



European Securities and
Markets Authority

The Chair

Date: 18 December 2013
ESMA/2013/1952

Francoise Flores
EFRAG
Square de Meeus 35
1000 Brussels
Belgium

Re: EFRAG draft comment letter on the IASB's Discussion Paper on A review of the Conceptual Framework for Financial reporting

Dear Ms Flores, *DEAR FRANCOISE,*

The European Securities and Markets Authority (ESMA) thanks you for this opportunity to contribute to EFRAG's due process. We are pleased to provide you with the following comments with the aim of improving the transparency and decision-usefulness of financial statements and the enforceability of IFRSs.

ESMA has considered EFRAG's draft response on the IASB's Discussion Paper (DP) *A review of the Conceptual Framework for Financial reporting*.

ESMA believes it is important the IASB started a debate on a large number of concepts relevant to the development of accounting standards, by publishing the DP. However, we believe several concepts need further analysis and clarification with respect to their impact on financial reporting as commented hereafter. As a consequence it will be difficult to express final views on several questions raised in the DP.

Objective, scope and approach

Although paragraph 1.22 of the DP states that 'the IASB will not necessarily change existing standards for any of the areas discussed in this conceptual framework', our understanding is that some of the existing standards or interpretations might present some major inconsistencies with the revised CF. It is therefore much needed that the forthcoming ED identifies and explains the existing requirements which are in contradiction with the revised CF. Moreover, we believe that standards with major inconsistencies with the CF would be suitable candidates for revision. ESMA agrees with EFRAG that the IASB may decide to issue a future Standard that conflicts with an aspect of the revised CF but this departure from the CF and the reasons for that should be described in the Basis for Conclusions on that Standard.

ESMA agrees with the purpose of the revised CF as a single and robust basis for the IASB to develop IFRSs and notes that it is essential to have a consistent approach between the CF and the standards. ESMA

agrees with EFRAG's view that issuers can also use the CF if there is no IFRS for a specific transaction or event but, when developing a policy as allowed by IAS 8, issuers should always comply with the CF. The CF should then strike the right balance, i.e. should remain at a high level to avoid the creation of inconsistencies between the CF and IFRSs while not staying purely conceptual to include useful directions. A number of existing standards may in the future be inconsistent with the revised CF. ESMA believes the IASB should consider the implications whether issuers are allowed to develop accounting policies by analogy with a standard that is in conflict with the CF.

Definitions, recognition, derecognition, distinction between debt and equity instruments

ESMA supports the amended definitions of assets and liabilities, which must largely be considered together with the new criteria for recognition and de-recognition and measurement principles that are to be applied. ESMA agrees with EFRAG's view that current implications on existing Standards of amending the CF should be identified at the level of the Exposure Draft, so that constituents have a clearer understanding of the possible outcomes of the proposed changes. Overall, it is difficult to have final answers to the proposals without looking at the level of standards and assessing the impact of these changes such as the removal of reference to probability. This could be a concern as the new definitions possibly widen the number of items to be recognised in the statement of financial position, subject to the prudence notion discussion.

ESMA urges the IASB to clarify the dividing line, between what can reasonably be defined as an 'asset' or a 'liability' of an entity and what cannot. In particular, we recommend the IASB to explore and clarify that the CF will not result in the recognition of unjustifiable assets in the statement of financial position following either definition, or recognition or measurement. In addition, ESMA recommends the IASB clarifying concepts such as 'executory contract' or 'conditional obligation' which are included as part of the notion of 'present obligation'. ESMA fully agrees that present obligation should not be considered as strictly unconditional. ESMA agrees with EFRAG that constructive obligations are too narrowly defined. Additionally ESMA would not add in the economic resource definition the terms 'to the entity' (as in view 2 proposed by EFRAG in its draft comment letter) but would support to add in the CF the logic expressed by IFRIC 2 - *Members' Shares in Co-operative Entities and Similar Instruments* to deal with entities with no or little residual equity.

ESMA agrees with the preliminary view of the IASB to continue to use the definition for 'liability' as a basis for distinguishing liabilities from equity instruments. ESMA supports maintaining the definition of equity as a residual interest, agrees that the distinction should be based on the characteristics of the instruments issued and supports the strict obligation approach. However, ESMA believes that the IASB should provide explicit guidance on which types of instruments constitute primary and secondary equity claims. ESMA also encourages the IASB to explore the concept of 'wealth transfer' and consider how to depict the potential dilution of the ownership in an entity in a way that is most useful to the users of financial statements. ESMA encourages the IASB to consider all the potential impacts of the wealth transfer notion

in the financial reporting and their understandability by users of financial statements. Thus, ESMA does not support EFRAG's alternative view to reflect the changes due to wealth transfer in comprehensive income as supported by EFRAG since ESMA does not believe that for the rights and obligations that could relate to an entity's trading, borrowing and investing activities it would be inappropriate to account for them as transactions with owners and reflect them in the statement of changes in equity, instead of being reflected.

Measurement

Regarding measurement, ESMA agrees with the rejection of a single measurement approach, as for some categories of assets or liabilities fair value will be relevant, while for others this will not be the case. In the absence of an analysis of potential consequences of revised definition on the current standards, ESMA has concerns with regards to potential recognition and measurement impacts and urges the IASB to perform such analysis. ESMA disagrees with EFRAG on the introduction of explicit probability thresholds acting as filters. Yet, ESMA believes that removing a 'probability' test for the definition and recognition criteria may well equate to removing a 'sense check' that currently exists for many issuers when in practice they are deciding to recognise assets and liabilities. We believe that if this 'sense-check' is now deemed to be performed at the measurement stage, this should be made explicit and further developed in the ED. Furthermore, the IASB should provide more guidance for potential exemptions from the CF such as those in section 5 and clarify the notion of 'current value'. ESMA agrees that in proposing to select a measurement basis, the IASB should consider both the financial position and financial performance of an entity.

ESMA believes that there should be consistent theoretical approaches/arguments in the CF on the use of discount rate in cash-flow-based measurements. Today there are different approaches in different standards for discount rates.

Presentation and disclosures

Like EFRAG, ESMA acknowledges the need to address the disclosures challenges including the communication principles and the need to introduce some discipline in the notes, including the example on risk information to be provided. ESMA supports the development of a Disclosure Framework within the CF. Nevertheless we do believe the objective of the notes should be broader than to supplement the primary statements by providing additional useful information to enable users in making decisions about providing resources to the entity. We do not believe that notes should only require forward-looking information if it provides relevant information about items that existed at the year-end but we would also support the inclusion of relevant forward-looking information on some unrecognized assets and liabilities (for instance on contingent assets and liabilities).

