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Global Mindset, Asian Insights

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International Accounting Standards Board
1st Floor 30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

RESPONSE TO EXPOSURE DRAFT – CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

ISCA sought views from its members on the above ED through a three-month public consultation and from the ISCA Financial Reporting Committee which includes experienced technical accounting professionals from large accounting firms.

We envisaged the Conceptual Framework to be sufficiently resilient and robust so as to serve as a solid foundation for high quality financial reporting standards. The Conceptual Framework should also comprise internally consistent principles and concepts to be used in the development and revision of accounting standards.

We support IASB's project to revise the Conceptual Framework (the "Framework") and noted IASB's intention to make significant improvements to the Framework without delay by building on the existing Framework. However, we believe that IASB should take this opportunity to consider some fundamental aspects of the Framework, specifically the concept of financial performance and basis for other comprehensive income. In our 2014 comment letter to the discussion paper on the Framework, we highlighted the need for IASB to address the above aspects of the Framework and not be overly conscious of the completion timeline such that it compromises the usefulness of the Framework in improving financial reporting.

It was acknowledged by IASB that there are existing inconsistencies between the revised Framework and the existing standards. Furthermore, there may be new inconsistencies as a result of the revised Framework. Any decisions to amend existing standards would require IASB to go through its normal due processes which may take considerable amount of time. Hence, we propose that IASB considers adopting a forward looking effective date for the revised Framework instead of an immediate effective date upon issuance.

Our detailed comments and responses to specified questions in the ED are set out below.

Question 1—Proposed changes to Chapters 1 and 2

Do you support the proposals:

a) to give more prominence, within the objective of financial reporting, to the importance of providing information needed to assess management's stewardship of the entity's resources;
b) to reintroduce an explicit reference to the notion of prudence (described as caution when making judgements under conditions of uncertainty) and to state that prudence is important in achieving neutrality;
c) to state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form;
d) to clarify that measurement uncertainty is one factor that can make financial information less relevant, and that there is a trade-off between the level of measurement uncertainty and other factors that make information relevant; and
e) to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information?

Why or why not?

Prudence & Neutrality

IASB has re-introduced the concept of neutrality in the revised Framework via the exercise of prudence whereby assets and liabilities should be neither overstated nor understated.

The revised Framework defines prudence as "the exercise of caution when making judgments under conditions of uncertainty". Paragraph 2.18 states that "Neutrality is supported by the exercise of prudence. The exercise of prudence means that assets and income are not overstated and liabilities and expenses are not understated. Equally, the exercise of prudence does not allow for the understatement of assets and income or the overstatement of liabilities and expenses, because such mis-statements can lead to the overstatement of income or the understatement of expenses in future periods".

In our view, the definition of prudence and paragraph 2.18 of the revised Framework is confusing and not helpful in explaining the role of prudence within the concept of neutrality, despite the Board's effort to define it as "cautious prudence" in BC2.9.

It also appears that the concept of neutrality is left to be interpreted at respective standards' level. One example is the recognition of variable consideration in IFRS 15 *Revenue from Contracts with Customers* whereby there is a constraint in the recognition of such variable considerations. Such constraints could be seen as exercising "more prudence" under such circumstances.

We agree with the Board's view that cautious prudence can help achieve neutrality in applying accounting policies and hence contribute to faithful representation of assets, liabilities, equity, income and expenses. It is commendable that the Board has introduced cautious prudence in the revised Framework to help preparers, auditors and regulators counter a natural bias that management may have towards optimism. However, in order for this to happen, the concepts of neutrality and cautious prudence need to be better clarified.

We recommend that IASB clarifies the concept of neutrality and provide more guidance in the revised Framework on their premise for the exercise of more or less prudence. This would facilitate consistent application of the concept of neutrality and deter structuring opportunities of transactions to achieve desired outcomes.

Question 2—Description and boundary of a reporting entity Do you agree with: a) the proposed description of a reporting entity in paragraphs 3.11–3.12; and b) the discussion of the boundary of a reporting entity in paragraphs 3.13–3.25? Why or why not?

Description and Boundary of a Reporting Entity

We appreciate that the revised Framework provides flexibility to how a Reporting Entity (RE) can be defined for the purpose of general purpose financial reporting. Such flexibility would benefit financial reporting under initial public offerings (IPOs). On the other hand, it appears that management is given the flexibility to define the components of a RE for non-IPOs purposes.

Paragraphs 3.11 and 3.12 of the revised Framework state that a RE is not necessarily a legal entity and is an entity that chooses to prepare general purpose financial statements. In situations where the RE is not a legal entity but a portion of an entity, it is not clear whether it is the Board's intention to consider such carved-out financial statements to be general purpose financial statements in accordance with the revised Framework. In addition, the definition of a RE has been largely left to be determined by respective local jurisdictions. This may result in potential inconsistencies across jurisdictions.

