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Brussels, 25th November 2015

Dear Sir or Madame,

Comment on IASB's Exposure Draft 2015/3 – Conceptual Framework for Financial Reporting

We have set out some general comments on the Exposure Draft ("ED") – Conceptual Framework for Financial Reporting below. Our comments are made from the perspective of small and medium-sized entities ("SMEs") and small and medium-sized practitioners ("SMPs") but it is clear that these may also be valid from the perspective of other stakeholders.

This letter will outline our observations and concerns and the context to these comments.

About EFAA

The European Federation of Accountants and Auditors for SMEs ("EFAA") is an umbrella organisation for national accountants and auditors' organisations whose individual members provide professional services to SMEs within the European Union and Europe as a whole. It was founded in 1994 and has member bodies throughout Europe representing over 320,000 practitioners.

EFAA represents accountants ("preparers") and auditors providing professional services primarily to SMEs. Constituents are mainly SMPs, including a significant number of sole practitioners. EFAA's members, are therefore, SMEs themselves.

SMPs are European SMEs' most important business advisors. They help entrepreneurs gain access to finance, and they provide valued business advice allowing them to grow their businesses in a sustainable manner. An important characteristic of SMEs is that most of their business relations are based on very close personalised cooperation and mutual trust. Hence, their accountants and auditors need to provide targeted services to accommodate the individual needs of SMEs and of the users of their financial statements.

Why is EFAA responding to this matter?

We believe that the effect of this proposed conceptual framework ("CF"), if implemented, could be significant. Not only may it change, in due course, the standards which European listed groups (and other companies voluntarily choosing to adopt IFRS) follow in preparing their financial statements, but it is likely to have a significant "trickle down" effect on unlisted companies.

This is because SME accounting in Europe is not only framed under the requirements of the European Accounting Directive ("Directive") but is influenced and driven by the requirements of National Standard Setters. The Directive is a high-level framework for accounting which sets out certain principles but is silent on how to account for many matters. In those cases, National GAAP is usually followed and their requirements in turn often follow IFRS pronouncements.

CHAPTERS 1 AND 2—THE OBJECTIVE OF GENERAL PURPOSE FINANCIAL REPORTING AND THE QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION

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?

(a) We agree with the importance of the stewardship objective and we consider stewardship to be a significant objective for financial reporting alongside the provision of information for economic decisions.

(b) We agree that prudence should be part of the CF. The way it is stated in the ED means that it is a quality (caution in the face of uncertainty) which should be followed in the preparation of financial statements. We agree with that given the greater risks from the overstatement of profits. In the SME context prudent reporting of results can assist in ensuring the entity's continuation as a going concern, which is a key objective of both the SME itself and the users of its financial statements. We accept that prudence can be connected with neutrality in the sense that uncertainty should normally affect the value placed on assets or liabilities by way of a proper risk premium.

However, we see an important role for prudence in standard setting in the possibility that there should in some cases be asymmetric recognition of assets and liabilities and gains and losses. This asymmetrical prudence can be seen in the standards themselves, for example in the treatment of onerous and executory contracts (IAS37), contingent assets and liabilities (IAS37), deferred tax assets and liabilities (IAS12) and in variable consideration in IFRS15. This possibility is confirmed in the basis of conclusion but being so self-evidently important in standard setting it should be dealt with in the CF itself, as a possibility (not a necessity) in Chapter 1 and under recognition criteria in Chapter 4.

We see less of a role for prudence in setting the standards for the measurement requirements in IFRS, given the proposed treatment of significant measurement uncertainty in paragraph 5.21. Reporting entities need to use prudence in applying the measurement requirements and ensuring that uncertainty be captured in valuations via the proper reflection of risk.

(c) We agree with the specific reference to substance over form.

(d) We agree with the treatment of measurement uncertainty as noted above.

(e) We agree with relevance and faithful representation as the fundamental characteristics of useful financial information.

CHAPTER 3—FINANCIAL STATEMENTS AND THE REPORTING ENTITY

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?

Firstly, we think it helpful that the concept and possibility of combined financial statements is included in the CF; IFRS for SMEs includes guidance on what is required.

Secondly, in our view 3.23 is not helpful and would be better deleted. The value of unconsolidated compared to consolidated financial statements depends on the purpose for which they are being used.

