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

Via email: commentletters@ifrs.org

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Dear Members of the IASB

Exposure Draft: Conceptual Framework for Financial Reporting

The Corporate Reporting Users' Forum welcomes the opportunity to comment on the IASB's Exposure Draft: *Conceptual Framework for Financial Reporting* (the ED).

CRUF acknowledges that the current ED has adopted several of the points that the CRUF has raised regarding the Discussion Paper of the Conceptual Framework (the DP), which was published in July 2013. These points include the following:

- Reinstatement of prudence.
- Adoption of View 2 proposed on the DP regarding the meaning of 'present obligation' in the definition of a liability.
- Enhanced guidance regarding the elements of financial statements.
- Acknowledgment of different objectives of the statement of financial position and statement of profit or loss regarding the section of measurement basis.
- Use of OCI to enhance relevance of the P&L for the reporting period, when the presumption that all income and all expenses are included in the statement of profit or loss is in fact rebutted.

The CRUF recognises the importance of the Conceptual Framework as a tool to enable the IASB to develop better standards and to help users decide what to do when current standards provide insufficient or conflicting guidance. While we broadly welcome the Conceptual Framework, we feel that the Conceptual Framework would be improved by the inclusion of some very high-level statements about the purpose of and interaction between the three primary statements. We published our guiding principles (which include such statements) about 10 years ago and we think that they remain valid today. We have attached the guiding principles to this letter.

In short, we feel that the Conceptual Framework as currently formulated lacks a conceptual framework. Like many accounting documents, the Conceptual Framework focuses on detail and omits the bigger picture. What purpose does each primary statement serve? Are they supposed to be capable of being reconciled? The third aim of the Conceptual Framework is to "assist others to understand and interpret the Standards". By "others", we presume that the IASB means people who are not blessed with an accounting qualification. We think that the Conceptual Framework fails in this third aim.

The Conceptual Framework is supposed to act as a beacon to help future standard setters judge whether their work is furthering the aim of making company accounts fit for purpose. It would therefore be helpful if the Conceptual Framework provided more clarity about the purpose of each primary statement, rather than just high level boiler plate.

In the following pages, we would like to comment on some of the questions raised in the ED.

Responses to specific questions

Question 1(a) Information to assess management's stewardship

We agree with the ED's proposal that more prominence should be given to the information which is needed to assess management's stewardship of the entity's resources. We agree that information about how efficiently and effectively management discharges its responsibilities to use the entity's resources would be useful in assessing management's stewardship (1.22).

Question 1(b) Prudence

We agree with reinstating an explicit reference to prudence. We especially appreciate the paragraph in the ED that the exercise of prudence supports neutrality and that the Conceptual Framework should not identify asymmetric prudence as a necessary characteristic of useful financial information as a positive development.

We believe that systematic bias toward understatement of assets/income or the overstatement of liabilities/expenses to be incompatible with relevant financial information. Financial information should be based on neutrality and any recalculations or adjustments should be undertaken by the users as needed.

On the other hand, we agree that there are cases where asymmetric accounting policies may be used to provide relevant information, such as different recognition thresholds for contingent assets and contingent liabilities as mentioned in BC2.14.

Question 1(d) Measurement uncertainty

While the ED states that measurement uncertainty is a factor which may lower relevance, we believe that measurement uncertainty affects faithful representation, which in turn influences relevance.

In a similar vein, regarding recognition criteria, we believe that low probability and measurement uncertainty should be linked to the degree of faithful representation rather than directly to relevance (5.13, 5.21).

Question 2 Description and boundary of a reporting entity

The ED states that financial statements are prepared from the perspective of the entity as a whole (3.9). However we believe that what is relevant information may differ among the various types of users.

Although financial statements are prepared for both investors and creditors, we consider that the needs of the shareholder should be paramount as shareholders bear the highest risk.

Question 6 Cost

We acknowledge that cost should not be ignored as a factor, but we are concerned that preparers may use the cost clause as an excuse to avoid disclosure. Therefore, we believe that "(c) information that results in benefits exceeding the cost of providing that information" (5.9) and "Cost" (5.24) should be excluded from the ED.

Question 6 Probability

Paragraph 5.13(b), which states that "if an assets exists, but there is only a low probability that an inflow or outflow of economic benefits will result", reflects the lower emphasis placed on specific probability thresholds in the ED. However, we are concerned that this may cause distortions in cases where provisions are used or of frequent impairments (and/or impairment reversals) etc., which may lower the usefulness of financial statements.

We suggest that the probability criteria should be strengthened by including the following. The probability criteria most often used are "probable" and "more likely than not". However, there are cases where these are not suitable. The probability criteria should be determined as necessary, on an individual standard level, based on relevance, faithful representation and cost considerations.

Question 12 Description of the statement of profit or loss

We agree with the main points of the ED.