Paragraph 3.18 states that when a RE is not a legal entity, the boundary of the RE needs to be set in such a way that the financial statements provide relevant financial information and faithfully represent the economic activities of the entity. We are of the view that paragraph 3.18 is too general and that the Board should consider providing additional guidance or constraints, at the revised Framework level, as to what would constitute as reasonable boundaries for general purpose financial reporting.

Question 3—Definitions of elements

Do you agree with the proposed definitions of elements (excluding issues relating to the distinction between liabilities and equity):

a) an asset, and the related definition of an economic resource;
b) a liability;
c) equity;
d) income; and
e) expenses?

Why or why not? If you disagree with the proposed definitions, what alternative definitions do you suggest and why?

Definition of economic resource as a "right"

The revised Framework shared some examples of the forms of rights that may exist. However, the term "right" is not clearly defined in the revised Framework and could be interpreted as requiring a counterparty to exist so that the entity can enforce a right against the counterparty. In some situations, there may not be any counterparties involved in the creation of assets when an entity enhances its own value without a right to claim from any counterparty. This emphasis on the existence of a "right" may lead to expenditures not being capitalised as assets but expensed to income statement; notwithstanding that such expenditures would have the potential to produce future economic benefits.

We note that Paragraph 4.16 of the revised Framework states that "there is a close association between incurring expenditure and acquiring assets, but the two do not necessarily coincide. Hence when an entity incurs expenditure, this may provide evidence that future economic benefits have been sought, but is not conclusive proof that an asset has been obtained". This paragraph provides some guidance but we believe that the relationship between 'incurring expenditure' and 'acquiring assets' warrants further elaboration at the conceptual framework level.

Question 13—Reporting items of income or expenses in other comprehensive Income

Do you agree with the proposals on the use of other comprehensive income? Do you think that they provide useful guidance to the IASB for future decisions about the use of other comprehensive income? Why or why not?

If you disagree, what alternative do you suggest and why?

Question 14—Recycling

Do you agree that the Conceptual Framework should include the rebuttable presumption described above? Why or why not?

If you disagree, what do you propose instead and why?

Other Comprehensive Income and Recycling

As we have already pointed in our comment letter on the Discussion Paper, the rhetorical question that standards setters and accounting bodies have not answered is the definition of performance. Without defining performance, the boundary between 'profit or loss' and Other Comprehensive Income ("OCI") cannot be determined as no one knows which one depicts performance. This is closely related to the recycling issue whereby if 'profit or loss' is performance, then recycling from OCI to 'profit or loss' is definitely necessary so that actual performance are not lost in OCI. Alternatively, if OCI is performance, recycling to 'profit or loss' should be prohibited since there would be double counting. Hence, we do not foresee that the issue on recycling can be resolved without tackling the fundamental need for defining performance.

We note that the revised Framework does not set out a clear definition of what constitutes OCI, 'profit or loss' and that there are no clear principles for recycling from OCI to 'profit or loss'. IASB has the discretion to determine which items are 'included' or 'not included' in OCI or recycled subsequently to 'profit or loss'.

We are of the view that the Conceptual Framework should set out clear guiding principles for OCI and 'profit or loss' for future standard setting and for users to comprehend the differences between OCI and 'profit or loss'.

Question 15—Effects of the proposed changes to the Conceptual Framework

Do you agree with the analysis in paragraphs BCE.1–BCE.31? Should the IASB consider any other effects of the proposals in the Exposure Draft?

Inconsistencies between existing standards and revised Framework

IASB has stated that it will not automatically change existing Standards as a result of the changes to the Conceptual Framework. Any decision to amend an existing Standard would require the IABS to go through its normal due process for adding a project to its agenda and developing an Exposure Draft and an amendment to that Standard.

We are concerned that this approach taken by IASB would cast doubts over the credibility of the revised Framework. We propose that IASB adopts a forward looking effective date for the revised Framework instead of an immediate effective date upon issuance. Notwithstanding that, IASB can still apply the concepts in the revised Framework when issuing or revising standards during the interim period. This would allow sufficient time for IASB to make necessary amendments to rectify the inconsistencies in the existing standards. In addition, priority should be given to inconsistent standards with immediate or significant impact and timelines should be set up and clearly communicated.

Should you require any further clarification, please feel free to contact Ms Lim Ju May, Deputy Director, Technical Standards Development and Advisory, or Ms Jezz Chew, Manager, Technical Standards Development and Advisory, from ISCA via email at jumay.lim@isca.org.sg or jezz.chew@isca.org.sg respectively.

Yours faithfully,

Mr Titus Kuan
Director
Technical Advisory and Professional Standards