ESMA disagrees with EFRAG on the notion of 'primary performance' for the measurement and presentation in profit or loss. ESMA agrees with the proposals regarding the presentation in the statement of comprehensive income whether it leads to two statements for the Profit or Loss and Other

Comprehensive Income (OCI) or to the solution to maintain the Profit or Loss presented as a separate (sub) total of the statement of comprehensive income because we believe in the distinction between Profit or Loss and OCI. When the IASB should make such a distinction, a principle is needed. We note that the DP does not address what is performance and what differentiates conceptually the Profit or Loss from OCI and under which circumstances there should be recycling. ESMA disagrees on the EFRAG's preferred broad approach for OCI eligibility and recycling those OCI category items into profit or loss. We acknowledge that defining performance is not easy and that issuers can use non Generally Accepted Accounting Principles measures to reflect their views about the performance of an entity, we prefer the narrow approach, which is conceptually sound and firmly believe that the IASB should develop an OCI approach in relation to Profit or Loss that is consistent with this narrow approach. In this regard ESMA calls the IASB to bring further clarification to the definition of the bridging items.

Other issues

ESMA agrees with the IASB on the reliability concept not being reintroduced as a qualitative characteristic of financial reporting views but disagrees with EFRAG's view on the introduction of 'faithful representation' and the preference of reliability.

ESMA disagrees with EFRAG's view on stewardship notion as the balance to be found between stewardship and providing information to help investors assessing the prospects of future net cash inflows should not harm transparency.

ESMA believes transparency and comparability in financial statements is of paramount importance and thus does not oppose the reintroduction of prudence in the CF as long as it does not harm transparency and comparability or lead to the creation of hidden reserves (by overstating liabilities and understating assets). ESMA believes that issuers should apply a certain degree of 'caution' as part of the recognition and measurement of assets, liabilities and the determination of gains and losses but considers that this type of prudence is already included in the standards. Yet ESMA believes this should be clarified in the CF.

Although understanding the business model of an entity is important for users of its financial statements, ESMA disagrees with EFRAG's view that the role of the business model in financial reporting should be referred on a systematic basis and believes that the IASB should use the business model concept carefully when developing or revising some IFRSs. ESMA would call for the notion of business model being analysed and clearly defined in order to avoid a too flexible interpretation and misuse.

Finally, as a general comment, ESMA did not grasp the rationale for the inclusion of the cost benefit analysis in some sections while this is a pervasive constraint that is common to any information to be provided in the financial reporting. Therefore, ESMA believes the Board should include a section at the beginning of the CF addressing all constraints' implication for financial reporting rather than addressing it in some of its sections.



Our detailed comments on the questions in the DP are set out in the appendix I to this letter. Please do not hesitate to contact us should you wish to discuss any of the issues we have raised.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'SM' with a horizontal stroke extending to the right.

Steven Maijoor
Chair
European Securities and Markets Authority

APPENDIX 1 – ESMA’s detailed answers to the questions in the IASB’s Discussion Paper DP/2013/1 – *A Review of the Conceptual Framework for Financial Reporting*

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?

1. ESMA agrees that the primary purpose of the CF is to assist the IASB by identifying concepts to be used consistently when developing and revising IFRSs. Yet, as indicated in paragraph 1.26 of the DP, the CF has also other purposes, such as helping parties other than the IASB to understand and interpret existing IFRSs and helping issuers in developing, and auditors and enforcers in assessing accounting policies when no IFRS specifically applies to a particular transaction or event as required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. We also agree with the IASB that a long list of possible uses is not necessary.
2. We agree that the CF should always be the primary conceptual source to develop new IFRSs. ESMA also believes that the Basis for Conclusions of any standard should always include explicit references to the CF to anchor the conceptual background for the requirements.
3. In recent years examples have been discussed where an IFRS could deviate from the CF, including practical expedients. We are convinced that in the future this should be limited to rare situations in which departing from the CF provides more relevant information to the users of financial statements than applying CF principles. ESMA believes that the deviations from the CF can only be limited if the CF is sufficiently robust and urges the IASB to include in the CF itself such conceptually sound principles. ESMA is not opposed to practical expedients when they do not lead to information substantially different from those resulting from the CF sound principles. Such practical expedients should not substitute but only supplement those principles so that preparers who can apply them are

not prevented from using them. This also means that the introduction of a practical expedient in an IFRS should always be explicit.

4. ESMA also agrees that in case the IASB deviates from the CF when developing some principles for IFRSs, the IASB shall describe in the basis for conclusions why the CF could not be used and why the IASB considers the solution to result in more relevant information. We also believe that only the IASB should have this possibility, while issuers using the CF when developing a policy based on IAS 8 should always comply with the CF and not be allowed to design an accounting policy that is not in compliance with the CF. We understand that paragraph 1.29 of the DP can be read in this intention; yet ESMA urges the IASB to state it explicitly and clarify this by amending paragraph 11 of IAS 8.
5. We believe that issuers can also use the CF if there is no IFRS for a specific transaction or event. Thus the CF should strike the right balance, i.e. should remain at a high level to avoid the creation of inconsistencies between the CF and IFRSs while not stay purely conceptual to include useful directions. A number of existing standards may in the future be inconsistent with the proposed CF. ESMA believes the IASB should consider the implications if users are allowed to develop accounting policies by analogy with a standard that is in conflict with the CF.

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 an 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?

6. We welcome the new definitions proposed in the DP as they more accurately reflect the IASB's intellectual considerations used to take positions in latest developed standards. The simpler wording used in definitions and the fact that they mirror each other also makes them easier to understand and apply even if definitions should always be looked at in their context.
7. ESMA understands that the new definitions are to be considered together with the new criteria for recognition and de-recognition and in particular the two requirements to result in 'faithful

representation' and to be 'relevant'. As a whole, the new definitions focus adequately on the attributes of 'assets' and 'liabilities' as resources and obligations to which an entity has access rather than on the inflow and outflow of economic resources that will result from access to the former. We support the shift away from the probability of those inflows or outflows which seem to have been the characteristics most commonly used to decide the recognition of 'assets' and 'liabilities' in the past and which have undoubtedly led to some difficulties in application. We deal further with this matter in our answers to questions 3 and 6.

