ISDA Safe, Efficient Markets

14th January 2014

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
Delivered by email

Ref.: Discussion Paper DP/2013/1 – A Review of the Conceptual Framework for Financial Reporting

Dear Board members,

We are writing to you to comment on the International Accounting Standards Board's ('IASB' or 'the Board') above referenced Discussion Paper (DP). ISDA[1] welcomes the opportunity to comment on this important project. In this letter we outline our key messages in response to the DP and in the Appendix we provide our more detailed responses to the specific questions.

Key messages

- We welcome the DP and the Board's efforts to update the Conceptual Framework.
- We regret that because it is solely an IASB project there is a heightened risk that IFRS and U.S. GAAP will, in future, diverge in some important respects. However, we recognise that completion of the Conceptual Framework will be far more easily achieved in a reasonable period of time if it is not a joint project.
- We are pleased that the Board has chosen to address in the DP some topics where there is currently complexity or the conceptual basis is unclear, such as the distinction between equity and liabilities and the use of OCI, but have concerns as to some of the proposed solutions. In particular:
    - We do not believe that the criteria for derecognising assets should be based solely on control. In the case of financial instruments, transactions such as repurchase

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agreements are in substance a collateralised loan and should be accounted for as such. We believe a risk and rewards overlay is important.

- The strict obligation approach for distinguishing debt from equity would allow many obligations to be structured so as to be recorded as equity, which we do not believe would provide useful information to users of the financial statements. For example the approach would allow obligations that are settled in a variable number of shares to be classified as equity.

- We are pleased that the Board has addressed the principles of OCI. In summary, we believe that a combination of Approaches 2A and 2B would be the preferred solution. However, we believe that the Board should more comprehensibly explore what is meant by 'performance' in the Conceptual Framework, and hence what financial statements are intended to communicate. In our view, this would assist the Board in determining the conceptual basis for the use of OCI. In this regard, our members believe that profit or loss is recognised as the primary measurement of performance by users and therefore an item in OCI should normally be recycled through profit or loss if the OCI amount is realised externally, for example, through a sale.

- We are also pleased that the Board has decided to re-open some of the more controversial aspects of IFRS. This includes the timing of when present obligations such as those relating to the UK bank levy can be recognised in the financial statements. However, we have observations on the proposals concerning constructive and present obligations, which are further detailed in our answers to the questions in section 3 of the DP in the Appendix to this letter.

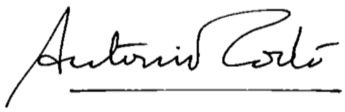
- The Board's proposal to remove the probability threshold for the recognition of assets and liabilities is of concern to our members. In our view, it would be inappropriate to amend the established accounting treatment of contingent liabilities, including litigation, through the Conceptual Framework project or for this to become an exception to the Conceptual Framework. Litigation is not as rare as the DP suggests.

- We agree with the principle for offsetting as set out in the DP, and consider that it would helpfully guide the Board when it next comes to reconsider the offset of derivatives traded under an enforceable master netting agreement. We continue to believe that the difference in the current treatment between IFRS and U.S. GAAP in this regard is not useful to users of financial statements.

- We agree that the business model should be considered in determining the accounting treatment and that this concept could usefully be explored in more detail in the Conceptual Framework, given that there are differences of view as to what consideration of the business model actually means. This includes the extent to which certain criteria such as sales activities should determine the accounting classification of financial instruments compared to other aspects of the model.

- We believe that the concept of prudence as articulated in the pre-2010 version of the Conceptual Framework was helpful and that consideration should be given as to whether it should be reintroduced. The pre-2010 version of the Conceptual Framework made it clear that the concept had to be applied so as to ensure neutrality in financial reporting, and therefore only required a degree of caution in the exercise of judgement.

Yours faithfully,



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Appendix – Detailed responses to the specific questions raised in the DP

Appendix – Detailed responses to the specific questions raised in the DP

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?

Our members believe that the Conceptual Framework should do more than just 'assist' the Board, it should *guide* it in developing and revising IFRSs.

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?