Thirdly, chapter 3 refers to unconsolidated financial statements whereas IFRS for SMEs refers to separate financial statements. We would advocate consistency in this regard.

Our answer to Question 8 on the potential extensions to the reporting entity is set out below.

CHAPTER 4—THE ELEMENTS OF FINANCIAL STATEMENTS

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?

We agree with the definitions of assets, liabilities, equity, income and expenses. We note that the definition of assets is broad and would encompass a number of items that would not be included in the current definition and therefore the recognition criteria are particularly important.

We would highlight as particularly important for SMEs the cases where low probabilities of inflow should bar recognition of assets (5.19), measurement uncertainty precluding recognition of assets and liabilities (5.21), the importance of considering effects on profit/loss (5.23) and the cost/benefit constraint in 5.23.

There is also more supporting material needed for the definition of liability (as set out in our answer to Question 4 below).

We continue to believe that the elements defined should include cash inflows and outflows.

Question 4—Present obligation

Do you agree with the proposed description of a present obligation and the proposed guidance to support that description? Why or why not?

Whilst there is an explanation in 4.32 to 4.35 of this condition 'no practical ability to avoid a transfer', we believe that some aspects should be more definitively dealt with. We note that liabilities contingent on the future actions of others would generally be recognised, but those dependent on the entity's own action would only be recognised where the 'no practical ability' would be applied. In addition, 4.32 talks about business disruption or adverse economic consequences, but we believe that there is a scale from probable economic advantage to economic compulsion that would have to be addressed.

In terms of a past event, the concept of the 'stand ready' obligation should be covered.

We also note that 4.31(a) refers to the receipt of economic benefits and we think that in some cases that should be an important factor in deciding whether a liability exists.

Question 5—Other guidance on the elements

Do you have any comments on the proposed guidance?

Do you believe that additional guidance is needed? If so, please specify what that guidance should include.

We have no further comments.

CHAPTER 5—RECOGNITION AND DERECOGNITION

Question 6—Recognition criteria

Do you agree with the proposed approach to recognition? Why or why not? If you do not agree, what changes do you suggest and why?

We have noted above our concern that the possibility in some cases of asymmetrical recognition of assets compared to liabilities, and of gains compared to losses needs to be reflected in the discussion of recognition criteria. We have further noted in answer to Question 3 above the particularly significant recognition criteria and also the importance of prudence in our response to question 1b.

Question 7—Derecognition

Do you agree with the proposed discussion of derecognition? Why or why not? If you do not agree, what changes do you suggest and why?

We agree with the discussion of derecognition.

CHAPTER 6—MEASUREMENT

Question 8—Measurement bases

Has the IASB:

(a) correctly identified the measurement bases that should be described in the Conceptual Framework? If not, which measurement bases would you include and why?

(b) properly described the information provided by each of the measurement bases, and their advantages and disadvantages? If not, how would you describe the information provided by each measurement basis, and its advantages and disadvantages?

We agree that the two main categories of measurement bases are historical cost and current values. However the implication of this for measurement bases that do not appear to fit under either of these is not clear, for example the equity basis of measurement (for associates and JVs).

The equity method needs to be addressed by the CF, either here as an accepted measurement basis, or under Chapter 3 as a form of consolidation based on an extension of the reporting entity to those where there is common control or significant influence.

Question 9—Factors to consider when selecting a measurement basis

Has the IASB correctly identified the factors to consider when selecting a measurement basis? If not, what factors would you consider and why?

We agree with the factors identified in paragraph 6.54. We would support a default and presumption in favour of historical cost over current values.

Question 10—More than one relevant measurement basis

Do you agree with the approach discussed in paragraphs 6.74–6.77 and BC6.68? Why or why not?

We do not support in principle the concept of the recognition of items on more than one measurement basis. Recognition using one and disclosure of the other is a preferable solution. However we accept this has developed in existing standards, but would see it as an exceptional solution not to be widely used, and which does add complexity (see our comments in response to Question 13 and Question 14). We also note that it is important that financial information is comparable in order for the user to have a comprehensive understanding.

CHAPTER 7—PRESENTATION AND DISCLOSURE

Question 11—Objective and scope of financial statements and communication

Do you have any comments on the discussion of the objective and scope of financial statements, and on the use of presentation and disclosure as communication tools?