8. ESMA also supports the retention of the words 'as a result of past events' which are important to prevent recognition of assets or liabilities that largely depend on future acts of an entity. We would welcome that the use of the 'control' concept in the new definition be based on further guidance in the form of principles rather than examples.
9. ESMA is concerned with the general relationship between measurement, definition and recognition principles as we believe it is difficult to assess the full impacts and consequences of the revised definitions for assets and liabilities without knowing the overall effects on the actual standards if any. In particular the impacts of the changes in the definition for assets and liabilities in combination with the recognition and de-recognition criteria and/or the measurement proposals may yet be hard to fully grasp.
10. The new definitions may lead to the recognition of more assets and liabilities than under the current CF (i.e.: unsupported workforce asset) and we urge the IASB to clarify the dividing line between what can reasonably be recognised as an 'asset' or a 'liability' of an entity and what cannot. For example, a company's workforce or the ability to raise prices or to reduce a liability in the future all appear to meet the proposed definition of assets but may not meet the recognition criteria while currently not recognised. ESMA considers that they should not be recognised in the accounts. For the lottery ticket example in the DP we understand that both definition of an asset and criteria for recognition are met, but the measurement would be nil. Another example could be the fundamental research intangibles in scope of the IAS 38 *Intangible Assets* in the automotive sector.
11. We ask the IASB to explore and clarify that either through measurement, recognition or definition the CF will not result in the recognition of unjustifiable assets in the balance sheet.

Questions 3 and 8

Questions 3 - Whether uncertainty should play a 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?

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 re-vising 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 do you suggest, and why?

Uncertainty and probability

- 12. ESMA agrees with the IASB that the concept of probability is more closely aligned to the measurement of an asset or liability than it is to the actual definition of these items. ESMA acknowledges the two main problems created by the probability criterion. One is related to the absence of recognition first and then a cliff effect in recognition when the probability reaches 50%. In practice another problem is that, with similar fact patterns, some issuers will recognise a liability while some others will not, which might harm comparability.
- 13. Yet ESMA wonders whether more items may not be recognised in the future by applying the proposed definition with the removal of the ‘probability’ filter which acts as a ‘sense check’ for many issuers when making judgements on items to be recognised. We are thus not convinced that the new recognition criteria, based on ‘relevance’ and ‘faithful representation’, adequately reinstate this ‘sense check’ and ask the IASB to clarify how all these elements fit together.

14. ESMA also wonders whether the replacement of the word 'expected' in the definitions, which clearly caused problems in the past, with the word 'capable' merely replaces one difficulty of definition with another. Again more concrete explanation regarding how the word 'capable' should be interpreted in practice would be helpful.
15. ESMA would welcome the IASB to provide in the CF more elements on the definition of 'economic resources', for instance by referring to current terms used to define and recognise intangibles in IAS 38 *Intangible Assets*.
16. Finally, we believe the IASB should also explore the effects of the revised CF when issuers have no standard to apply; for example, if there will be additional incentive to recognise assets.

Recognition criteria

17. Regarding question 8, ESMA agrees that in general users would not benefit from the recognition of assets or liabilities that do not provide either relevant information or result in a faithful representation.
18. However, we believe that the DP is not clear in justifying the preliminary views on recognition. We have noticed some inconsistency in using guidance in paragraph 4.26 (b) which reintroduces the probability criteria ('low probability that an inflow of economic benefits will result') whereas paragraph 4.8 makes clear that probability should be removed from the CF. Yet, in our view, it does not seem to be consistent with the proposal to remove the 'probability' criterion from the recognition principles. This could make difficult understanding the fundamental underlying concepts set out in this section.
19. With regards to cost constraints, ESMA notes that it is already included in paragraphs QC 35-39 of chapter 3 of the CF and did not grasp the rationale for the inclusion of the cost benefit analysis in some sections while this is a pervasive constraint that is common to any information to be provided in the financial reporting. Therefore, ESMA believes the IASB should include a section at the beginning of the CF addressing all constraints' implication for financial reporting rather than addressing it in some of its sections. In addition, as it applies to both assets and liabilities, examples in paragraph 4.9 of the DP should be extended to the recognition of liabilities as well. Regarding paragraph 4.10 of the DP, ESMA believes this is a matter of applying relevance and does not see the added value mentioning the cost benefit analysis.
20. We believe that the DP is not sufficiently conclusive and clear with regards the concept of 'relevance'. Most of the examples in paragraph 4.9 of the DP focus only on one particular aspect of relevance, which is also closely related to lack of sufficient faithful representation, when the level of uncertainty

in an estimate is so large that the reliability of the estimate and its relevance is questionable. However, other aspects of relevance, in relation to its predictive and/ or confirmatory value, are not addressed and no general principle is drawn to provide a sound concept the IASB could use in the future.

21. In this regard, we would encourage the IASB to refrain from placing useful guidance and indicators directly in its 'summary of preliminary views', without previous mention, when we would prefer them to address that in the main text before, describing the rationale of the different alternatives envisaged in preliminary views, which then would be recapped in the summary.
22. It is not clear from the CF how the internally generated goodwill should be recognised. If the underlying principle is that all assets and liabilities should be generally recognised unless the IASB finds valid reasons to do otherwise, then, when the internally generated goodwill is an asset based on IFRS 3 *Business Combination*, the completeness criterion would probably not provide a valid reason to conclude that its recognition would not provide relevant information.
23. ESMA also notes that if faithful representation issues were addressed in substance in the caption related to relevance, when referring to faithful representation (paragraphs 4.12-4.21) the IASB also mixes references to relevance. Should the IASB conclude that relevance and faithful representation are so interlinked that they cannot be assessed separately, ESMA believes that both notions should be analysed together instead of making cross-references that makes difficult to understand them separately. In the DP the IASB has not made the case for describing at least one unfaithful representation issue that was not directly related to the significant level of uncertainty that makes the relevance of such an estimate questionable. Consequently, the IASB should better explain and justify the reasons for referring separately to recognition criteria and faithful representation and which cases, other than lack of relevance, it is possible that an asset or liability that provides relevant information to users cannot be represented faithfully.

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?

24. A clear distinction of what should be presented in the Profit or Loss and what should be in the OCI is of paramount importance. This distinction requires robust principles of the usage of Profit or Loss

and OCI and to differentiate between the various items discussed. Once these robust principles exist there should be no separate need for definitions that allow users to distinguish receipts, payments and transfers between these different elements. There is therefore no particular benefit for the IASB to seek and define such items as part of the review of the CF and consequently, we agree with the DP proposal not to define separate elements of income or expense to describe what should be reported in profit or loss and what should be reported in OCI.

25. However, should the IASB believe there is a need of distinguishing between these elements, we believe that robust criteria should be defined in that respect in the CF itself, rather than at standard level.

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?

