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17 December 2015

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: Exposure Draft: *Conceptual Framework for Financial Reporting*

Our Reference: 2015/JE/C1/IASB/143

Dear IASB Members:

The International Organization of Securities Commissions (IOSCO) Committee on Issuer Accounting, Audit and Disclosure (Committee 1 or C1) thanks you for the opportunity to provide our comments regarding the International Accounting Standards Board (IASB or the Board) Exposure Draft, *Conceptual Framework for Financial Reporting* (the Exposure Draft or ED).

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting standards, including rigorous application and enforcement. Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect a general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

Introductory Remarks

Members of Committee 1 are supportive of the IASB's objective to improve financial reporting by providing this proposed new Conceptual Framework.

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As securities regulators, members of Committee 1 are primarily concerned with clarity of concepts and principles and consistency of application of accounting standards and interpretations thereof. Our comments have been developed with this in mind.

We are providing our observations and comments with an objective to help achieve greater understandability and enforceability in some key areas of the proposed Conceptual Framework that C1 members believe are of greatest consequence. In keeping with this objective we have not attempted to provide a comprehensive commentary to all questions or to consider and address all aspects of the proposed Conceptual Framework.

In reviewing the proposed Conceptual Framework, C1 members have been most concerned with whether the proposed concepts underlying the definitions of asset, liability, and equity are clear and how assets and liabilities that are currently recognized under existing standards would be affected. C1 members are equally concerned about the enforceability and consistent application of these concepts when companies use the Conceptual Framework as a basis to interpret IFRS.

Proposed changes to Chapter 1, The Objective of General Purpose Financial Reporting, and Chapter 2, Qualitative Characteristics of Useful Financial Information

Relevance (prudence and measurement uncertainty)

1. C1 members agree that relevance and faithful representation are two fundamental qualitative characteristics of useful financial information.
2. C1 members agree with the approach of including prudence as a component of neutrality as set forth in paragraph 2.18, which provides a balanced approach to addressing differing views held by many jurisdictions regarding the concept of prudence. This conclusion is based upon the assumption that the term “prudence” refers to the manner of making an accounting judgment, versus referring to making an accounting measurement that involves “conservatism” in its determination. C1 members are proponents of specifically identifying prudence as an important component of neutrality in this context. Additionally, the last sentence of 2.18, which addresses the need for neutrality when exercising prudence, could be ended after “liabilities and expenses” given a misstatement to the statement of financial position may be as important as misstatement of profit and loss components.
3. C1 members note that paragraph 2.13 refers to “other factors” that should be considered when evaluating the impact of measurement uncertainty on determining what is relevant financial information. C1 members believe that the concept of how measurement uncertainty should be considered is not sufficiently clear. C1 members



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believe that describing what “other factors” the Board is referring to in describing the trade-off between measurement uncertainty and “other factors” that make information relevant would be helpful in understanding the Board’s intent when applying this concept.

Description and boundary of a reporting entity

Reporting Entity

4. C1 members believe that the use of combined financial statements should have some conceptual boundaries in the Conceptual Framework. Otherwise entities may combine financial information of separate entities under any reasoned argument that the information is useful to a subset of primary users of the financial statements. C1 members note the Board’s reference in BC 19 that combined financial statements can provide useful information to users in some circumstances. While C1 members acknowledge the Board’s reference to a standards level project, members believe that it is necessary to put some examples in the Conceptual Framework of those circumstances in which combined financial statements could be appropriate. C1 members recommend that the Board explicitly articulate and support concepts such as the existence of common control or common management between entities as situations where combined financial statements may be relevant.

Definitions of elements in the financial statements

Interaction of Proposed Definitions with Current Standards

5. C1 members appreciate that the Board’s intent with the proposed definitions of elements may be to establish a new paradigm for financial reporting. However, members cannot be sure of the Board’s intent for users of IFRS because conflicts between existing standards and the new definitions of elements have not been clearly or fully addressed within the ED and companion documents.

