability, as we propose, one would have the following criteria for the recognition of elements in profit or loss for the period:

- Cash flows realised (either in the current period or a previous period) which can be economically attributed to the current period, because they are related to the activity of the period following the principle of the matching of costs and revenues. If the application of the matching concept leads to the deferral of elements which do not satisfy the definition of an asset or a liability, then these could be recognised in OCI (such as, for example, a cash flow hedge). In addition, in order to identify the period to which the realised cash flows should be attributed, we think it is necessary to reopen the debate about the event which should trigger the allocation of an element of expense or income to the period: the transfer of risks or rewards or the transfer of control.

- Future cash flows, provided that these can be forecast and that the flows are thus probable: probability in this context relates both to the potential realisation of the flows and that the value to be recognised should be close to that which will actually be realised in the future. Where certain cash flows could be certain of being realised but at an amount that could be different from that accounted for in the balance sheet, the former would be recognised in profit or loss and the difference in OCI.

- Moreover, these probabilities should be assessed in the light of the business model of the entity. Applying this approach to the profit or loss account, one would account in OCI for the changes in the value of assets and liabilities for which the probability of the realisation of the future cash flows is still too low for recognition in profit or loss to be relevant. This would thus include those elements referred to as “transitional items”. Certain “bridging items” would also qualify for this category when the amounts used for the balance sheet are not sufficiently certain of occurring for them to be recognised in profit or loss.

Thus, OCI can make the link between future cash flows recognised in the balance sheet the probability of realization of which is too low for them to be recognised in profit or loss for various reasons such as:

- Realization depends upon a further action or decision (decision to sell shares, to renegotiate a debt, to sell a subsidiary, etc.;

- The amount recognised in the balance sheet does not have a high probability of being realised at that value in the context of the business model (for example, fair value in the balance sheet for financial instruments held for collection in accordance with the contractual terms).

In connection with this last point, we think that when the Board is considering requiring a balance-sheet value which is judged not to be relevant for the profit or loss account, and thus recording items in OCI, the Board should systematically re-verify that the proposed measure for the balance sheet is relevant and to reconsider whether having two different values for the two primary statements really does satisfy the criteria of a positive cost/benefit balance. In fact, we would indicate that the use of OCI does not resolve all the issues discussed above: the volatility induced in equity by the elements in OCI is an important problem for many entities.

We think that this problem stems from what we see as the Board’s tendency in recent standards (revenue for example) to reflect upon the impact on the balance sheet (is there an asset or a liability to recognise?) before examining the question of the relevance to the balance sheet.

Following on from the above discussion, approach 2B (the “broad approach”) is our preferred approach among those discussed in the DP, but we would recommend that it include a principle of systematic recycling.

Section 9 Other issues

Question 22
Chapters 1 and 3 of the existing Conceptual Framework Paragraphs 9.2–9.22 address the chapters of the existing *Conceptual Framework* that were published in 2010 and how those chapters treat the concepts of stewardship, reliability and prudence. The IASB will make changes to those chapters if work on the rest of the *Conceptual Framework* highlights areas that need clarifying or amending. However, the IASB does not intend to fundamentally reconsider the content of those chapters.

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

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

We think that the IASB cannot avoid reopening the debate on these chapters, as they are crucial to the development of the later chapters of the Conceptual Framework. We also think it is important to complete the deliberations on the reporting entity which also plays an important role in the preparation of consolidated financial statements.

Objectives and qualitative characteristics

We note that in its introduction the DP evokes only very briefly the objectives and qualitative characteristics of financial reporting as they were included in the CF during the first phases of its revision. We are aware that many constituents disagreed with some of these changes and think that it is important to obtain a consensus on these aspects of the CF before proceeding with the revision of the definitions and measurement principles. It is clear to us that the recognition criteria for balance sheet elements, measurement principles and the definition of the profit or loss statement could differ substantially as a function of the different potential articulations of the objectives of the financial statements. We therefore think that the IASB should address the following matters:

- <u>The assessment of “stewardship</u>” should be reincorporated in the CF as one of the principal objectives of the financial statements. Not to do so would create the risk of ignoring the needs of a large part of the actual users of the financial statements (management, shareholders, and long-term investors). We think that this is all the more important since the DP refers to this role indirectly several times. We do not agree with the argument in paragraphs 9.5 to 9.9 that the IASB has simply stopped using the term “stewardship” while maintaining the notion that this is one of the principal objectives of financial reporting. As it is worded today, the first objective of financial reporting (paragraph OB2) is to provide information useful to providers of resources to enable them to forecast future cash flows. The assessment of stewardship is relegated to the status of a tool for estimating these future cash flows (OB4).

