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Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of some 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU alone.

EBF Response to the IASB Discussion Paper: Conceptual Framework

Key messages

- The Conceptual Framework should be the primary source for development of new requirements or guidance on the "complain or explain" basis. While the Framework should be principle based, it must be sufficiently clear given its usage by preparers and others in the absence or lack of clarity of a standard addressing a particular issue.

- An analysis of the implications of the proposed changes to the Conceptual Framework on a standard level would be appreciated as an annex when the IASB develops the Exposure Draft. Conflict between the Framework and existing standards should not necessarily lead to reopening of the standards, unless evidence of significant issues.

- Assets and liabilities should be recognized when leading to useful and understandable information. EBF would agree with the removal of the probability threshold from the CF provided that sufficient weight is given to criteria of faithful representation and cost efficiency to prevent measurement methods having to be developed for low probability items when it is clear that the cost of the process will not be outweighed by the benefits.

- The EBF is concerned with the recognition criteria solely based on the control notion that was rejected by the constituency in the proposed amendments to IAS 39. Consideration of risks and rewards is important to achieve fair representation of risks to which the entity is exposed. The EBF is also not comfortable with partial derecognition that depends on the unit of account (and definition of asset as a bundle of rights that can be separated). The EBF believes that the framework should include more analysis of the unit of account, but that it is important that it is not defined only as "the contract level".

- EBF supports retaining the existing definition of a liability that encompasses both legal and constructive obligation. The EBF supports a view that a present obligation must have arisen from past events and be practically unconditional (view 2).

- Distinction between equity and liability is important. Faithful representation cannot be achieved if the legal form of the instrument takes precedence over its commercial substance.

- The EBF does not support the re-measurement of secondary equity claims and the concept of a "transfer of wealth" as it would lead to a more complex accounting while the usefulness of the approach is unclear.

- The EBF strongly supports a mixed measurement model where entity's business model plays a prominent role in determining the relevance of a particular measurement basis.

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- It is crucial to avoid excessive and irrelevant disclosures that could reduce the readability and understandability of financial reports. The discussion on the relevance and location of the disclosures should take place at the level of CF, such as requirement to disclosure alternative measurement base, if proven irrelevant.

- The EBF believes that recycling should be allowed where it permits more relevant information. We support the broad approach to recycling.

EBF RESPONSE TO THE QUESTIONS 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?

a) Any new IFRS requirements and guidance should be derived from the objectives and concepts of the framework. The IASB should give clear prominence to the Framework as the primary conceptual source when developing new requirements and guidance. While it is important for the Framework to remain principle based, it should be sufficiently clear to help IFRS Interpretations Committee. In addition, some importance should be given to the Framework as a tool used by preparers in preparation of financial statements in the absence of a standard addressing a particular issue.

b) New standards should be developed on the basis of comply or explain where there is an apparent conflict with the Conceptual Framework ("CF"). However, standards may deviate from the Framework, either because one aspect is being given more emphasis in a particular situation (for example, cost vs benefits) or to better meet the primary objectives of financial reporting by providing information that is more relevant in a particular situation. While such differences could call into question whether the CF should be amended, this will be a matter of judgment. The CF should generally be expected to remain stable although it may need updating from time to time.

c) The EBF would appreciate including an analysis of the implications of the proposed changes to the Conceptual Framework on a standard level as an annex when the IASB develops its Exposure Draft. This, we believe, will enable constituents to comment on the CF, with a better understanding of the potential consequences, if any, for individual standards. Currently, it is not always clear what issue the IASB is trying to address by amending the existing Framework nor is it necessary clear whether the proposed changes could impact the standards. While it will be useful for the IASB to highlight possible implications at the standards level, we do not believe there is a need to re-open existing standards, unless there is an evidence of significant problems with a standard, which would be addressed in any case through the normal agenda setting process.

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?

The EBF considers that the definitions of assets and liabilities would be acceptable on their own but questions the conjunction with recognition criteria. The proposed definitions may increase the pressure on recognition of assets/liabilities, potentially widening their current scope. However, while more items could be defined as assets, in practice they may not be recognized where costs exceed benefits or where measurement could not be considered faithfully representative. If the outcome cannot be reliably determined, the measurement may not be sufficiently reliable for recognition. Uncertainty becomes an aspect of measurement, rather than recognition.