C1 members note that certain assets and liabilities that are recognized under current accounting standards do not appear to comport with the new definitions of these elements. Certain of these assets and liabilities may arise as a matter of current accounting conventions such as matching costs with revenues. To illustrate this issue with regard to assets, but without limitation, consider decommissioning costs capitalized under IAS 37 as a result of recognition of an expected decommissioning obligation. It is not clear how the recorded decommissioning asset captures a right to a future economic benefit. While we understand decommissioning assets are not a



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separate unit of account from the related asset (e.g., property, plant and equipment), nonetheless, paragraphs 4.15 and 4.57 seem to indicate that capitalized costs must represent a right to a future economic benefit to be considered an asset. To illustrate our concern with regard to liabilities, but without limitation, consider the provisions of IAS 20 that require government grants to be recognized in profit and loss over the periods in which an entity recognizes the related costs for which the grants are intended to compensate. In this case, a company may have no obligation remaining to receive the grant but because the grant may benefit many future periods the grant may remain as a liability in order to match costs with benefits.

The Board should consider additional explanation for these types of assets and liabilities, some of which result from matching costs and benefits. At a minimum, we believe that the Board should acknowledge in the Basis for Conclusions the existence of such items and how they were considered by the Board in deliberations to and conclusions reached in the Conceptual Framework.

Further, C1 members do not understand what the Board's intent is regarding these items once the proposed Conceptual Framework becomes effective. Does the Board anticipate future standard setting to revise the accounting standards that gave rise to recognition of these assets and liabilities to bring the accounting into alignment with the new element definitions? Does the Board anticipate that these conflicts will remain after the Conceptual Framework becomes effective? If so, for what period of time and with what resolution? Members believe these points should be specifically addressed in the Conceptual Framework or Basis for Conclusions.

Asset Definition

6. C1 members support the separation of the concepts of identification and recognition of assets. However, members remain concerned about whether or not the recognition criteria are sufficiently clear such that they can be applied consistently. Specifically, paragraph 4.13 requires identification of an asset without regard to probability so long as there is at least one potential outcome from which the asset could produce an economic benefit, while paragraph 5.13b suggests that a low probability of an inflow would indicate that the asset is not relevant. Paragraph 5.18 indicates that a low probability of economic benefit may not affect recognition if the measurement attribute incorporates the low probability of producing an economic benefit in its value, while Paragraph 5.19 provides that a low probability may not be useful to users. Accordingly, there appears to be great latitude for arguments either way which could result in companies with similar facts and circumstances coming to different conclusions. This is a particular issue for IFRSs that specifically require consideration of the Conceptual Framework when applying standards level guidance, such as IFRS 3 when identifying individual assets. C1 members recommend that if the Board believes that assets with a low probability of economic benefit are relevant, it should make it



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clear what concepts should be considered in assessing when that is the case. For example, it may be helpful to refer back to Chapter 2 and reaffirm the concept that when probability is so low such that both confirmatory and predictive values through recognition would not be expected to impact user's decisions, the recognition threshold for relevance is not met.

7. C1 members believe that the conceptual definition of an asset could be better understood by addressing the conceptual nature of costs for which there may be different interpretations as to whether they provide a right to potential economic benefits. For example, costs incurred to start a business, including those incurred to conform with jurisdictional and organizational requirements, may be viewed by some as providing a right that has the potential of producing economic benefits if those costs were essential to conducting operations or to generate inflows to the company. This may also include certain costs that may lead to successful or unsuccessful outcomes such as exploration costs or research and development costs. Members recommend the Board indicate in the Conceptual Framework or Basis for Conclusions whether there is any limitation on the type of rights that would give rise to an asset under the new Framework so that stakeholders can better understand the Board's intent as well as better understand the new definition of asset in relation to current financial reporting.
8. C1 members observe that paragraph 4.23 suggests that economic benefits that flow to a principal from a resource held by an agent would result in the agent not having any asset because it does not control the economic resource in its role as agent, but rather the principal does. We believe, and recommend the Board clarify that, an agent may have an asset due to its rights in relation to economic benefits as a result of the agency relationship with the principal. Rights are defined to be assets in this Conceptual Framework ("CF"), so rights of an agent in this scenario would seem to give rise to recognition of an asset(s) if the criteria are met.
9. C1 members question whether certain costs that have historically been capitalized as assets for accounting purposes may be more akin to enhancements to existing rights of a related asset rather than being rights in and of themselves. While we understand that some costs that are capitalized may not be a separate unit of account, paragraph 4.57 suggests that individual capitalized costs nonetheless represent rights. We recommend expanding the description of "rights" to include enhancements to existing rights to more fully cover the population of costs that have historically been capitalized. Some examples, without limitation, include: a) stripping activity assets under IFRIC 20, b) other development costs of mineral interests, and c) certain costs that are capitalized under IAS 16.