We understand that the Board did not wish to include stewardship as an objective because of the perceived difficulties of constituents in understanding this term. We think that what is important is not the term itself but the idea that the information should allow the user to judge the management's success in fulfilling its responsibility in its management of the entity's resources and obligations. Perhaps a better approach would be to use the term "accountability", which would probably be more easily understood.

- <u>Faithful representation</u>

We think that the promotion of this notion to the detriment of those of prudence and reliability does not contribute to the quality or relevance of financial statements.

When the Board decided to replace the notion of "reliability" with that of "faithful representation", our main concern was the way that this "faithful representation" notion was defined. While we agreed with the "complete and free from error" characteristics, we were opposed to the "neutral" attribute which in many cases may conflict with the relevance characteristic which has been set as the first qualitative characteristic in the framework. Indeed, this focus on neutrality has gradually led the Board to give more weight to external perspectives, relevant or not, over internal management's assessment of its business model and how it should affect the representation of economic events. Perhaps one of the most obvious illustrations is the fair value measurement attribute (especially quoted prices in active markets) that the Board judges to be more relevant information (because it is neutral, free of "management" bias). However, this "fair value" cannot depict how the entity manages its assets / liabilities through its business model in all circumstances.

This trend towards a value which the Board judges to be neutral was also evident in the proposed revision of IAS 37 (non-financial liabilities), where the Board proposed the following:

- A liability should be measured at the lowest amount possible when there is an alternative for the entity in settling its obligation (arguing that an entity would rationally choose this settlement option).
- To extend the use of expected value to measure single obligations even if a "most probable" approach is likely to provide more relevant information.
- To measure some liabilities ("service liabilities") at the amount that the entity would rationally pay a contractor to undertake the service on its behalf (even though the entity would rationally choose to carry out the service itself).

In addition, in always focusing on external data, standards often require entities to estimate (or guess) what a "market price" from a "market participant" perspective should be, thus going against the prudence, reliability and relevance characteristics.

Furthermore, this neutrality notion has been strengthened by the comparability criteria, placed first in the list of enhancing qualitative characteristics. Even though it is specified in paragraph QC23 that comparability is not uniformity, we believe that, in practice, this consideration has been ignored in many cases. We have indeed noted, especially in the IFRIC process, that the main objective pursued is to standardise the accounting methods, even if it leads to irrelevant outcomes. It is actually unrealistic to believe that financial reporting could be established on a perfect, common basis, denying all those features which are specific to the business and management, and replacing them by a perspective of a hypothetical market participant acting in a hypothetical market environment.

We therefore believe that the two fundamental characteristics for financial reporting should be "relevance" and "reliability", both applied in the context of an objectively defined and observable business model for the performance of which the entity's management will be accountable.

Reliable information should be the information which all users could trust (i.e. on which they could rely) because the management has fulfilled its responsibility in providing verifiable and prudent data. Reliability should refer to information which is "complete and free from error" but should also encompass the notions of prudence and verifiability.

Reliability is also intended to ensure that the items recognised and measured in the financial statements have a reasonable assurance of occurring (to ensure that the financial reporting has predictive value) with a high level of confidence and verifiability. As an illustration, take the example of investments in equity instruments: the current IAS 39 allows entities to measure them at cost when there is no market price in an active market and when fair value cannot otherwise be reliably measured. We believe that such an approach is far preferable to requiring companies to make fair value measurements which are unreliable (too many assumptions and projections needed) and non-prudent (high uncertainty about the effective realisation of this value).

- <u>Prudence</u>

Concerning the notion of prudence, which we think is also encompassed in the principle of reliability; we believe that it should be explicitly mentioned as an enhancing qualitative characteristic. This principle of prudence must also be clearly articulated, particularly in connection with the treatment of uncertainties in the definition and criteria for recognition of assets and liabilities

The aim of the principle of prudence is to ensure that cash flows (negative or positive) reported in the financial statements, are the most predictable possible- that is, the most likely of occurring. The concept of prudence obviously calls upon the judgment of management but it may be properly channelled if the objectives pursued are properly defined and when prudence is applied and judged in the context of the Business Model.

