



**ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION**

January 15, 2014

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

Dear Sir,

Re: IAA comments on the IASB 2013 Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (DP/2013/1)

In response to the request for comments on the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the DP), I am pleased to transmit on behalf of the International Actuarial Association (IAA) our comments and recommendations.

These comments have been prepared by the Insurance Accounting Committee of the IAA. If, upon reading these comments, you identify any points that you wish to discuss or obtain further insight, please do not hesitate to contact Francis Ruygt, chairperson of the committee, care of the IAA secretariat. We hope that our comments provide assistance to the IASB Board and staff on this project and we look forward to providing further assistance as the IASB moves to revising its final Conceptual Framework. The IAA will be pleased to develop the ideas presented in this comments further with you.

Yours sincerely,

Robert L. Brown
President

Attachment: [IAA comments](#)

Comments by the International Actuarial Association on the IASB 2013 Discussion Paper - A Review of the Conceptual Framework for Financial Reporting (DP/2013/1)

International Actuarial Association and its Due Process

The International Actuarial Association (the “IAA”) represents the international actuarial profession. Our sixty-five Full Member actuarial associations, listed in [Appendix A](#) to this statement, represent more than 95% of all actuaries practicing around the world. The IAA promotes high standards of actuarial professionalism across the globe and serves as the voice of the actuarial profession when dealing with other international bodies on matters falling within or likely to have an impact on the areas of expertise of actuaries.

We are pleased to be given the opportunity to provide input to the IASB on this important Discussion Paper. These comments have been prepared by its Insurance Accounting Committee, the members of which are listed in [Appendix B](#) to these comments. It has also been subject to the due process required for it to constitute a formal view of the IAA and will be posted to the IAA’s official web site

Introduction

We believe the IAA has expertise and actuaries play an important role in financial reporting matters. The MoU relationship with the IASB has encouraged us to provide a response to this important DP, and by doing so aim to assist the IASB in the further development of a revised Conceptual Framework. We hope that this response will support further development of the IASB’s Conceptual Framework, recognising that in some areas our responses are somewhat detailed.

General Comments

The IAA appreciates this IASB project, as we believe the Conceptual Framework needs to be updated to ensure that the concepts that underlie the standards that form the basis of the preparation and presentation of financial statements are appropriate. Our comments are in large part based on the experience of the IAA over the last decade with IASB’s standards development for insurance contracts and other practice areas of actuaries, e.g., pension and other employee benefits. In particular, the discussion regarding insurance contracts has shown that several concepts in the Conceptual Framework need further alignment with the businesses that are the subject of financial reporting.

Our primary recommendations and comments include the following.

1. *Uncertainty:* We support the proposal that in definitions and recognition, terms that could be construed as applying the probability concept, such as “expected” should be eliminated and that uncertainty should be regarded in the context of measurement. To this end, we believe that the conclusions reached in the Insurance Contracts and Fair Value Measurement projects should be applied in a more general manner wherever a current measure of uncertain future cash flows is deemed an appropriate measurement. We believe that it would be helpful to include in the Conceptual Framework a discussion of the role uncertainty should play in measurement, how it may be measured (that is, implicitly in prices or explicitly when relevant prices are not observable) and how its consequences should be communicated to users of financial statements. We note that, where significant, the IASB is making increasing use of a current risk-adjusted expected present value approach as a basis for estimating economic values (valuation technique) where appropriate (e.g., IFRS 13, ED/2010/1 and ED/2013/7). As a result, we believe that its inclusion in the measurement section of the Conceptual Framework is worthwhile. We believe this valuation concept underlies all valuation techniques intended to reflect economic values, even when simplification is deemed appropriate. We would be pleased to work further with the IASB on measuring or disclosing uncertainty to aid user’s understanding of financial statements.

2. *Financial Position, Profit and Revenue:* We believe that these three concepts are central to how many users seek to understand financial reports; as such, they deserve to be explored more fully in the Conceptual Framework. The inherent tension between faithful representation of financial position and faithful representation of profitability should be discussed in the Conceptual Framework level, to avoid inconsistent positions being taken in individual IFRSs.
3. *Liabilities:* We believe that the IASB has significantly developed the conceptual basis for liabilities in the Insurance Contracts project, and that the lessons learned in that project deserve to be incorporated into the Conceptual Framework. In particular, they include:
 - It is important that related assets and liabilities be measured in a manner consistent with each other to minimise distortions in reported income and performance measurement, resulting from inconsistent accounting measurements as circumstances change.
 - It is necessary to consider offsetting items together to avoid accounting inconsistencies when uncertainties in each are mitigated (offset).
4. *Own Credit Risk:* We believe that, if liabilities are measured on the basis of future flows of resources, there should be no allowance for own credit risk of the entity, i.e., the risk that the liable entity will default on its obligations, except when securities are issued when it is implicit in the issue price and, possibly, for liabilities that are likely to be traded. Nor should liability values be subject to an impairment adjustment if that risk increases (or decreases). Such allowance would distort faithful representation of the entity's financial position and profitability. This does not necessarily mean that allowance should not be made for a general level of credit risk when this provides a practical proxy for other factors, e.g., in the use of high quality corporate bond yields in IAS19. An allowance for own credit risk provides a way for entities to understate their liabilities and losses, thereby disguising the extent of a worsening financial situation (or providing an over-optimistic measurement of performance), thus reducing financial reporting transparency and generating potentially biased financial values.
5. *Fair Values:* We are concerned with the possible misinterpretation and misapplication of fair value measurement in IFRS 13. This is a result of the presumption that, when a market value exists (i.e., when an individual or limited number of transactions are observable), the value generated automatically overrides other considerations that may be more relevant to a fair value of an asset or liability. Although such an approach may be appropriate for assets held for immediate re-sale, it is less so when early realisation is less likely and when current market prices are less relevant in the context of the entity's business model.