26. ESMA agrees with the outcome of the review in the DP that constructive obligation is not applied in the same way in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, IAS 19 *Employee Benefits*, IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* and IFRIC 21 *Levies*.
27. ESMA supports the proposed definition as it encompasses both legal and constructive obligations. However, we do not support the definition of a liability that would consider a liability as an obligation that is only enforceable by legal or equivalent means, as we believe this principle would lead to diversity in practice as constructive obligations are enforceable in some countries and not in others (as explained in paragraph 3.57 of the DP). ESMA agrees that such an approach could unduly restrict the possibility to recognise a liability and the amount of liability recognised may not represent the full expected economic outflows of resources (please refer to example of mining activities in paragraph 3.61 of the DP).
28. ESMA would like to draw the attention to paragraph 3.53 of the DP which refers to the 2005 ED of IAS 37 and IAS 19 and indicates that the IASB's view is that there is no constructive obligation to restructure a business when the issuer has announced a detailed restructuring plan. In our view, this would lead to a change from current practice and might be inconsistent with the definition of

conditional obligations (from paragraphs 3.72 to 3.97 of the DP), which according to either view 2 or view 3 (we support the rejection of view 1) would require an entity to recognise a liability even if conditional to future events depending on the entity's future actions.

29. Consequently, we believe more guidance is needed on the articulation of constructive obligation, economic compulsion and obligations which are conditional on the entity's future actions. Finally, ESMA notes that the notions of 'constructive obligation' and 'economic compulsion' are also closely linked with the notion of 'present obligation' discussed in question 6.

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.**
- (d) The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favor 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.

30. ESMA agrees that it is necessary to clarify the notion of 'present obligation' in the CF as some inconsistencies have been observed in the past, such as for example:
- a. Paragraph 9 of IFRIC 21 states that 'An entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period as a result of the entity being economically compelled to continue to operate in that future period';

- b. Paragraphs 39 and 70 of ED Leases states that leases payables do not include variable lease payments unless there are in-substance fixed payments or linked to an index or a rate ; and
 - c. Paragraphs 39 of IFRS 3 states that contingent considerations are included in the consideration transferred and are measured at fair value.
31. As previously mentioned, ESMA supports the rejection of view 1. ESMA is concerned that the notion of ‘past events’ is not clearly articulated in the DP. In paragraph 3.87 of the DP, for instance, ESMA questions why a levy based on market share is not considered a present obligation under view 3. ESMA usually considers that an entity is present in the market including at the reporting day because of its past events, even if the market share is determined for the levy at a specific moment. Hence, ESMA does not understand the rationale to consider that a levy based on market share is not a present obligation. We wonder whether this is because in the example the entity has not started this activity at the reporting date.
32. The frontier between ‘economic compulsion’ which is rejected by the IASB and the notion of ‘practically unconditional obligation’ developed in view 2 (paragraph 3.77) is not very clear. Indeed, economic compulsion could be seen as ‘an event that the entity does not have the practical ability to avoid’ in particular circumstances. ESMA believes the two notions should be clarified and illustrated. For instance, ESMA is not sure if in the following example discussed in the London CF Roundtable the conditional part of the amount payable will be considered as liability at the moment the football player is transferred both under view 2 and 3. Football player Z is transferred from club A to club B. The amount payable by club B is X plus Y after 40 appearances of player Z in the first team of club B.
33. Having said that, the views 2 and 3 should first be further clarified, including the impact on existing standards and interpretations, before ESMA would be in a position to express its point of view.
34. Finally, ESMA encourages the IASB to consider the consequences of adopting view 2 or 3 especially on IFRIC 21 which would be applicable for periods starting on or after 1 January 2014, that is to say the same year the ED on the proposed CF is expected.

Question 7

Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

Substance of a contract

35. ESMA tentatively support the IASB's preliminary view expressed in paragraph 3.102 of the DP. ESMA believes that these concepts were applied in all recent standards.

Economic compulsion

36. ESMA agrees that the notion of economic compulsion is a major issue that the IASB should further analyse and address its substance. Paragraphs 3.104-105 mention this issue clearly using a financial instrument example.
37. ESMA agrees that the CF is an appropriate place to tackle it and give useful guiding principles. We also agree with the IASB's preliminary conclusion in paragraph 3.108 that 'it might be appropriate to take economic compulsion or significant economic incentives into account when determining whether a contractual claim against the entity is a liability or equity'.
38. When addressing the 'economic compulsion' notion for the assessment of specific transactions, ESMA agrees with the IASB that further details and consideration should not be addressed in the CF only but together with each standard to decide if and how 'economic compulsion' should be retained. Altogether ESMA believes that 'economic compulsion' should not be retained in a lot of cases and examples when using proposed guidance in paragraph 3.102 of the DP.

Executory Contract

39. The DP provides examples of executory contracts in relation to inventory ordered but not yet received. However, ESMA considers that such issue should not be included as an example but instead the CF should lay the foundation for a concept or principle for the notion of executory contract. ESMA encourages the IASB to further develop on this issue and to provide an overview of the rationale and impacts per specific standards concerned by executory contracts such as IAS 17 *Leases*, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

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?

- 40. ESMA believes that this section presents, without concluding at this stage, different alternatives relating to the de-recognition concept and discusses its interaction with the control and risks-and-rewards approach. As those latter two concepts are interlinked, ESMA recommends the IASB to consider the risks-and-rewards aspects of the control notion. The recommended approach in the CF should ensure that recently developed models in the consolidation and revenue recognition standards remain consistent with the CF.
- 41. ESMA believes the IASB should limit the level of discretion in selecting any of the three alternatives provided in paragraph 4.50 of the DP. The same applies to the option regarding full or partial derecognition. If the CF is to set robust concepts to guide the IASB, issuers, users and enforcers it is of paramount importance to provide enough guidance and criteria that reduce the possibility of options to very rare cases. Otherwise, in the absence of explicit requirement in IFRSs, the IASB and issuers would have excessive discretion in developing respectively standards or accounting policies.
- 42. In addition, ESMA believes that examples are different in nature from guiding principles and the DP should provide sufficiently clear rationale for all the Board's preliminary conclusions. In this regard, readers of example 4.2, based only on the arguments provided, may have difficulty to understand the IASB's preliminary conclusion that the risks-and-rewards approach portrays more clearly than the control approach that transaction. There is no reference in the example that, also in this case, the risks-and-rewards approach entails recognising assets and liabilities that would not be reported for a stand-alone forward contract and may not meet the definition criteria and no justification is provided why this is a clearer portrait. Finally, the solution suggested in paragraph 4.44 of the DP does not solve all related concerns in relation to example 4.2 as the amount of recognised assets or liabilities is still completely different under both approaches, even if the measurement basis is changed.
- 43. With regard to paragraph 4.43 of the DP dealing with alternative accounting for derivatives, ESMA believes the IASB should elaborate further on the rationale used and better assess the effects of the proposed approach in comparison with the current accounting treatment. We also believe that the proposed model entails a risk of rendering financial statements more complex by recognising 'artificial' items to show extra leverage or risk notionals more directly. Changes to current practices

according to the new principles proposed should be sufficiently described in the CF, and especially if they were leading to derecognition.