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?

Assets and liabilities should be recognized when doing so provides useful and understandable information. Criteria that focus on whether the results are cost effective and faithfully representative may achieve this in a more straightforward manner than defining a probability threshold. The application of judgment is unavoidable and already widely used in practice. The application of a probability threshold would also create other issues such as determining what the threshold should be set at (probable, virtually certain, as defined by IAS 37).

Therefore, the EBF would agree with the removal of the probability threshold provided that sufficient weight is given to the above criteria to prevent measurement methods having to be developed for low probability items when it is clear that the cost of the process will not be outweighed by the benefits.

There has been some discussion of a new notion of uncertainty about whether an asset or liability will result in any inflow or outflow of resources to determine the probability threshold ("outcome risk"). The EBF believes the concept is unclear and would not support it.

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?

While the EBF recognizes the difficulties in defining profit or loss, it believes that description of the elements in a way which indicates the link to profit or loss or OCI in a clear way would be helpful.

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?

The EBF supports retaining the existing definition of a liability that encompasses both legal and constructive obligation.

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.

The EBF favors view 2.

The EBF does not support view 1 which would require the obligation to be strictly unconditional. Unconditional threshold would significantly reduce the number of liabilities recorded currently, missing information about inevitable future costs of the entity's past actions.

View 3 would unduly extend the population of obligations in some circumstances.

Question 7

Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?
We have no additional comments.

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?

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?

The EBF is concerned with the recognition criteria solely based on the control notion that was rejected by the constituency in the proposed amendments to IAS 39. For example, derecognition of repo transactions of liquid assets would not be consistent with the economic substance, result the recognition of inappropriate profits and losses and fail to reflect risk as hedged items will be derecognized while risks and rewards would remain. Derecognition of assets in case of a sale and repurchase agreement will also create inappropriate recycling of unrealized gain or loss in P&L for assets accounted at FVOCI. This may be difficult to understand. We believe that repo transactions are appropriately accounted for as secured finance and would not support any proposed changes to this treatment.

The EBF therefore believes that consideration of risks and rewards is important to achieve fair representation of risks to which the entity is exposed.

The EBF is also not comfortable with partial derecognition that depends on the unit of account (and definition of asset as a bundle of rights that can be separated) which is not well developed in the Conceptual Framework

As the CF leaves to the standards level whether retained interests result in disclosure, different presentation or secured borrowing treatment, the EBF questions whether this part of the CF will be as helpful as it could be to the IASB and its other users.

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?

<u>General considerations on distinction between liability and equity</u>

While the equity vs liability chapter is in our view too detailed for the purposes of CF, we understood from the discussions with the IASB that this will be removed from the CF and addressed at the level of standard, which we welcome. Below, we provide some general consideration on distinction between equity and liability as requested at the outreach meeting with the IASB on 21 November 2014.

Faithful representation cannot be achieved if the legal form of an instrument takes precedence over its commercial substance. Currently, the accounting classification for financial instruments depends solely on the terms of the contract and different accounting outcomes can be achieved depending on the contractual terms which may or may not change the economic results in practice.

Under Basel III, contingent convertible instruments ('CoCos') could qualify as either Additional Tier 1, Tier 2 capital or senior debt depending on the contractual terms. The selection of the trigger level and other loss absorbing mechanisms are largely determined by the trade-off between regulatory capital eligibility considerations and cost of issuance.

When qualifying for the Tier 1 category (Additional Tier 1) there should be no contractual obligation to pay interest and the instruments should have no fixed maturity date (perpetual). Even though those characteristics are included in the contracts, the focus in the term sheet is on interest rate, write down triggers and call possibilities for the issuers. This means the instruments are considered to be fixed income instruments with an enhanced credit risk. Such instruments are rated by rating agencies even though no contractual obligations exist to pay anything.

In practice, the contract may be constructed in a way that would allow for either equity or liability classification under IAS 32 which may not always be in the line with markets perception of such instruments.