We are encouraged that the ED explicitly stated the continued use of net income. On the other hand, we are disappointed that net income was not defined. We strongly encourage the IASB to initiate the definition of net income as a new long-term project, separated from the current Conceptual Framework project. By doing so, we believe we can expect the continuous improvement of the Conceptual Framework in the future, while avoiding any delay in completion of the current project.

We believe that it is inconsistent that assets, liabilities and equity are defined within the statement of financial position, but only income and expenses are defined in the statement of profit or loss. As the ED is currently written, net income is simply the residue after expenses are subtracted from income, and as such net income does not have a clear raison d'être. By giving net income a clear definition, net income can hold equal importance as income and expense and become part of a three-pillar structure (along with income and expenses) for the statement of profit or loss.

We propose to define net income as "the profits attributed to the current accounting period of a reporting entity which is a going concern, using accrual accounting. Net income will not include profits due to change in the current value of assets and/or liabilities, except in cases where such changes in current value are regarded as part of recurring business operations". In other words, it would exclude most unrealised gains and losses.

By defining net income as above, OCI will become easier to define, and it will become possible to present uniform sub-totals of income in the statement of profit or loss (such as operating profit/loss), which many users find useful.

Operating profit/loss, as a sub-total of net income, would preferably exclude financial profit/loss, extraordinary profit/loss, and tax related subtractions (such as corporate income tax); however, specifics can be determined at the standard level.

Regarding the definition of net income, and related to our answer to Question 2, we also believe that making it clearer which part of income/profits is attributable to shareholders of the reporting entity would improve usefulness to users. Net income should be defined as after non-controlling interests, i.e. net income that is attributable to the shareholders of the reporting entity. Having a net income definition that conflicts with the net income used for EPS calculation is inherently undesirable. There are implications for the project where the IASB is seeking to define "Financial Instruments with the Characteristics of Equity" and we believe that again a definition of equity consistent with that used in defining fully diluted EPS is desirable. Non controlling interests would be a separate category in the balance sheet which has some equity characteristics but not for the shareholders of the reporting entity.

While comprehensive income is also available to investors, net income attributable to the shareholder of the reporting entity is more predominantly used by investors as a key input to the various valuation metrics such as Price-to-Earnings ratio (P/E multiple), Excess Income Model and so forth.

Net income is still one of the most predominant metrics of financial performance because investors need a certain level of conviction when they estimate the future cash flow of a reporting entity. Net income for the current financial year based on accrual accounting generally leads to cash flow, which brings the level of certainty necessary for forecasting.

However, this does not mean that investors are looking only at net income. As OCI is a temporary profit based on end-of year market prices and foreign exchange rates, investors generally do not forecast or calculate present values of OCI as they would do for net income, but they do recognize that OCI provides valuable information regarding equity. This is particularly true where balance sheet items are used as part of the calculation of "Enterprise Value" which is widely used in financial analysis.

Therefore, we believe that what is most important for investors is not whether net income, OCI, or the total of both is the most relevant. Both net income and OCI carry relevant information of their own sake and they act to complement each other when they are used in decision making by investors. Thus, we believe it is vitally important for us to be able to identify the difference between the two.

In order to make a clear distinction between net income and OCI, net income must be defined. Furthermore, we believe that by defining net income, the conditions that need to be met for recycling will also become clear (we will further explore this subject in our answer for Question 14).

Question 14 Recycling

CRUF members have varying views on recycling. One of the tenets of the CRUF is that we do not seek unanimity; there will always be some issues where members differ. We have therefore split this section into two: the argument for full recycling and the argument for a more differentiated approach.

Full recycling

Some CRUF members believe that all OCI should be recycled, for the following reasons.

First, full recycling will ensure that the cumulative amounts of net income, cash flows and comprehensive income will all be equal through the lifetime of the reporting entity. This will enhance the robustness of net income for financial analysis purposes.

Second, full recycling will help to make the distinction between retained earnings and accumulated OCI on the statement of financial position clearer.

Supports of full recycling see retained earnings as belonging to shareholders, finalized on the date of the statement of financial position, and as a resource available for dividends. They see accumulated OCI is a temporary and unrealized gain resulting from changes in valuation, which is subject to fluctuation in the future.

They believe that clear distinction between retained earnings and accumulated OCI is very important to equity analysis purposes, but they are concerned that the difference will become less clear without full recycling.

They are aware that there are opinions that when the profits/losses from the sales of long-term assets which have been included in OCI are reported in the statement of profit or loss the volatility of net income will rise and this will lower relevance. However, these one-time items are easy to be identified by users and would not be a major problem for financial analysis. On the other hand, they would like to point out that making realized profits/losses more assessable to users may have the additional benefit of providing information or insight regarding management's intentions.

They believe that the benefits of the aforementioned robust definition of net income and a clear distinction between retained earnings and OCI would outweigh any disturbances caused by any increases in net income's volatility, and therefore strongly advocate full recycling of the OCI without any conditions.

Looking at the recycling issue from a different angle, they disagree with the criteria stated in the ED for including or excluding income/expense from the statement of profit or loss, i.e. whether or not the exclusion of income/expense enhances the relevance of the information in that statement for the period (7.24).