We also believe that it is important to make fair value and other current value approaches generally available as an alternative measures, where this faithfully represents the context of the business model of the reporting entity. When such estimates are uncertain and generate gains on initial estimation and subsequent gains or losses on re-estimation, it may be appropriate to distribute what would otherwise be the initial gain as well as the effects of re-estimation over time (in the form of an additional profit or expense margin).

6. *Accounting Mismatches:* We believe that, while it is important to use measures appropriate to the reported items and to require consistent measurement between entities and over time, it is also important to ensure that, where these items inter-relate, assets and liability measurement bases should be chosen to avoid inconsistent accounting values (accounting mismatch) that can lead to misleading representation of the underlying economics of the management of the assets and liabilities (through the business model). Although this need has been recognised in the Insurance Contracts project and in hedge accounting, it should be of more general application and deserves to be addressed at a conceptual level in the Conceptual Framework. In particular, there is a need to differentiate between the use of the same value (in case of contractual cessions, as in Insurance Contracts project for participation and reinsurance) and the use of the same measurement approach (as in hedge accounting).

In the remainder of this document we address our views on the specific questions raised in the DP.

Section 1 Introduction

Development

In 1.11, the IASB lists projects they have drawn on. While the Insurance Contracts project is still ongoing, we believe that it deserves to be mentioned here. This project has applied a number of general issues, for example, in regards to the measurement and treatment of uncertainty within the context of long-term liabilities and the definition of a liability, where the previous Conceptual Framework needed revision or did not deal with these issues. The new Conceptual Framework should fully reflect the lessons learned in the Insurance Contracts project, as discussed in our answers to subsequent questions.

Status

In 1.32, it is stated that the IASB may deliberately depart from the Conceptual Framework in a particular standard. If this occurs, it raises the question of whether this is a true exception or whether it indicates a deficiency in the Conceptual Framework, which should lead to a revisit of the Conceptual Framework for refinement or expansion, as applicable.

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?

IAA Comments

- (a) We agree.
- (b) We agree. But note that this should either trigger discussion of whether it is desirable to review the Conceptual Framework for further sophistication or to include a discussion of the issue for the next review of the Conceptual Framework. However, we recognise that the Conceptual Framework cannot and should not address all special cases, but must restrict itself to general principles, with scope for pragmatic responses to special needs. If this arises, we believe it is appropriate to indicate the reason for such departures.

Section 2 Elements of financial statements

Question 2 The definitions of an asset and a liability are discussed in paragraphs 2.6–2.16. The IASB proposes the following definitions:

- (a) an asset is a present economic resource controlled by the entity as a result of past events.
- (b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.
- (c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.

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

IAA Comments

In general, we agree, but we note there is no mention here of the issue that an item may fulfil both definitions (a) and (b) and of how such an item should be classified. The issue is further discussed in Section 3 below.

We are concerned that the application of “control” is not clear-cut, for example, in the context of IAS 19 where the question of whether the entity controls pension fund assets and surpluses is addressed. While we don’t think the discussion of this topic needs to be further expanded in the Conceptual Framework, additional guidance on “control” would be helpful to enhance general understanding and to better enable individual IFRSs to address these criteria in a consistent and appropriate manner.

A further concern arises from the wording in (b), where “transfer an economic resource” is used. One interpretation is that this wording implies that the ability of the obliged entity to perform is a pre-condition for the existence of a liability. If this is what is intended by the chosen wording, then there is potential for misinterpretation. We believe that the definition of a liability should only require an obligation to transfer economic resources – not the ability to do so.

Also, since the definition of economic resources does not include any indication as to who has the right to benefit from the resource, the phrase “transfer of economic resources” does not imply that there is a transfer of that right, i.e., control. We believe that the definition of a liability should focus on the transfer of control, not on transfer of the economic resource itself. Otherwise, the liability of a shipping agent would be as well the economic resource to be shipped not only the shipping service.

Further, the transfer of control might be to a party other than the party to whom the obligation is owed. For example, consider a construction contract that requires the construction company to obtain construction insurance as one of its responsibilities under the contract. This requires an outflow of economic resources from the contractor to an insurer (the premium), but no transfer to the counter-party exists or will occur.