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?

Definition of equity

- 44. ESMA agrees with the preliminary view of the IASB that the CF should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.
- 45. ESMA notes that the notion of residual interest in the assets of the entity implies that equity is not being directly re-measured as acknowledged and should not depict the market value of the entity as the purpose of the financial statements is not to show the full valuation of the entity (as articulated in the paragraph OE 7 of the CF and paragraph 5.3 of the DP).

Distinguishing between equity and liabilities

46. ESMA agrees with the IASB's proposal to continue using the definition of a liability in order to distinguish liabilities from equity instruments and therefore supports the proposal in the DP to base that distinction on the characteristics of the instruments issued.
47. The proposed 'strict obligation' approach is consistent with the entity perspective on financial reporting, facilitates consistency in distinguishing between equity instruments and liabilities across entities and thus we believe it provides the most relevant information to users of financial statements.
48. ESMA observes that the alternative 'narrow equity' approach, which would classify as equity only the most residual existing class of equity instruments issued by the parent, does not allow a consistent approach in the classification of instruments across various entities, industries, corporate structures and jurisdictions and thus does not provide relevant information to users of financial statements.
49. ESMA believes that even at the conceptual level, the approach to distinguish between equity and liabilities based on the definition of liability should be complemented by the principle currently included in IFRIC 2 - *Members' Shares in Cooperative Entities and Similar Instruments* that requires an entity to assess, at the individual standard level, the existence of the obligation by all terms and conditions of the instrument, including relevant local laws, regulations and the entity's governing charter.

Obligation to issue equity instruments

50. In light of its preference for the 'strict obligation' approach, ESMA conceptually agrees that the obligations to issue equity instruments do not usually meet the definition of a liability. However, ESMA acknowledges that there might be financial instruments (with settlement options in cash or equity instruments), for which classification as a liability might provide more relevant information for users of financial statements. Such a decision should be done on a case by case basis at the level of individual standards.
51. ESMA is of the view that the nature of primary and secondary equity claims is fundamentally different and holders of primary and secondary equity claims are in a different economic situation that should be depicted by an explicit and unambiguous distinction directly in the CF. Consequently, ESMA has doubts whether holders of secondary equity claims should be described as fully fledged owners of the entity. ESMA believes that the IASB needs to provide additional guidance on which types of instruments constitute primary and secondary equity claims, given the different re-measurement requirements.

Obligations arising on liquidation

52. ESMA supports the view that an obligation that arise only on liquidation of the entity does not meet the definition of a liability, given that financial statements are prepared on a going concern basis. At the same time ESMA is of the view that instruments which are in substance liabilities (e.g. obligation arising only on liquidation of a limited-life consolidated special purpose entity) should be classified as liabilities. Another relevant example would be the case of nuclear facilities operators, which must acquire financial assets to meet future decommissioning costs.

Re-measurement of equity claims

53. Even though ESMA understands that re-measurement of equity claims might create tension with the definition of equity as the residual interest in the assets of the entity, we still see merit in updating the measure of all equity claims at the end of each reporting period. As ESMA believes that updating the value of equity claims provides relevant information for users, notably the effects of dilution and potential dilution of ownership of the entity, ESMA would encourage the IASB to explore further the requirements for different types of equity claims.

Primary equity claims

54. ESMA understands the requirement to allocate the change of the underlying net assets to all classes of primary equity claims, similar to the requirement currently in place for measurement of non-current interests. We acknowledge that such allocation would create additional complexity in financial reporting, but we believe that, in some situations, this complexity¹ would be outweighed by the more relevant information provided to users of financial statements.
55. However, ESMA recommends the IASB to consider whether adequate disclosure in the notes could be sufficient to provide the information, so that it is not necessary to modify the primary statement of changes in equity. Moreover, ESMA believes that the decision whether the measurement of primary equity claims should be updated by allocating the change of the underlying net assets should be made on a case by case basis at the level of individual standards. With regards to the term of re-measurement ESMA would prefer to avoid it when referring to primary equity claims and would prefer to refer to it as 're-allocation' of the changes of the underlying net assets to primary equity claims.
56. Finally, ESMA believes that the IASB should provide more guidance to answer questions about the relevance of the information provided relating to the 're-allocation' of the changes of the underlying net assets to primary equity claims (i.e. what should be the measurement basis) and to the level of granularity of envisaged presentation in the primary statements or in the notes. ESMA equally

¹ especially when primary equity claims consist of different categories of shares with significantly different rights attached to them (for example different classes of ordinary shares, preferred shares)

considers that when introducing this notion a more detailed guidance on allocation of various types of equity claims would be required at the standard level.

Secondary equity claims

57. ESMA understands the idea and agrees with the IASB's tentative view that secondary equity claims should be measured in the same manner as an entity would measure a comparable financial liability but reflecting the effects of re-measurement directly in the statement of changes in equity. However, we question whether the proposed wealth transfer is the most adequate way to do so. Indeed ESMA raises the question of the measurement methodology and wonders whether, for example, in case of negative value of a secondary equity claim, the information is most adequately conveyed in the notes or in the statement of equity. ESMA wonders whether it could be an intended consequence to have some line items becoming negative because of the reallocation.
58. The difference in re-measurement between primary and secondary equity claims reflects the underlying fact that holders of primary and secondary equity claims are in a different economic situation and holders of secondary equity claims may not be described as fully-fledged owners of the entity.
59. In addition, ESMA encourages the IASB to explore the notion of 'wealth transfer' and to consider how to depict the potential dilution of the ownership in the entity in a way that is most useful to the users of financial statements. As the notion of 'wealth transfer' is new in the financial reporting, ESMA encourages the IASB to consider all the potential impacts on financial statements and their understandability to users of financial statements.
60. ESMA agrees that the distinction between liability and equity is important to depict leverage in the financial statements. In the context of financial reporting, we believe that leverage or outflow of economic resources should mainly form the basis of this distinction and the additional return leverage and dilution effect could be depicted by prominent presentation or disclosure in the financial statements or possibly by the presentation of wealth transfers as proposed by the IASB.