The IASB should keep these new types of instrument in mind when discussing the definitions. In addition, the equity classification presently prohibits those instruments from being included in hedge relationships even though they may be used to fund banking book positions (both interest rate and FX risks are managed this way).

Under Recovery and Resolution Directive, the governments will be in the position to decide to write down the senior debt. The classification will be therefore driven by law, and may or may not be explicitly mentioned in the contract.

This further puts the emphasis on different kinds of subordinated debt instruments. Should the classification at initial recognition be based on the current conditions? Or should consideration be given what could happen in the future based on contractual terms or legal requirements? In addition, the DP does not discuss separation of instruments into debt and equity components.

Further details to the general remarks above:

<u>Treatment of interest contra notional amount</u>
IFRS IC staff reached the conclusion when studying a request that it was obvious that the interest payments of the instrument with no obligation to pay interest should be considered to be dividends while the nominal amount includes an obligation in some circumstances may qualify as debt. Whether this results in the most meaningful and understandable information should be considered in the review of debt/equity.

<u>Regulatory consequences</u>
As mentioned above, the contractual terms of certain instruments is based on the need of an entity to receive a certain regulatory treatment. We believe that it is important that framework/specific standards explores situations where the contractual terms are considered so unlikely to occur that they are disregarded in the initial and subsequent pricing unless and until the terms become relevant.

<u>Going concern and liquidation</u>

Considerations should be given to the relevance of defining debt and equity based on a presumption of liquidation of the entity at the balance sheet date when financial statements are prepared on a going concern basis.

In previous discussions regarding the debt/equity classification there were suggestions that equity should be defined as the most residual interest in the entity. It is questioned whether that would be workable. The development of certain instruments and the legal framework (e.g. the capital adequacy rules (CRD IV/CRR and recovery and resolution regimes) has led to a situation in which different instruments are the most residual depending on the circumstances.

For example, different regulatory capital instruments may be temporary or permanently written down when the entity stills fulfills the definition of being considered to be "going concern" and others may by contract or by law be written down to preserve the status of the entity as being a "going concern".

In some cases the write down triggers an exchange of ownership, but the equity of the entity as such will still be intact.

However if things really go wrong, those instruments may not be written down or converted. Instead, the entity enters into liquidation. Normally, in those circumstances the shareholders will have the most residual interest in the entity.

Management actions

If it were decided that the debt versus equity classification should depend on more than just the contractual terms, then management actions and intent as demonstrated by as past behavior giving rise to valid expectations on the part of holders may be relevant. Some entities have proven that they use possibilities to avoid paying interest or not calling instruments at first call date while other entities do make all the efforts to always pay interest or call instruments at first call date.

Comments on "wealth transfer" model proposed in the Discussion Paper

EBF fails to see the logic in re-measuring secondary equity claims. Presenting value movements within the statement of changes in equity as a transfer of wealth between equity holders would result in more complex accounting given the consequential requirements e.g. to re-measure all equity-settled share based payment awards at the end of each reporting period. In addition, the usefulness of the information provided by re-measurement is unclear. The potential dilution may best be explained through disclosure.

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 fulfill 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?

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.

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.

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?

Please find below our views on the measurement chapter (Questions 11-14).

In circumstances where financial instruments are managed on fair value basis, this information alone is sufficient for management to explain the business model and performance of the entity and for users to fully understand the future expected cash flows. Fair value reflects both the business model and the expected future cash flows for financial instruments that are actively traded in liquid markets. However, the current fair value and the change in fair value between reporting periods do not always faithfully represent transactions in financial instruments undertaken or their contribution to sustainable earnings where the business activity is not based around short-term trading or the instruments are not managed on a fair value basis.

If the instrument is held for use in the business to generate cash flows and there is no current or future intention to sell significant amounts, the aim is to achieve a stable income flow earned on an ongoing basis over a certain period. In this case, material profit from short-term market movements will not arise. The assets are expected to be held for substantially all their lives, and this means that the future cash flows are readily identifiable. Holding a financial instrument to maturity is similar to holding inventory, where it is considered inappropriate to recognize any increase in market value until the item is sold and the revenue is earned (although it is appropriate to recognize impairment).