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Liability Definition

10. C1 members support the separation of the concepts of identification and recognition of liabilities and support that a consistent definition of liabilities and assets is conceptually sound. However, members observe that the Conceptual Framework's guidance on relevance seems to indicate that not all liabilities need to be recognized. Members find this notion troubling. Members believe this area of accounting is especially sensitive due to the inherent risk of management bias to understate liabilities in order to portray a more favorable financial picture of the company. One way to address this potential bias would be to require that the relevance of liabilities be viewed from a user's perspective as opposed to management's. CI therefore suggests that the Board emphasize in the Conceptual Framework that the assessment of relevance is required to be applied from a user's perspective rather than management's.

If the Board does not choose to add this acknowledgement and emphasis, C1 members believe that, at a minimum, when considering relevance in relation to recognition for liabilities, that it be clear how a low probability of transferring an economic resource should be considered. Paragraphs 5.17 through 5.19 seem to suggest it depends on facts and circumstances but it is not clear upon what concept those facts and circumstances should be evaluated. It may be helpful to refer back to Chapter 2 and reaffirm the concept that when probability is so low such that both confirmatory and predictive values through recognition would not be expected to impact user's decisions, the recognition threshold for relevance is not met. For example, if at inception all settlement outcomes of transferring an economic resource are remote of occurring over the expected life of a financial instrument, and predictive and confirmatory information that could be offered through recognition does not exceed the cost, then the relevance threshold is not met for purposes of recognition.

11. CI members agree with the concept that a present obligation is a liability. However, there are some liabilities that members believe may not meet the requirements that (i) the obligation has arisen from past events, and (ii) there is no practical ability to avoid the obligation. As well, it is unclear to members how the two concepts interact with one another.

C1 members are concerned about how paragraph 4.35 should be applied. For example, members wonder if the concept of practical ability is aligned with events that are expected to occur in the normal course of business and how that interacts with past events. For example, if a statutory requirement imposes a levy when a certain sales threshold is met and it is almost certain that such a sales threshold will be met in the normal course of business, would the levy be accrued notwithstanding the threshold has not actually been met, because there is no practicable ability to avoid the obligation in the normal course of business? Or, is the statutory requirement not considered the past event and rather the sales threshold being met is the past event?