Entities with no equity instruments

61. ESMA disagrees that it would be appropriate in situations when an entity has issued no equity instruments, to treat the most subordinated class of instruments as if they were an equity claim. ESMA believes that such treatment would be against the definition of equity as a residual and would impair comparability among entities.
62. ESMA notes that the IAS 32 *Financial Instruments: Presentation* includes examples (Example 7 and 8 of the IG to IAS 32) related to entities with no or limited equity that might be relevant in developing

an alternative presentation approach in case an entity has no equity instruments. ESMA would encourage the IASB to consider whether availability of this or a similar presentation approach should not be mentioned directly in the CF in order to capture the diversity of corporate structures around the world (e.g. for mutuals and cooperatives or even Islamic finance).

Questions 11 and 12

Questions 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 fulfil 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?**

Questions 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.

- 63. ESMA agrees that different measurement bases for subsequent measurement are needed since there are situations where the cost basis will be useful (such as for property, plant and equipment) and others where it will not be the case (i.e for derivatives). The objective is for an entity to reflect fairly the use of the assets and settlement of the liabilities and to provide relevant information to users of its financial statements. The two-measurement-bases approach proposed in the DP decreases the information asymmetry between management and investors and thus increases the relevance of information.
- 64. While we agree that a single measurement basis for all assets and liabilities may not provide the most relevant information for users, we believe that the number of valuation basis should be limited in order to preserve comparability. ESMA promotes the necessary measurement selection: either current value for items contributing 'directly to cash-flow', or 'cost value' could be relevant. To this point we would like to suggest the IASB to use the term fair value when possible rather than current value as the difference could be questioned.
- 65. In some cases, when a standard allows a choice in the measurement basis and the issuer has not chosen the current value measurement, the disclosure of the current value information in the notes is acknowledged to be relevant. This information assists users to assess how an asset or a liability is likely to contribute to future cash flows or how the measurement choice results in the right

measurement basis, including current value basis in case of sales. On the other hand, if an entity is using assets which do not have an alternative use, usually current market price is not relevant information, because there are no markets for those items.

66. The IASB should consider both statements of financial position and financial performance when it selects the measurement basis. Measurement decisions should not result in information that creates artificial mismatch in profit or loss. In order to avoid this ESMA agrees that the IASB could allow the selection to choose fair value instead of cost in order to decrease accounting mismatch or information asymmetry, but only from cost to current value. Furthermore ESMA believes that the IASB should clarify what belongs to 'current values', similar to paragraph 6.44 dealing with cost-based measurements.

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.

67. ESMA agrees with these preliminary views that liabilities without stated terms should have a cash-flow-based measurement. ESMA also believes that concepts behind the principles on how to estimate the cash-flows and the discount rate should be included in the CF or in the standards.
68. ESMA agrees that liabilities that will be settled according to their contractual term should mainly have a cost-based measurement. However, ESMA believes that the IASB should allow for a fair value option for liabilities to address accounting mismatch.

69. While discussing the subsequent measurement of liabilities, ESMA noted that the link with stewardship was hardly developed although equal prominence should be promoted between the notions of stewardship and measurement usefulness when assessing prospects for future cash flows. We acknowledge this could also be a relevant comment for the asset side. Alternatively the discussion of the link with performance could be made and included in the DP too.

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 (ie the asset or the liability is highly leveraged).**

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

70. ESMA agrees with the preliminary view as expressed in paragraph 6.19 of the DP. Since derivatives have no or very little cost, a cost-based measurement is not representative for future cash-flows and therefore not relevant. Many derivatives also have an active market or have input from an active market and then current market price is readily available.

Question 15

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

71. ESMA believes that one issue that needs to be addressed relates to consistency in the determination and use of the discount rate as part of the cash-flow-based measurements, as current standards have different approaches in this respect. In some standards the discount rate should reflect the time value of money but not the actuarial risk or investment risk (i.e. IAS 19 *Employee benefits*) and in other standards the discount rate should include a risk premium (IFRS 4 *Insurance contracts*) or the entity's own credit risk (IFRS 13 *Fair value measurement*).

72. ESMA recommends the IASB to clarify the objectives for the use of the discount rate and its articulation with the cash-flow-based measurements through guiding principles. ESMA believes in this regard that the CF should contain a sound conceptual basis for all elements included into the discount rate (including entity's own credit risk when relevant).

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.[...].

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 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.

73. ESMA believes that the IASB takes the right direction in proposing to include the presentation and disclosures in the CF. ESMA agrees with the statement made in paragraph 7.23 of the DP that when one aggregates similar pieces of information this may not obscure relevant information but when inappropriately aggregated this could result in misleading information. However, ESMA does not understand the relationship between aggregation of information and the inclusion of a large amount of insignificant details, which suggests that these insignificant details should be aggregated. ESMA is not sure this is always necessary. Based on the materiality concept ESMA believes that information that is not material, both on an item by item basis and on a collective basis should be omitted.

74. ESMA supports the development of a Disclosure Framework within the CF. However ESMA does not believe the objective of the notes should be limited to support the primary statements as stated in paragraph 7.33 of the DP. Indeed ESMA believes information about items not recognised in the primary statements is useful in assessing the financial position and performance of an entity and enabling users in making decisions about the entity. ESMA would like to propose to amend the objective to include the following goal of the notes: to supplement the primary statements by providing additional useful information to enable users to (better) assess the financial position and performance of an entity and to enable users in making decisions about the entity’.
75. ESMA disagrees with the IASB’s view that notes should only require forward-looking information if it is relevant information about assets and liabilities that existed at the end of the year (emphasis added). Forward-looking information can also give relevant information on some unrecognised assets and liabilities (such as uncertain assets or liabilities) and stewardship analysis could be added if this adds relevant information. ESMA would hence suggest broadening the scope of material disclosures.

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?

76. We expressed our views on the concept of materiality and its interaction with relevant items such as going concern or risk in ESMA’s letter on ‘Considerations of materiality in financial reporting’ (ref ESMA/2013/218) communicated to the IASB.
77. Further, ESMA agrees, based on the responses received to the Consultation Paper ‘Considerations of materiality in financial reporting’ (ref ESMA/2011/525), that the application of the materiality concept needs to be improved, particularly regarding the disclosures in the notes. Additional guidance in relevant standards would be thus useful and welcomed.
78. ESMA believes that obscuring relevant information could have a negative impact on all qualitative characteristics of financial information and this matter could be spread beyond the additional guidance proposed to clarify that disclosure of immaterial information would impair the understandability of material information only as stated in paragraph 7.46 (c).