We agree with what is included in these sections; historical cost in general, with fair value changes through the profit and loss account noting that as previously stated, we are not advocates of mixing the different measurement bases.

Question 12—Description of the statement of profit or loss

Do you support the proposed description of the statement of profit or loss? Why or why not?

If you think that the Conceptual Framework should provide a definition of profit or loss, please explain why it is necessary and provide your suggestion for that definition.

We agree with the description of the profit and loss account as the primary source of information about the entity's financial performance. We recognise it as a long standing and the most widely used measure of performance. For this reason, it seems to us, that it would be better if the CF included a definition. However we accept that for now it is difficult to provide that. In the absence of such a definition then we agree with the default position being that all income and expenses are reported in profit and loss, unless required or allowed by an IFRS to be included in OCI.

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?

We consider that more emphasis in the CF should be given to the statement of comprehensive income as a whole and less to the separation of OCI from profit and loss. What is most important is that there is transparency for the readers of the financial statements of the different components of comprehensive income. In the end the stewardship objective means that management are accountable for comprehensive income and not just what is in profit and loss. We believe that IASB should be looking more to encouraging helpful analysis of all of the components of comprehensive income so that users can identify items that are likely to be persistent and have more implications for the trend of future performance from those that may be 'one off'. This implies a reconsideration of IAS1 and the relevant parts of IFRS for SMEs.

Our views on this issue come from an SME perspective, but in our opinion are nevertheless relevant to listed companies as well.

We also note that 7.24 sets out the criteria for IASB to decide when an item should be reported in OCI. We do not object to either (a) or (b) but think they are too imprecise to form an adequate basis for such decisions to be taken on a consistent and coherent basis. The business model concept should potentially be an important aspect. In general, where fair or current values are used, that those changes in fair value would go through P&L. The current incoherent picture of OCI treatments is one of the most significant weaknesses in current IFRS and one where the CF is expected to point the way.

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?

We do not agree with the rebuttable presumption proposed, but consider that the presumption should be reversed.

As noted above we think there should be more emphasis on comprehensive income rather than on its separation into two components. Recycling of elements that have formed part of OCI increases the complexity and reduces the understandability of the performance statements.

We do see the need for recycling for cash flow hedging instruments, but believe that to be a special case.

Question 16—Business activities

Do you agree with the proposed approach to business activities? Why or why not?

We prefer the term 'business model' to 'business activities' which seems rather meaningless in this context. There might be merit in an overall discussion of the business model and its significance and that it is addressed in the different Chapters of the CF for example on presentation, measurement and the unit of account. It will also be needed for Chapter 7 and the OCI issue (see Question 14 above).

Question 17—Long-term investment

Do you agree with the IASB's conclusions on long-term investment? Why or why not?

We agree with the conclusions of the IASB that long term investors can be served by the current formulation of the CF.

Question 18—Other comments

Do you have comments on any other aspect of the Exposure Draft? Please indicate the specific paragraphs or group of paragraphs to which your comments relate (if applicable).

As previously noted, the IASB is not requesting comments on all parts of Chapters 1 and 2, on how to distinguish liabilities from equity claims (see Chapter 4) or on Chapter 8.

In our view the inclusion in 1.6 of the other sorts of information that might be needed should be improved. There has been a general reassessment of the importance of non-financial information in corporate reporting to which the CF should respond. Integrated Reporting is one such indication of the wider perspective that is needed. IASB's own Management Commentary guidance points to different factors than are currently included in 1.6.

We also note that Chapter 8 introduces the concept of capital maintenance adjustments, these are not included among the elements discussed in Chapter 4 nor appear on the diagram at 5.6 for example. In 8.4 such adjustments are regarded as expenses, but in 8.8, 8.9 and 8.10 they seem to be specifically excluded from being expenses. They therefore undermine the main model.

Furthermore the non-application in IFRS of the concepts of capital maintenance needs to be made clearer than it is in 8.9. Capital maintenance adjustments, as far as we are aware, are not being specifically required in IFRS at present. For both these reasons we think the whole of Chapter 8 would be better removed from the CF.

I trust that the above is comprehensive but should you have any questions on our comments, please do not hesitate to contact me.

Yours faithfully,

Bodo Richardt

President