Information that will assist in understanding the timing of the potential cash flows, credit risk and probability of default will be most relevant and useful for the users of financial statements. Amortised cost, including any impairment and taking into account the additional details in the notes, provides investors with more relevant information on potential cash-flow performance than fair value alone.

Accordingly, either fair value or amortised cost can provide the most relevant information depending on the circumstances, and so using the business model approach to determine this helps ensure that the primary financial statements are presented on the basis that best reflects the earnings flows that different types of instrument will achieve.

The EBF considers that the measurement chapter is too high level and would benefit from further elaborations. We believe a discussion on the structure of cash flows that the IFRS 9 builds on or principles for justification of day 1 profit deferral could be elaborated at conceptual level.

The EBF also believes more focus should be given to the business model.

The importance of the business model can be illustrated by an example of inventory at cost that is not being challenged as it provides and understandable base line margin that users can vary depending on their view of future prices, while avoiding temporary market price movements change the value in the financial statements. We believe that the same applies for financial instruments. Useful information about margin based on cost is lost if fair values are used in the profit or loss. Please see our answer to question 23.

Question 15

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

We do not have further comments.

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.

The EBF believes it is crucial to avoid excessive and irrelevant disclosures that could reduce the readability and understandability of financial reports. The discussion on the relevance and location of the disclosures should take place at the level of CF, such as requirement to disclosure alternative measurement base, if proven irrelevant. The concept of materiality is also important in this regard.

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?

The EBF believes that the concept of materiality is clear although we acknowledge there may be differences in practical application. It must be taken into account that materiality is applied at entity level and involves a degree of professional judgment taking into account not only entity specific factors but also various macro-economic aspects. Different reporting outcomes could therefore be the result of application to different circumstances surrounding a specific item and not necessarily a result of diverging understanding. The concept of materiality is an entity specific aspect of relevance and cannot be reduced to a set of prescriptive rules. If necessary, the principle behind materiality could be articulated more clearly to increase consistency in application and comparability at global level.

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?

The EBF believes disclosure must remain principle based to avoid provision of excessive and irrelevant information to users of financial statements.

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 revising particular Standards?

The EBF agrees. Net profit is a key performance indicator for the market.

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?

The EBF believes that recycling should be allowed where it permits more relevant information. We believe profit or loss as well as OCI should be defined, however we are aware of the difficulties to do this is despite many years' effort.

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.

The EBF supports the broad approach.

The EBF believes profit or loss is a summary of all transactions in the period resulting in changes in equity, excluding transactions with owners. The P&L should include the realization of value changes that may have previously been recognized in previous periods, not only changes in value of assets and liabilities that have taken place the current period.

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.

There has been recent discussion on reintroduction of the word “prudence” in the CF. The EBF understands prudence in term of requiring more evidence in support of gains and assets that for losses and liabilities in order not to overestimate gains/assets and underestimate losses/liabilities. Prudence can on one hand be particularly important when it comes to using judgment in making estimations. On the other hand over-conservatism in one period leading to increased revenues in subsequent periods or biased recognition of gains and losses should not be encompassed in the term “prudence”.

The EBF believes the concept of prudence is visible throughout the standards that contain adequate safeguards against overoptimistic management estimates and assumptions. The discussion on introduction of the concept of prudence in the Framework should not take place without thorough explanation and understanding of the term prudence and clarification of the difference between prudence and prudential considerations.

Stewardship is an important element as management must be considered as users of financial information in the same way as investors and creditors. Basing a measurement on information that is used in managing the business is key to ensuring that the financial reporting is relevant, reliable and understandable.

Management is accountable for the sound use of the resources the resources that have been entrusted to them and have to explain how the business follows the management strategy. It is important that they can report to their shareholders on past transactions and events of the period to fulfill their fiduciary duties and stewardship responsibilities to shareholders. Therefore, the communication framework for financial reporting should result in information that is relevant, reliable, and reflects the company's business model in a way users and preparers can both understand. While there is no explicit reference to stewardship in chapter one, we believe that the wording of OB4 and the paragraph 1.27 of the basis for conclusions are explicit enough to indicate that the conceptual framework continues to treat information about stewardship as one of the requirements to meet the objectives of financial reporting.