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12. C1 members also believe that additional clarification would be helpful regarding the concept of the practicable ability to avoid a transfer of economic resource as it pertains to economic compulsion. For example, a company may have deemed it practicable to avoid cash settlement of a perpetual bond with a variable indexed interest rate at inception of the bond. However, due to changes in the rate over time the company may be compelled to pay the bond down at times subsequent to inception of the instrument. Based on BC 4.73 through 4.75, however, it may be concluded that economic compulsion on its own cannot create a present obligation and therefore the bond would not be a liability. However, BC 4.73 through 4.75 also suggest that economic compulsion would not be ignored. This leaves substantial uncertainty as to how to apply this concept. While we understand that standards level guidance will address how to assess specific types of instruments, clarification of the concept of economic compulsion, and about how past events could create economic compulsion in the future by their terms, should be considered in the Conceptual Framework.
13. Additionally, C1 members believe that the Board should consider whether it is premature to conclude that a company's own shares should be excluded from the definition of an economic resource in all cases. Although excluding a company's own shares establishes a clear line between debt obligations and equity in this proposal, members question whether this concept will be retained when evaluating findings from the Board's current research project regarding *Financial Instruments with Characteristics of Equity* and related potential future standard setting. Since IFRS (e.g., IAS 32) currently recognizes certain share settled contracts as liabilities, a significant conflict would exist between the proposed Conceptual Framework and standards level requirements. Until sufficient research has been done as to whether or not some share settled contracts should remain as liabilities, we suggest the definition of a liability could be expanded to alleviate this conflict by being silent as to whether or not a company's own shares constitute an economic resource by removing paragraph 4.30. Please see our comment under the heading "Equity" below for further details.

Executory Contracts

14. C1 members have concerns about how the proposed Conceptual Framework addresses off-market executory contracts. C1 members question whether the language in the ED adequately addresses the meaning of 'favorable' and 'unfavorable' and how that may impact initial and subsequent measurements. C1 members believe that additional explanation should be provided regarding how to think about contracts for which market conditions or terms change the relative favorability of contracts and if this is inherently an ongoing assessment.



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Equity Definition

15. C1 members agree with the definition of equity as the residual interest in the assets of the entity after deducting all of its liabilities. However, members are concerned that the proposal will significantly change how stakeholders currently assess whether a financial instrument is classified as a liability versus as equity. Members observe that because a liability is defined in the ED as a present obligation of the entity to transfer an economic resource as a result of past events, and the ED makes it clear that a company's own equity instruments are not economic resources, this would lead to the conclusion that obligations settled solely in a company's own shares are never a liability. While this definition offers a clear distinction between a liability and equity, C1 members are concerned that because the Board is undertaking a separate research project to specifically address the distinction between liabilities and equity at the standards level, the Board may end up deviating from this determination in the Conceptual Framework. C1 members believe this should be avoided. To avoid this, C1 members recommend the following:
 - a. If the Board believes a company's own shares are never a resource, then the Board should provide the conceptual basis for this conclusion. For example, the conceptual basis may be rooted in the idea that claims to economic resources have a direct effect on the liquidity of an entity, whereas equity claims primarily impact dilution of owners. If there is another or additional conceptual basis for the distinction, this should be expressed as should the reasons about why the Board believes this approach best meets the objectives of financial reporting.
 - b. If the Board is not able to provide a conceptual basis and the supporting rationale for its conclusions in the proposed Conceptual Framework, then C1 members believe that paragraph 4.30 should be removed or modified to allow flexibility in how a resource is defined in relation to an obligation that an issuer settles in its own shares and thus,
 - c. Reserve the determination of whether or when an entity's own shares may be considered a resource until a more thorough deliberation is undertaken to consider distinct instrument types. For example, circumstances in which an entity employs its own shares in lieu of cash is a common means of settling instruments.

C1 members believe that standards level work on liabilities and equity should be completed in a timely manner. There are currently difficulties faced in practice when making liability and equity determinations and further definitive guidance is needed.



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Derecognition

16. C1 members agree with the proposed derecognition guidance in the ED and believe it is important to have developed elements on derecognition in the Conceptual Framework. Members agree that the goal of derecognition is to faithfully depict an entity's financial position and P&L impacts resulting from the transaction or event. As acknowledged in the ED, achieving this goal might be difficult and alternative methods might exist to achieve it in individual standards. Consequently, we agree that these alternatives can be explored at the level of individual standards.
17. C1 members welcome the discussion on modification of contracts in paragraphs 5.33 - 5.36 of the ED. Nonetheless, in order to address existing diversity in practice we believe more comprehensive guidance would need to be provided at the level of individual standards. For example, it is not clear when eliminating or modifying certain terms or rights of a financial asset means an entity would derecognize the existing asset and recognize a new financial asset. It is also not clear what factors should be considered when making such a determination versus maintaining a continuation of the existing asset. C1 members believe it is important to provide standards level guidance in order to attain a consistent interpretation in relation to modifications of contracts.