Our members have concerns with the approach taken in the DP to eliminate the recognition threshold, as set out in our response to Question 3. This issue might be addressed by introducing recognition criteria for assets and liabilities.

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?

Our members do not agree with the preliminary view in paragraph 2.35 and the conclusion that a probability threshold would only be necessary for what the DP describes as 'rare cases'. We believe that these cases are not as rare as the IASB believes, for example, litigation is not a rare occurrence. The example given in paragraph 2.32(g) in respect of litigation states "It may be uncertain whether the entity has an obligation at all until the court determines whether this is the case". Moreover, uncertainty as to whether an asset or liability exists is implicit in the current definition of contingent assets and liabilities, and these are far from rare. Given how common contingent assets and liabilities are, we do not believe that it is appropriate for the Conceptual Framework not to establish a probability threshold to determine whether such an asset or liability exists, nor to relegate this issue to specific standards. Such an approach would imply that the accounting for contingent assets and liabilities should change (although we would disagree) or else the accounting for a major aspect of business life will be in conflict with the future Conceptual Framework.

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 have no comments on the elements, but please refer to our comments on OCI made in response to question 21.

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?

Our members agree that to restrict the definition of a liability to obligations that are enforceable by legal or equivalent means would not provide useful financial information. However, we do not agree with the guidance suggested in paragraph 3.50 of the DP. As worded, a restructuring provision would not meet the criteria in this paragraph for a constructive obligation, as there is no third party to whom the entity has a duty or responsibility or who would benefit from its fulfilment. We do not believe that there is any desire on the part of preparers, regulators or users to amend the accounting for such provisions.

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.

Our members believe that an entity should recognise a liability which it has no practical ability to avoid**.** For instance, we believe that banks should record a levy in their interim financial statements, even if it is calculated based on the level of liabilities as at the year end. Not to be able to do so does not provide information which is useful to users of the financial statements. Therefore, we believe View 2 provides better information than View 1.

We agree that the role of economic compulsion needs to be reconsidered, as discussed in paragraphs 3.103 to 3.108 of the DP. In our response to the IASB's ED on the *Characteristics of Equity* dated 5 September 2008, we expressed our concern that because IAS 32 does not always reflect economic compulsion it is, in some instances, an unduly form-based standard. We gave, as an example, the accounting treatment of perpetual instruments on which fixed discretionary dividends, which step up after a number of years, are only payable in the event that a dividend is paid on ordinary shares. Perpetual instruments repayable at the option of the issuer are required by IAS 32 to be treated as equity, notwithstanding the fact that payment of dividends and the effective repayment of principal are economically near certain and so the instruments are, in practice, issued, purchased, traded, and managed as debt.

Notwithstanding the above, we agree that this last matter can be best addressed by amending IAS 32 rather than through the Conceptual Framework project.

Question 7

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

Paragraph 3.112 states that, "Strictly speaking, trade date accounting is inconsistent with the concepts discussed in the Discussion Paper". However, the DP does not further address this inconsistency or seek to resolve it. We believe that this issue should be addressed.

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?

Our members agree with the IASB's preliminary view**,** except for the threshold issue as explained further in our response to Question 3.

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?

In our response to the Board's agenda consultation dated 30 November 2011, we noted: "While we do not propose an entirely new standard, our members believe that targeted improvements based on the IAS 39 principles are required to address a number of significant interpretation issues that currently exist. These include the issues referred to the IASB by IFRIC and what is meant in IAS 39 by 'continuing involvement'".

However, we do not believe that the control-based approach set out in the DP would be the right response for derecognition of financial assets. For example, it is well understood by the market that a repurchase agreement is, in substance, a collateralised loan, and so to account for it as a sale, as required by a control based model for derecognition, would not reflect the commercial substance of that arrangement. In our view this would not provide useful information to the users of financial statements. Hence, we believe that any new derecognition approach should involve consideration of both 'control' and 'risk and rewards'.