Faithful representation contains neutrality, completeness and freedom from error characteristics that were also part of the reliability concept. While the substance over form is missing, paragraph 3.26 of the basis for conclusions explains that the concept is redundant as faithful representation already implies representing the substance of an economic phenomenon. It may be helpful to put greater emphasis on this concept.

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?

It is the view of the EBF that the business model approach is often the most useful way of presenting financial information in a way that is relevant to a particular entity and the environment in which it operates and should be given a prominent place in the CF.

Financial statements should provide information about the financial position of the entity and the effects of its transactions and other events, so that users can evaluate the prospects for future net cash inflows, and also how management are discharging their responsibilities for the entity's resources.

A properly articulated business model will be helpful in communicating management's understanding of the business to the market. The business model should describe how the entity creates, delivers and captures value, reflecting how the business is managed. For financial services firms the business model will include a broader consideration of the relationship between assets and liabilities, and how these are used to create value.

The fundamental qualitative characteristics in the CF are relevance and faithful representation and these are enhanced by their relationship to the business model concept. Recognising the business model in standard setting is that it creates financial information that is measured on a basis that is more relevant to how the entity operates in its economic environment and provides a more faithful representation of an entity's financial position and performance.

The business model approach recognises that there are different ways in which a combination of asset and liabilities can be used to create value for shareholders. Since the business model sets out how value is created and delivered to customers, understanding how assets and liabilities will be used, whether individually or managed together to create and deliver value is critical. Recognising the business model in financial reporting means that an entity's financial statements contain information that reflects the entity's specific circumstances and is more likely to be useful in predicting future cash flows. For example, entering into a contract to receive a commodity creates different expectations of future cash flows for a commodities trader than for an energy provider. Another example would be when an entity holds a property, and the value to the entity would be different depending on whether an entity intended to use the property in its business or to obtain rental income or capital gains.

Clearly if different measurement bases are used by different entities then there could be a reduction in comparability, however there is a difference between comparability and uniformity. If two entities have different business models, then differences can be expected to arise in their future cash flows and reflecting this in the financial reporting should be more useful for investors than a single approach which would be less reflective of these differences.

The business model approach is already utilised in IFRS 9 'Financial Instruments' which takes account of the fact that banks use different portfolios for different purposes. Where a portfolio of instruments is held for trading, then fair value provides the most useful information for investors. Where a portfolio will be held to collect cash flows, fair value is less relevant and amortised cost is more representative of the value to an entity.

In addition to having strategies for using financial instruments in the business, banking institutions have different strategies for mitigating risks. While some risk mitigation techniques are focused on reducing volatility in the fair values reflected on the balance sheet, other techniques are focused on ensuring stability of cash flows and income. Hedge accounting is another example of where different measurement rules are permitted in certain circumstances, because this better represents an entity's risk management objectives in the financial reporting.

In summary, using a business model is a way for entities to present financial information to investors in a way that is appropriate to that entity's operating environment, and is an approach already used in several IFRSs, most notably in IFRS 9.

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?

The EBF believes that the framework should include more analysis of the unit of account, but that it is important that it is not defined only as "the contract level".

There are good arguments for use, in certain circumstances, of a unit of account that combines individual contracts and sometimes being a part of a single contract or parts of contracts. The latter is normally expressed as the unit of account being a portfolio of components rather than the contracts as such (e.g. portfolio of interest rate risk or FX risk in different time bands or certain insurance risks within insurance contracts).

The IASB has already recognized this need in individual standards. However the alignment with the Conceptual Framework is important. Numerous discussions between the IASB and the EBF during past years have highlighted difficulties occurring from the focus on a single asset or single liability.

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?

Standards should not be developed for non-going concern situations which are likely to be unique.

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.

The EBF believes it is important that capital maintenance concept is consistent with the purpose of financial reporting.