Measurement bases

Attributes

18. C1 members note that the two broad categories of measurement attributes that are proposed, including historical cost and current values, are broad enough to include most measurement approaches and allow the Board flexibility to determine the relevant measurement attribute when formulating standards level guidance. C1 members, however, question whether the measurement attributes provided include all value concepts that currently exist under IFRS. For example, members believe that it should be clarified which measurement attribute the equity method would be considered under the new Framework or if this should be a separate category of measurement. CI recommends the Board specifically clarify this in the proposed Conceptual Framework.



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Reporting items of income or expenses in other comprehensive income

Presentation

19. C1 members observe that the presumption that all items that are classified in OCI are to be recycled unless specific standards level guidance provides otherwise may create a perception that net income before other comprehensive income is more important to a user's assessment of performance than is total comprehensive income. Members question whether this was the Board's intent in proposing this presumption and recommend that the Board make some statement in the Conceptual Framework or Basis for Conclusions to explain whether or not this was the intent and whether or not the Board thinks this will be the result.

20. C1 members note that paragraph 7.23 establishes a rebuttable presumption that all income and expense items will be included in the statement of profit and loss. Paragraph 7.23b provides guidelines for when this presumption can be overcome for components of income and expense related to assets and liabilities measured at current value. However, members believe paragraph 7.23b may require further explanation to illustrate the meaning of separately identified components of income and expense. While there is an example provided of interest income associated with an interest-bearing financial asset to illustrate this concept, it is not clear how the income and expense components that would arise if the related asset were measured at historical cost are intended to be considered because they are not specifically addressed. We recommend the example be expanded in order to do so.

Another example, without limitation, that raises a similar concern about overcoming the presumption that all income and expense items will be included in the statement of profit and loss is equity securities that are held for other than trading purposes and for which changes in fair value are elected to be presented through OCI under IFRS 9. Gains or losses upon disposal of those assets will not be recycled into the statement of profit and loss, according to IFRS 9. However, gains and losses would arguably be recognized had the equity securities been recorded at historical cost. We recommend clarifying what separately identified components the Board intended to include in the statement of profit and loss and when the presumption of recycling can be overcome by providing additional explanation and additional examples to illustrate the concepts included in the paragraphs within 7.23.

21. C1 members understand that only when standards level guidance permits an income or expense item to be included in OCI will entities be able to classify an income or expense item in OCI, as noted in BC7.44. Similarly, items included in OCI will be required to be recycled through profit and loss unless standards level guidance specifically permits not recycling (refer to BC7.57). As such, CI's understanding is



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that the guidance in paragraphs 7.23 through 7.27 only applies to the IASB when setting standards and is not provided as general interpretation guidance for entities to utilize when no standard exists or that would allow companies discretion over when to exclude income or expense from the statement of profit and loss. C1 members believe that this should be explicitly stated in the Conceptual Framework, as the Basis of Conclusions is not considered authoritative. This is particularly important given that the Conceptual Framework is authoritative and one of the stated objectives of the Conceptual Framework is to assist parties in interpreting standards.