79. In paragraph 7.46 of the DP the IASB indicates an entity may omit a specific disclosure item from its financial statements if the information is not material. Based on the definition of materiality in paragraph 7 of IAS 1, ESMA believes a second test has to be carried out in order to decide if a disclosure item may be omitted or not. As part of a collective assessment, an entity should assess if the omission of a specific disclosure combined with the omission of other specific disclosures that are individually not material can influence the economic decisions that users make on the basis of the financial statements.

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?

80. ESMA believes that, in order to set useful and informative disclosure requirements, the CF should include communication principles. We believe the communication principles as defined in paragraph 7.50 of the DP are a good start to ensure usefulness of disclosures. Yet ESMA believes further research should be done if the communication principles were to be included in a standard or in the CF.
81. Then, taking into account the status of the CF, ESMA recommends that the communication principles should also include the consistent application of terminology in the interest of consistent application and enforcement. ESMA believes that consistent application of terminology should be central in standard setting activities.
82. Overall, ESMA believes that communication principles regarding the sensitivity analysis about uncertainty measurement could be added as well its underpinning assumptions. Finally, ESMA likes the proposal to add the use of graphs and tables to the types of disclosures as mentioned in paragraph 7.41 of the DP.

Question 19

The IASB's preliminary view that the Conceptual Framework should require a total or sub-total 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?

83. ESMA agrees with the IASB's preliminary view in paragraph 8.22 of the DP to maintain the presentation of profit or loss as a separate total or subtotal and with the arguments presented in paragraph 8.20 (a) and (b) as reasons for maintaining it. These arguments are linked to both principles 1 and 2 in paragraph 8.40 whereby profit or loss is seen as the default location for presentation of an income or expense item and 'the primary source of information about the return an entity has made'.
84. However, ESMA regrets that despite the discussion included in the DP on how to distinguish between OCI and profit or loss (please see paragraph 8.40) and if and when to recycle items from the OCI to profit or loss, the DP does not address the presentation in the financial statements. ESMA sees the increasing use of and discussion around the use of subtotals measures as a proof that performance and subtotals should be addressed in detail and soon at least at the standard level.
85. Furthermore, ESMA believes that in light of the current discussions about the meaning of financial performance, it is important that the CF foresees the inclusion of a 'performance line-item' even if the subsequent determination of this starting point line item is guided by IAS 1 rather than the CF itself.
86. ESMA understands the paragraph 8.21 (a) as being not an argument in favour of the abolition of the profit or loss total/sub-total but rather as a reason against the use of OCI, as it is its existence and the confusion around its use that results in potential earnings management and not the existence of a profit or loss total/sub-total. Similarly, ESMA would call for the notion of business model being analysed and clearly defined in order to avoid a too flexible interpretation and misuse leading ultimately to the concerns expressed in paragraph 8.21 (a) (i) and (ii). For further discussion on the business model, please also refer to our response to question 23 and for more views on OCI to our response to question 20.

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, ie 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?

87. ESMA welcomes that the IASB recognised that the question around the use of OCI and the reporting of financial performance (including recycling) was a key topic resulting from the IASB's Agenda Consultation in 2011. ESMA urges the IASB to develop robust and clear guiding principles for the use of OCI in line with the narrow approach set out in paragraphs 8.40 – 8.78.
88. ESMA fully supports the arguments put forward in favour of recycling in paragraph 8.24 and questions whether the arguments in paragraph 8.25 are really against the concept of recycling or rather against the existence of OCI in general. For example paragraph 8.25(e) states that recycling may trigger earnings management. ESMA believes that the fact that an entity may choose to present items of income or expense in OCI may encourage earnings management more than the subsequent recycling of said amounts. It is stated in paragraph 8.25(b) that recycling adds complexity and may obscure the income and expenses relating to the period. However, in line with Principle 3, paragraph 8.52 states that recycling should occur 'when the reclassification results in relevant information. In many cases this will be in realisation, settlement or impairment...'. Thus ESMA fails to see how this obscures the results for the year. Furthermore, it is stated in paragraph 8.53 that if recycling at some future date would fail to provide relevant information then the element in question should not have been recognised in OCI in the first place.
89. Finally, ESMA disagrees with paragraph 8.25(c) when recycling results in items are recognised more than once as it believes that there is an initial recognition (either in OCI or profit or loss) and a subsequent reclassification from OCI to profit or loss.
90. ESMA believes that the concept of recycling should be better detailed in the CF (in particular articulation of the reasons underpinning the decision as to whether or when to recycle). For example regarding translation differences in associates and subsidiaries, ESMA would like the CF to describe the underlying rationale that should be used to recycle in profit or loss on sales. Moreover, ESMA believes that the definition of a bridging item is key to the decision whether to recycle an amount recorded in OCI. In this regard, and as further detailed in question 21 below ESMA would call the IASB to bring further clarification to the definition of bridging items.

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.

91. ESMA supports the ‘narrow approach’ described in paragraphs 8.40 to 8.78 of the DP. ESMA believes this approach is conceptually sound, less flexible and as such easier to enforce and that its adoption would limit discretion afforded both to an entity’s management but also to the IASB in drafting future standards.
92. ESMA considers that the ‘broad approach’ outlined in paragraphs 8.79-8.94 of the DP lacks conceptual basis and is more an attempt to fit the definition of OCI and its use in current standards rather than addressing the key question of what should be presented in OCI as opposed to profit or loss. ESMA questions the basis for including transitory re-measurements in OCI and particularly the discretion afforded about whether and when to recycle them.
93. ESMA acknowledges the issues identified in paragraphs 8.72-8.74 with respect to the use of OCI for net defined benefit assets or liabilities. ESMA is of the opinion that rather than tweaking the definition/use of OCI to fit with the nature of these assets/liabilities, a better approach would be to adopt the solution proposed in paragraph 8.74(a) to tweak the ‘operational and discount rate issues discussed in paragraph 8.73(b) so that the re-measurements of net defined benefit assets or liabilities could be treated as bridging items.’
94. ESMA disagrees with the solution in paragraph 8.74(b) as it believes that this would call into question the conceptual basis for this treatment and thus would not be consistent with decisions taken in other standards and the accounting treatment would lose credibility. Finally, in response to paragraph 8.74(c) ESMA does not believe that these assets or liabilities would be sufficiently material in all cases to warrant presentation as separate line items. Thus, in conclusion, ESMA believes that it is possible to amend net defined benefit assets or liabilities to fit within the ‘narrow approach’.
95. Although ESMA appreciates the effort the IASB has spent in preparing the analysis contained in Table 8.2 comparing the current use of OCI to the proposed definitions under the narrow approach, ESMA would call for the IASB to better articulate the concepts of bridging items in particular and mismatched re-measurement to a lesser extent and more clearly define these new terms. Indeed ESMA questions the validity of a proposed concept if the IASB cannot currently determine whether certain existing elements fall into the scope of these concepts or not (e.g. IAS 16 *Property, Plant and Equipment* revaluation gains, IAS 19 net defined benefit asset or liability re-measurements, IFRS 9 changes to fair value attributable to issuer’s own credit risk).