The decision whether relevance is increased or decreased can be subjective, which leaves room for interpretation and can be a deterrent to the stability of standards development.

To avoid unnecessary confusion, the Framework also should clearly differentiate the two different questions in nature, i.e. whether OCI should be recycled and when OCI should be recycled.

<u>Partial recycling</u>

Other CRUF members share the IASB's view about splitting recycling based on relevance for performance measurement in the accounting period. They believe that there are different sorts of OCI items.

First there are items like cash flow hedges, which most agree should be matched against the hedged transaction in the income statement, implying that recycling is needed. Other items split into two further categories the former being like the example cited above where timing of realization of gains and losses may be relevant. However if OCI is given appropriate status then users will have adjusted their valuations to reflect current value and the realization of a gain or loss may be less relevant compared to the risk of manipulation of earnings by timing of gains or losses to smooth net income. They are particularly concerned about this in the banking and insurance sector where such realisations may be seen as "normal operations" and therefore not be visible for users to remove. The other category of OCI which they do not understand how the item will be recycled in practical terms relates to items like changes in the discount rate used for pensions as the timing of the crystallisation is somewhat arbitrary either at the scheme level or for the individual concerned. They are also concerned that the cost to implement recycling here would be prohibitive.

Question 16 Business activities

As we have mentioned in our comments to Question 12 and Question 14, we believe that net income and OCI should be defined as elements of the financial statements, and that income/expense which does not meet the criteria of net income should be included in OCI.

In relation to defining net income, we propose that how business activities are to be used to select the measurement basis should be further clarified. By doing so, we believe the consistency in how income/expense is divided into net income and OCI will improve, thereby enhancing net income's and OCI's relevance.

We would like to make the following two proposals on the selection of measurement basis for the specific items.

First, we believe that the following guidelines regarding the remeasurement of tangible fixed assets used in the DP should be reinstated:

> "if assets contribute indirectly to future cash flows through use, cost-based measurements normally provide information that is more relevant and understandable"
>
> "if assets contribute directly to future cash flows by being sold, a current exit price is more likely to be relevant"

We are concerned that the absence of clear guidelines such as the above might just increase the risk that the preparers would arbitrarily choose the remeasurement basis to make their performance and financial positions look better.

Our second proposal is to apply the same principle that we propose for fixed assets to the re-measurement of debt. We are aware that there are a lot of criticisms against the recognition of gains on debt when the entity's credit worthiness deteriorates.

More specifically, we believe that if the repurchase of a liability is a realistic option, then fair value should be used, but if repurchase is not realistic then historical cost would be more relevant.

About the Corporate Reporting Users' Forum (CRUF)

The CRUF was set up in 2005 by users of financial reports to be an open forum for learning about and responding to the many accounting and regulatory changes that affect corporate reporting. In particular, participants are keen to have a fuller input into the deliberations of accounting standard setters and regulators. CRUF participants include buy and sell-side analysts, credit ratings analysts, fund managers and corporate governance professionals. Participants focus on equity and fixed income markets. The Forum includes individuals with global or regional responsibilities and from around the world, including Australia, Canada, France, Germany, Hong Kong, India, Japan, New Zealand, South Africa, UK and USA.

The CRUF is a discussion forum. Different individuals take leadership in discussions on different topics and in the initial drafting of representations. In our meetings around the world, we seek to explore and understand the differences in opinions of participants. The CRUF does not seek to achieve consensus views, but instead we focus on why reasonable participants can have different positions. Furthermore, it would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative. This response is a summary of the range of opinions discussed at the CRUF meetings held globally. Local country differences of opinion are noted where applicable.

Participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer organizations. Accordingly, we sign this letter in our individual capacity as participants of the Corporate Reporting Users' Forum and not as representatives of our respective organizations. The participants in the Forum that have specifically endorsed this response are listed below.

(Signatures)

Naoki Hirai
Managing Director
Nomura Securities Co., Ltd.

Makoto Kaimasu
Executive Vice President
The Securities Analysts Association of Japan

Masayuki Kubota, CFA, CMA
Head of Rakuten Securities Economic Research Institute
Rakuten Securities, Inc.

Yoshihiro NOMURA
Senior Strategist
Nomura Securities Co., Ltd.

Koei Otaki
Senior Analyst, CPA
SMBC Nikko Securities Inc.

The Corporate Reporting Users' Forum

Peter Reilly

Ralf Frank
DVFA

Catherine Giordan
Equity Product Management
Exane BNP Paribas

Gunnar Miller
Managing Director
Head of Equity Research Europe
Allianz Global Investors GmbH

Marion Scherzinger
Head of IKB Investment Research IKB Deutsche Industriebank AG

Crispin Southgate
Director
Institutional Investment Advisors Limited

Jed Wrigley
Portfolio Manager Director Accounting and Valuations
Fidelity Worldwide Investments