22. If paragraphs 7.24(b) through 7.27 are permitted to be applied with an interpretive objective rather than only to the standard setting determinations made by the IASB, C1 members believe paragraph 7.24(b) provides too much leeway by the use of relevance as the factor that determines when something is presented as a component of comprehensive income instead of in the statement of profit and loss. Furthermore, paragraph 7.26 indicates that reclassification from other comprehensive income into the statement of profit and loss occurs when it will enhance the relevance of the information included in the statement of profit and loss. C1 members are concerned that paragraph 7.24(b) combined with paragraphs 7.26 and 7.27 could result in income and expense items being permanently held in other comprehensive income because they are never determined to be relevant to the information presented in the statement of profit and loss. Members suggest removing the specific guidance on relevance from this chapter because the concept of relevance in financial reporting is already addressed in Chapter 5. Adding additional guidance in this chapter seems to place too much emphasis on the concept of relevance with regard to other comprehensive income items and reclassification of such to the statement of profit and loss.
23. In paragraph 8.10, it refers to ‘income statement’ while in other places the ED uses either the term statement of financial performance or statement of profit or loss, which are two different statements as noted in paragraph 7.19. Paragraph 7.19 indicates that the statement of financial performance equals the statement of profit or loss plus other comprehensive income. It is unclear what is meant by ‘income statement’ in paragraph 8.10 and members suggest the term be revised to be one of the other terms already used throughout the ED.

Effects of the proposed changes to the Conceptual Framework

24. C1 members believe there are areas of IFRS where the proposed conceptual framework will be inconsistent with existing standards. See also our comments about relevance. For example, due to the cost attribution guidance in IAS 19, *Employee Benefits*, members believe some employee benefit plan assets and/or liabilities may not meet the definitions of asset and liability in the proposed Conceptual Framework. Members



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also believe there are similar inconsistencies between the proposed definitions and the accounting required in IFRS 14, *Regulatory Deferral Accounts*.

Business activities

25. C1 members believe that the way in which entities conduct business is an element to take into account when developing an accounting standard, whether that be in guidance about unit of account, selection of a measurement basis, as well as presentation and disclosure. Members believe additional guidance should be included in the Conceptual Framework which addresses how business activities are taken into account when developing a standard for financial reporting.
26. Depending on the characteristics of the assets, liabilities, income and expenses, the nature of business activities is one of the considerations used for standard-setting activities and their role in setting a standard will depend on the aspects of the financial reporting to be addressed. Hence, the detailed role of business activities in setting a standard can be kept at the level of individual standards (as was done for classification of financial assets in IFRS 9, *Financial Instruments*, or the consolidation exception for investment entities in IFRS 10, *Consolidated Financial Statements*).

Other comments

Practical Matters and Transition

27. C1 members continue to believe it is necessary to clarify how the Conceptual Framework will integrate with existing standards that may conflict with aspects of the revised Framework. We recognize the intent of the Board is that the revisions to the Conceptual Framework are not intended to supersede existing standards. However, it appears that some conflicts could exist between the revised Conceptual Framework and requirements of existing standards which may create difficulty in practice due to confusion about what guidance to follow, which could lead to diversity in application of IFRS in practice. We believe the Board should clarify their intent with regard to such conflicts and how the Board expects stakeholders to deal with such conflicts until such time as the related standards are revised to comply with the revised Conceptual Framework.

Additionally, some transactions may not fall specifically within the scope of IFRSs and therefore have been previously accounted for based on entity established policies grounded in the previous conceptual framework. C1 members believe these existing accounting policies developed from the previous conceptual framework will need to be



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revised once the new Conceptual Framework becomes effective. Members suggest the Board explicitly address this so that stakeholders can understand the Board's intent.

In addition, Members note that paragraph 15 of IAS 1 states in part, "Fair presentation [of financial statements] requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework." We therefore believe the Board should clarify how it intends that preparers consider the new Conceptual Framework in relation to existing standards that specifically reference the Conceptual Framework as well as those potential conflict situations noted in the above paragraphs. We also believe it would be helpful to constituents if the Board provides a list of conflicts, so far as they exist, between the proposed Conceptual Framework and existing standards and state whether the Board intends to address such conflicts that may exist, for example, including conflicts with IAS 32, IAS 37, and IFRIC 21.

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We appreciate your thoughtful consideration of the comments raised in this letter. If you have any questions or need additional information on the recommendations and comments that we have provided, please do not hesitate to contact me at 202-551-5300.

Sincerely,

Julie A. Erhardt
Chair
International Organization of Securities Commissions
Committee on Issuer Accounting, Audit and Disclosure