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Dear Sirs,

IFRS Foundation – Discussion Paper - A Review of the Conceptual Framework for Financial Reporting

Introduction

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Financial Reporting Expert Group has examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

Response

We welcome the IASB's work on the Conceptual Framework, which we regard an important foundation for current and future standard setting. In that context, we encourage the IASB to ensure that it devotes sufficient resources to the completion of the project and that it prioritises completion of a high quality Conceptual Framework, as opposed to being tied to the 2015 deadline.

When considering the Conceptual Framework, we encourage the IASB to recognise that financial statements are rarely either produced or read in isolation from other documents, such as a Directors' Report or Business Review. Whilst we do not think the IASB should be setting standards to cover other information, it should recognise the wider context within which financial statements are published. Cross-referencing to avoid duplication or to enhance clarity can be a useful aid to reporting whilst at the same time reducing the volume of disclosure.

We are concerned that the IASB will not be revisiting the 2010 chapters on fundamental concepts unless work on other chapters highlights need for a change. We consider that these chapters should explicitly include prudence, reliability and stewardship as fundamental concepts.

In our opinion these concepts can act as a check to some of the excessive complexity, subjectivity and resulting disclosures that have arisen in current standard setting. Furthermore, by subsuming these concepts within more generalised concepts, such as relevance of financial information or its faithful representation, is to miss important areas of tension between the more “detailed” concepts – e.g. the conflict between reliability (where seen in context of historic costs) and relevance (when seen in context of current valuations).

We also consider that the Conceptual Framework should be clearer on the objective that financial statements are seeking to meet. In particular, the Framework should be clearer on the tension between the provision of information relevant to assessing directors’ stewardship (historic information) and then necessary for the making of economic decisions (forward looking information). The lack of clarity on this objective in part leads to the disclosure problem that exists within IFRS at present. Lengthy disclosures designed to meet both objectives have resulted in overly long and complex financial statements, which undermine their relevance and the ability of users to understand them.

Response to specific questions

We have only responded to those questions where we have an observation to make.

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?

In general we agree with the proposed purpose of the Conceptual Framework. However, we would query the status. In particular, we are concerned that the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the Conceptual Framework. We are concerned that this could allow fundamental concepts to be revisited each time a Standard is released or updated, as particular groups of users seek to influence the standard setting process for their own interests. The Conceptual Framework should set out clear guidelines for when such departures are acceptable and the IASB should detail how it will engage in extended consultation and review in such circumstances.

We also consider that the IASB should always explain in the Basis of Conclusions how a Standard complies with the Conceptual Framework.

Question 2 and 3

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?

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?

We are concerned that the definition of assets and liabilities has not retained the notion that an inflow or outflow is 'expected'. In our opinion this could lead to more subjectivity, imprudent accounting and greater complexity. It opens the door to the recognition of more and varied assets and liabilities where, presumably, probability would have to come into the measurement process instead of the recognition decision.

Question 5

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

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

We agree that the concept of constructive obligations should be retained and agree that the issuing of more guidance would aid consistency and comparability in this area.

Question 8

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

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

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

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

We agree with the criteria that assets or liabilities should not be recognised if the information is not relevant or if no measure of the asset or liability would result in a faithful representation. These are an important check on excessive complexity. Indeed we feel that assets and liabilities should only be recognised where the information is relevant, including the measurement base being both relevant and reliable.

This is an important concept and should be discussed and highlighted further as a part of the discussion on fundamental concepts.

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?

We do not agree with the suggestion that an entity should at the end of each reporting period "update the measure of each class of equity claim". This suggestion that classes of equity should be re-valued has significant consequences that should not be introduced by means of the Conceptual Framework. Consequently we do not support c (i) and (ii).

Question 11 – 13

Question 11

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?

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.

The section on measurement provides little discussion of the merits of different measurement bases and, with the implication that measurement using future cash flow based methods would be the default, continues the trend away from historic cost accounting.

We are concerned that measurement based on valuation techniques with a large degree of uncertainty (Level 3 valuations) can be inconsistent with the fundamental concept of faithful representation. It would, therefore, encourage the IASB to undertake further work in this area. In our opinion a focus on fair value can mask important information for users, namely future cash flows, and does not aid comparability when the choice of valuation techniques can make a material difference.

This section should also consider the use of discounted information in greater depth. We would question whether such information, which often masks contractual cashflows and, by the use of different discount rates, does not aid comparability, is relevant.

Question 16 - 18

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 g guidance on presentation and disclosure should be included in the Conceptual Framework.

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?

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 welcome the discussion on disclosures and materiality included within the Conceptual Framework and in particular the comment that "if information to meet a disclosure requirement in a Standard is not consider material, the entity may omit it from its financial statements" (7.46 (a)). We agree that the concept of materiality is clearly described, but differences in application mean that the IASB should provide additional guidance, outside the Conceptual Framework project. We urge the IASB to treat this project as a priority.

The scope of disclosures does appear to have been extended to explicitly include information concerning risk exposures and management and the business model. These are areas normally covered in a 'front end' of an annual report (certainly in a UK context) and we would not wish to see needless duplication.

We welcome the intention that each Standard should include disclosure objectives. However, we believe that these should not followed by a long list of disclosure requirements that 'shall' be provided. We are concerned that the table at 7.1 encourages this type of presentation, which we believe adds significantly to the disclosure burden.

Within the communication principals, the Conceptual Framework (7.50) should recognise that the needs of users may differ depending on the type of entity. For example, disclosures should be more detailed for a systemically risky financial institution than a small or mid-size quoted company. Whilst we welcome the recognition that there is a need to give entities "flexibility to determine what and how information is disclosed", we are concerned that Standards all too often ignore this need for flexibility and instead insert rigid requirements presumably to "optimise comparability" (7.50 (f)). We therefore suggest that 7.50 (f) is subdivided into two sections to enable equal weight to be given to these two different priorities.

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?

Considerations of an entities business model link to the concept of relevance. Therefore, the IASB should consider it when developing Standards. When it is used, such as in IFRS 8 where operating segments are linked to management reporting, we consider that it provides useful insight to users of financial statements. Defining a business model, however, is more difficult as there appears to be no standard definition in academic literature. The concept also cannot be understood in isolation from an understanding of business strategy. On balance we therefore consider it best to avoid seeking to develop a single definition of a nebulous concept.

If you would like to discuss any of our response in more detail, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive

APPENDIX A

Quoted Companies Alliance Financial Reporting Expert Group

Matthew Stallabrass (Chairman)	Crowe Clark Whitehill LLP
Joseph Archer	Crowe Clark Whitehill LLP
Edward Beale	Western Selection Plc
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Jack Easton	UHY Hacker Young
Bill Farren/Ian Smith	Deloitte LLP
David Gray	DHG Management
Matthew Howells	Smith & Williamson Limited
Chris Smith/Andy Ka	Grant Thornton UK LLP
Shalini Kashyap	EY
Paul Watts/Jonathan Lowe/Nick Winters	Baker Tilly
Niraj Patel	Saffery Champness
Nigel Smethers	One Media IP Group plc