We believe that prudence should, and can, be applied consistently to all items reported in the financial statements, without creating an excessive unbalance between assets (gains) and liabilities (expenses), and that, at minima, within a single standard (when one deals with both assets and liabilities) . The objective of the use of prudence indeed is not only to maximise liabilities / expenses and to limit the assets / gains, but it should result in the recognition in the financial statements of what it is reasonable to expect as future cash flows. It is, in our opinion, no more prudent to recognise liabilities with a low likelihood of generating cash outflows than it is to recognise unrealised gains on financial assets, with little chance of being realised.

As a general point on the objectives and characteristics, we think that the notions discussed above are so important that they warrant explicit inclusion in the Conceptual Framework. We are not convinced by the argument that the notion of prudence remains integral in the CF even though the term is not used explicitly. It is, in our view, not sufficient to challenge constituents to demonstrate why IFRSs are not prudent or to explain that stewardship is difficult to translate and thus has been set to one side. By its very nature, the CF should include all the objectives and characteristics necessary for the development of standards of quality. If a characteristic is applicable in the development of standards, that fact should be stated explicitly in the CF.

- <u>The notion of users</u>

Paragraph OB9 of the current CF refers to the interest of management in the financial statements, but effectively concludes that management is not a primary user since it has direct access to more detailed information than external users. We find such a conclusion to be unhelpful as it can lead to an ever-widening gap between the information available internally (and constructed to respond to management's needs) and the information published externally and prepared in accordance with principles that are not accepted as representative of the economics by entities. Such a gap cannot improve communication on financial performance, in our view

The Board should explain more clearly the differing needs of different users and set out its principles for deciding upon which users' needs should be satisfied as a priority in case of conflict or difference. In the third sentence of paragraph OB8 the Board states that there can be different and conflicting needs and that in developing a standard it will seek to provide the information that responds to the needs of the greatest number of users. We are not aware that there has ever been a debate on this subject in the context of the deliberation of a standard, and there is very little on this in the DP. We think that such debate is essential for the determination of what should be recognised on the balance sheet or in the profit or loss account, and using which measurement approach.

Reporting entity

Finally, we encourage the IASB to finalise its work on the reporting entity, as we think that the perspective from which the financial statements are prepared will inform the decisions made in respect of the objectives of reporting and hence the criteria for recognition, measurement and presentation. This matter should be debated now with the support of a thorough analysis of all the potential consequences of the different orientations that the Board might wish to take.

Question 23

Business model

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

Do you think that the IASB should use the business model concept when it develops or revises particular Standards? Why or why not?

If you agree, in which areas do you think that the business model concept would be helpful?

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

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

We agree that the Conceptual framework must recognise the notion of the business model and its importance in the preparation of the financial statements. The business plays a role in all areas of financial reporting: recognition, measurement, presentation of performance, use of OCI and so on. In order to facilitate as much as possible the forecasting of cash flows by the user, the financial statements must present events which have a high probability of realization and / or amounts which represent values which are probable of realization. In order to achieve this, the business model used must be specifically related to the entity's operations. We are convinced that the taking into account of the business model is the only route to arriving at financial statements which are specific to the entity and thus relevant. Comparability is a desirable goal, but it can be useful only when like elements can be compared and differences highlighted and understood.

On the question of how the Conceptual Framework should deal with the matter of the business model, we think that it could provide a general definition of what is understood by the business model and specify that an entity can have more than one business model to represent its different activities and that the business model is a matter of observable fact, not a management aspiration. A definition of the business model could be that it is “the strategy applied by the entity to manage its resources and obligations in order to create value. A an example, the value of assets might be realised through use or through disposal….

We do not think that the Conceptual Framework should go as far as to define what the individual business models are. The business model and its implications for the accounting should be described in each individual standard.

Question 24
Unit of account
The unit of account is discussed in paragraphs 9.35–9.41. The IASB’s preliminary view is that the unit of account will normally be decided when the IASB develops or revises particular Standards and that, in selecting a unit of account, the IASB should consider the qualitative characteristics of useful financial information.

Do you agree? Why or why not?

We think that the question of the unit of account should be dealt with in each relevant individual standard. Clearly the treatment should be decided upon in accordance with the objectives and qualitative characteristics defined by the Conceptual Framework.

Question 25
Going concern
Going concern is discussed in paragraphs 9.42–9.44. The IASB has identified three situations in which the going concern assumption is relevant (when measuring assets and liabilities, when identifying liabilities and when disclosing information about the entity).

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

We agree with the situations identified and have not identified any others.

Question 26
Capital maintenance
Capital maintenance is discussed in paragraphs 9.45–9.54. The IASB plans to include the existing descriptions and the discussion of capital maintenance concepts in the revised *Conceptual Framework* largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change.

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

We have no comment to make on this.