Adopting a solely control-based model would have other implications. Our members are also concerned that, given the importance of sales activity in the application of the 'business model' in IFRS 9 (see our response to question 23 below), treating repos as sales would mean that many debt securities funded by repos would not be eligible for amortised cost accounting.

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?

In our letter to the Board dated 30 November 2011, in relation to the Board's agenda consultation we noted: "It is necessary to return to the project on financial instruments with characteristics of equity, as (i) there are a number of practical implementation issues associated with IAS 32, and (ii) there are significant differences on this topic between IFRS and U.S. GAAP. This project should, however, be focussed so as to make targeted improvements to IAS 32, primarily to replace the "fixed for fixed rule with a principle that more effectively captures the nature of equity instruments, rather than seeking to change the standard fundamentally".

We are, therefore, pleased that the Board has chosen to explore this subject in the DP but, as noted in our previous correspondence, would encourage the Board not to fundamentally rethink this area of accounting.

We believe that it would be inappropriate to adopt the narrow equity approach, since many classes of instrument have the commercial characteristics of equity, without being the most subordinate.

We also do not believe that the most subordinate class of instruments should always be classified as equity. However, we agree with the Board's preliminary view that it may be appropriate in certain cases such as puttable instruments as addressed in IAS 32.

Furthermore, we do not support the strict obligation approach. In our view, permitting an entity's shares to be used as a currency, as proposed in this approach, would not improve accounting, for the reasons set out in BC 10 to BC 15 of IAS 32. In particular, under the strict obligation approach, it would be possible for any obligation to be recorded as equity, just by requiring it to be discharged in a variable number of the entity's own shares, which we believe is inappropriate and will not reflect the substance of the instrument.

We also note that the strict obligation approach would be complex to apply because of the need to re-measure equity instruments.

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?

Our members agree with the IASB's preliminary views.

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.

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

(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.

(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.

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.

Our members agree with the IASB's preliminary views and the proposed guidance in paragraphs 6.73 to 6.96 of the DP. In particular, we agree with a mixed measurement model for financial instruments, as noted in our response to the ED on *Classification and Measurement* dated 14 September 2009.

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.

Our members agree with the IASB's preliminary views**.**

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 (i.e. the asset or the liability is highly leveraged).

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

Our members agree with the IASB's preliminary view.

Question 15

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

No.

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.

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
(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.

Paragraphs 7.29 and 7.30 of the DP state that "the IASB believe that offsetting will generally not provide the most useful information for assessing an entity's financial position and financial performance. However, the IASB may choose to require offsetting when such a presentation provides a more faithful representation of a particular position, transaction or other event."

Our members agree with this as a statement of principle and believe it would helpfully guide the IASB when it next reconsiders the offset of derivatives traded under an enforceable master netting agreement. We believe that the approach currently required under IFRS overstates the economic resources of the entity and the claims against it, and may therefore be misleading to users of financial statements in "making decisions about providing resources to the entity", to use the wording of paragraph 7.17 of the DP. We also believe that the existing approach under IFRS does not provide the most faithful representation of an entity's solvency, or the credit and liquidity risk associated with derivative transactions executed under an enforceable master netting arrangement.

This continues to represent a major difference between U.S. GAAP and IFRS that we believe users of financial statements find confusing and unhelpful.

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?

Yes.

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 believe that communication principles would be of considerable value when developing or amending disclosure guidance in IFRSs and hence that these should be part of the Conceptual Framework.

Further, we agree with the communication principles proposed in paragraph 7.50 of the DP.

We note that there is currently considerable 'disclosure overload', which makes compliance with IFRS both onerous for preparers and risks more important disclosures being obscured. In our view, communication principles may help in reducing this disclosure overload.

However, we believe that communication principles should have greater application than just disclosure, since all financial reporting is a matter of communication. This matter should flow logically from the objectives of financial reporting in Chapter 1 of the Conceptual Framework.

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?

In our view, a total for profit or loss should be retained. An entity's net profit represents a key financial metric that is globally recognised and understood. The conceptual basis for this should be linked to a concept of 'performance', which would also help underpin the treatment of OCI (see our response to Question 20).

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, i.e. 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?