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.

96. ESMA notes that although the IASB followed its due process as part of the reissuance of the first chapters of the CF in 2010, the approach to develop and adopt individual chapters of the CF may have generated unintended consequences. Therefore, ESMA believes that the IASB should consider this carefully while focusing on the revision of the remaining chapters.

Stewardship

97. ESMA believes that the IASB needs to be consistent in the role of stewardship as proposed in paragraph 6.10 of the DP and in chapter 10 of the existing CF. We cannot form a view on this matter in the absence of common understanding of the definition of 'stewardship' or more importantly, of its implications on current IFRSs.
98. We could envisage that the answer to this question may have far reaching consequences such as having to adjust the objectives of general purpose financial reporting or affecting measurement by taking into account the needs of long term investors for example. ESMA yet wonders in practice what additional information would be included in the financial statements.
99. ESMA considers that same prominence in financial reporting and not a secondary objective should be attributed to 'assist users of financial information to assess the performance of management'. ESMA doubts that the current objectives of financial reporting stated in the existing CF reflects the view that no difference in perception should be attached to the preservation of shareholder's value compared to the faithful representation of relevant information.
100. ESMA believes the concept of stewardship goes over and above the focus on generation of future cash-flows as it also requires backward looking information to evaluate the effectiveness and efficiency of management in using the resources available, and is inherently linked to the agency theory.

Reliability

101. ESMA agrees with the IASB that the concept of reliability should not be reintroduced as a qualitative characteristic of financial reporting. ESMA shares the IASB's view that the notion of reliability is already implicitly covered in the principle of faithful representation, as financial reporting cannot give a faithful representation of economic phenomena if related transactions, assets and liabilities cannot be reliably measured. Therefore, ESMA believes that reintroducing reliability into the CF would be redundant.

Prudence

102. ESMA believes transparency and comparability in financial statements is of paramount importance and thus does not oppose the reintroduction of prudence in the CF as long as it does not harm transparency and comparability or lead to the creation of hidden reserves (by overstating liabilities and understating assets). ESMA believes that issuers should apply a certain degree of 'caution' as part of the recognition and measurement of assets, liabilities and the determination of gains and losses but considers that this type of prudence is already included in the standards. Yet ESMA believes this could be clarified in the CF, along with the definition of prudence, cautiousness and explanations about how and why cautiousness has replaced the concept of prudence.

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?

103. ESMA believes that the IASB should use the business model concept carefully and only occasionally when developing or revising some IFRSs. ESMA is of the opinion that business model is a way of applying the standard to provide more relevant information rather than a conceptual principle. Although understanding the business model of an entity is important for users of its financial statements, ESMA believes that a significant amount of business models exist, which means that it will not be possible for the IASB to take all possible business models into account when developing the CF or revising IFRSs. Besides, entities have possibilities in the current standards to add line items

in the statements and to include extra disclosures to reflect their business model. This may indicate that the role of business models in financial reporting could be better addressed at standard level.

104. Should the IASB decide to consider the business models when developing or revising a standard, we recommend to define the 'business model' notion and in particular distinguish between management intent and business model. There are good prospects that users would not understand all the effects of the business model and thus we are of the opinion that the IASB should clarify that if accepted in the CF the business model may not be relevant for all standards.

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?

105. ESMA agrees that the unit of account should be decided when particular standards are developed or revised. However, the IASB's CF should include guiding principles and concepts useful to assist in the selection of the correct unit of account applicable in each standard.

106. ESMA supports the approach based on the qualitative characteristics and the need to consider also the definitions of assets and liabilities. For instance, ESMA expects some clarification and guidance around the aggregation of components and accounting for rights as per paragraph 3.11. We believe the CF should address when and how group of assets or components bundled together should be recognised and measured.

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?

107. ESMA agrees that in the identified situations in the DP the going concern assumption might be relevant.

108. According to the current CF, when an entity has the intention or need to liquidate its operations, the financial statements may have to be prepared on a different basis and, if so, the basis used should be disclosed. However the current CF does not give any guidance on that different basis for accounting. Accordingly, in such a situation the management seems to have large discretion on how to present entity's financial statements (subject to IAS 1).
109. In 2012, the IFRS Interpretations Committee received a request for clarification on IAS 1 regarding 'Disclosure requirements about assessment of going concern'. ESMA noted that the upcoming amendment to IAS 1 about the disclosure of these material uncertainties would provide guidance on how to identify material uncertainties and contains requirements about disclosures on material uncertainties.
110. In ESMA's opinion, even in a situation where an entity will be a non-going concern entity, there will still be many interested parties in entity's financial statements (for example debt holders), so that financial statements should still fulfil their needs of information.
111. Following the financial crisis, we have identified practices which conflict with IAS 1 and/or IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and we believe that more consideration should be given to the measurement on a liquidation basis (when and how) and not only to disclosures.
112. Therefore, ESMA believes that the IASB should clearly state in the CF that, in case of an entity is on a near 'gone concern', despite the need to adapt the basis for preparation of financial statements, these should still be prepared according to the qualitative characteristics of financial information.
113. To conclude, ESMA believes that the CF should provide guidelines on what should be considered as basis for preparation of financial statements of a 'non-going concern' entity, to help management preparing those statements and to improve their understandability to users. Otherwise, with full discretion for the preparation of financial statements, the information given could be biased, incomprehensible and could be insufficient to fulfil the needs for information of the stakeholders.

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.

114. ESMA is not aware of any issues with IAS 29 *Financial Reporting in Hyperinflationary Economies* but would welcome a clearer reference in the ED as ESMA agrees that something could be done in the revised CF. ESMA believes the identification of different practices in equity or other performance impacts would be a supported start for the development of the notion of capital maintenance.

115. ESMA doubts the mere focus on IAS 29 should be retained when the concept is discussed at conceptual framework level, and then ESMA believes the IASB should ensure that no inconsistency will appear at standard level from the CF. This could be the case with financial reporting in hyperinflationary economies using Fair Value through OCI for other OCI items. ESMA is also concerned with what would be the capital control impacts in this perspective or what would be the accounting effects of the revaluation of Property, Plant and Equipment for capital maintenance purpose.