Our members agree that, in general, items recorded in OCI should be recycled to profit or loss, for the reasons set out in paragraph 8.24 of the DP. It is the recognition in profit or loss that is the primary measure of an entity's 'performance' as highlighted in our response to Question 19.

In particular, in this regard, our members strongly support the principle of cash flow hedge accounting, with gains and losses recorded in OCI and subsequently recycled to profit or loss.

Further, in our response of 13 July 2010 to the Exposure Draft Fair Value Option for Financial Liabilities, we recommended that revaluation gains and losses due to the effects of own credit on liabilities recorded at fair value through profit or loss using the fair value option, should be recycled to profit or loss, to the extent 'realised' by repurchasing the liabilities at less than their par amount.

Similarly, we believe that amounts recorded under IFRS 9 for equities in OCI should be recycled to profit or loss when realised, although we recognise that this would require an impairment model to be developed for such instruments.

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.

Our members recommend that the Board consider a combination of approaches 2A and 2B, but believe that the Board should seek a more conceptual basis for the use of OCI. In general we believe that an item in OCI should be recycled through profit or loss if the OCI amount is realised externally, for example, through a sale or the occurrence of the hedged cash flow in cash flow hedge accounting.

We note that approaches 2A and 2B individually have the following shortcomings:

- It is unclear whether under Approach 2A the changes in fair value attributable to an issuer's own credit risk for a financial liability at fair value through 'p&l' could be recognised in OCI. We believe that recognition of such fair value changes in OCI will result in more relevant information than recognition in profit or loss.
- Approach 2B on the other hand would potentially allow for items that are currently remeasured through profit or loss to be recognised in OCI, such as remeasurement of long-term provisions (table 8.4). We believe that such an approach would not provide the most relevant information compared to recognition in profit or loss.

In addition, Approach 2B seems to imply that some items classified as transitory remeasurement items would not be recycled (paragraph 8.91). As already mentioned in our response to Question 20, we believe that gains and losses on equities recorded in OCI should be recycled and subject to impairment, and that changes in fair value of liabilities due to own credit risk should also be recycled.

The IAS 19 accounting for pensions could be considered an outlier and would be difficult to be accommodated within a Conceptual Framework. Our members suggest that the accounting for pensions is therefore best addressed at standard level.

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 believe that the concept of prudence as articulated in the pre-2010 version of the Conceptual Framework was helpful and consideration should be given as to whether it should be reintroduced. The pre-2010 version of the Conceptual Framework made it clear that the concept had to be applied so as to ensure neutrality in financial reporting, and therefore only required a degree of caution in the exercise of judgement. It also made it very clear that the creation of hidden reserves, excessive provisions, the deliberate understatement of assets or income, or overstatement of liabilities or expenses were not permissible.

Further, to address the concerns of those commentators requesting the introduction of the concept of stewardship in the Conceptual Framework, we believe that the Board should more comprehensibly explore in the framework what is meant by ‘performance’, and hence what financial statements are intended to communicate.

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 support the use of a business model concept in IFRS 9, since financial instruments are used in different ways and it would be inappropriate to require the same accounting treatment irrespective of the manner of use. We agree that the business model concept should be reflected in the Conceptual Framework and would encourage the Board to explore it in more detail. As illustrated by many of the responses to the IFRS 9 project, there are differences of view as to what the use of a business model should actually entail.

For instance, not all of our members agree with the way that the model has been articulated in IFRS 9 and, in particular, the emphasis on the frequency of sales. We therefore encourage the Board to take a wider view in this respect, including consideration of what is done with the proceeds when a security is sold; there is a major difference between a business model in which the proceeds are immediately invested in another asset, and any gain or loss is effectively deferred, and a business model where the risk position is reduced and the profit or loss is regarded as realised.

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?

Our members agree with the preliminary view. However, they continue to be concerned that the use of 'p*q' to value 'level one' financial instruments may not always provide information that is useful to users of accounts, since markets may not be sufficiently liquid to enable the whole position to be exited at that price.

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?

No.

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

Our members agree.