Similarly, the existence of a liability does not depend on the ability of the obliged entity to satisfy the obligation, either immediately or in the future. In addition, an entity with more liabilities than assets has negative net assets, not zero. This condition may be resolved in a number of ways, but the liability continues until either satisfied or terminated by litigation or agreement.

Question 3 Whether uncertainty should play any role in the definitions of an asset and a liability, and in the recognition criteria for assets and liabilities, is discussed in paragraphs 2.17–2.36. The IASB’s preliminary views are that:

- (a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is ‘expected’. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources.
- (b) the Conceptual Framework should not set a probability threshold for the rare cases in which it is uncertain whether an asset or a liability exists. If there could be significant uncertainty about whether a particular type of asset or liability exists, the IASB would decide how to deal with that uncertainty when it develops or revises a Standard on that type of asset or liability.
- (c) the recognition criteria should not retain the existing reference to probability.

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

IAA Comments

We agree, but we note that where a triggering event has occurred, the “stand ready” concept usually provides a sufficient basis for recognition (3.71) -- the issue should then become one of whether a non-zero measurement should be reported.

Outcome Uncertainty

The discussion in 2.32 does not explicitly discuss the case, common in insurance contracts, where it is certain that there will be a transfer of resources, for example in a whole-of-life insurance contract, but where the amount or timing is uncertain (although we recognise that some of the examples given in that paragraph include some degree of timing uncertainty). While these are largely measurement issues, we believe that consideration at the conceptual level is desirable.

The discussion on uncertainty could be expanded to indicate that there can be circumstances where the ultimate income and expense arising from (possibly unknown) current events are uncertain. These issues are central to the Insurance Contracts project and Fair Value Measurement standard, which place a value on uncertainty, in the form of a risk adjustment (in the latter, where relevant prices are not available).

Stand Ready

We believe the discussion of existence uncertainty (2.20-2.31) should recognise the concept of a stand-ready obligation or its converse, a stand-ready entitlement. Stand-ready obligation is considered in the preliminary view (2.36) and in Section 3 (3.71).

In the hands of a policyholder, insurance is a stand-ready entitlement that reduces the uncertainty associated with value of the subject of the insurance.

Mutual Entities

We would like to raise the issue of the application of the concepts in the Conceptual Framework to the equity of a mutual insurance company where, although policyholders legally own the entire surplus of the entity, management must permanently retain an amount of surplus in the entity to meet regulatory capital requirements. That surplus would only become available for distribution to policyholders, if and when the entity ceases business or demutualizes. The relevant issues are:

- whether the obligation to members will result in a transfer of economic resources in the context of a going concern (2.35(ii));
- payments will only be made on liquidation (3.89(a));
- any payment depends on future action by the entity (3.97); and
- obligations to some members (right to surplus) are negated by obligations to others (maintenance of required capital (3.102(b))).

One contract feature that indicates that all surplus belongs to policyholders as a community is negated by a different contract feature that the payment depends on future actions of the entity. The key question involved is the meaning of capability. Can the obligation result in the transfer of the surplus that the entity needs to satisfy statutory capital requirements? The entity is not free to transfer those amounts, because it would then immediately result in the winding-up of the entity. This is similar to Scenario 4 of 3.73, but the other way round. If the mutual insurer pays out its entire surplus, it must discontinue its operation as an insurer (because a mutual insurer is not permitted to operate without capital). However, since this obligation is only met on liquidation, it is, therefore, not a present obligation.

We recommend that the Conceptual Framework indicate that capability and present obligation should be understood in a way that excludes circumstances that depend on future actions of the entity if those actions would have disproportionate consequences such as the inability to continue operation. Although the issue raised in the last sentence of (5.24(c)) is valid, it does not apply to mutual entities, because they do not have parents.

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?

IAA Comments

We agree that it is better to regard income and expense as generic elements. However, we suggest that a clarification might be helpful. The definition refers to increases and decreases of economic benefits. Since the definition of an asset refers to an economic resource from which an economic benefit is expected to flow, the intended meaning may be better expressed if this definition referred to increases/decreases of economic resources, rather than increases/decreases of economic benefits.

The income and expense definitions include enhancements and decreases of assets that are defined as economic resources capable of producing economic benefits, and not the economic benefits themselves.

Section 3 Additional guidance to support the asset and liability definitions

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?

IAA Comments

We agree that further guidance would be appropriate. We believe that the definitions of asset and liability should not be narrowed. Additional guidance may be helpful to enhance consistency across standards to more clearly distinguish constructive obligations from economic compulsion.

We recommend that the IASB clarify that a constructive obligation:

- 1) would cause significant damage to a the entity in terms of its relationship with an identifiable party if the entity does not fulfill the constructive obligation and
- 2) is associated with an economic motivation for the entity to fulfill the constructive obligation, because the entity would otherwise be expected to be subject to unfavorable economic consequences with a severity that may be at least the cost to fulfill the constructive obligation, the consequence of which would result directly from non-fulfillment of the constructive obligation.

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.

The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favour 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.

IAA Comments

If a present obligation has arisen from past events, it should usually be a liability. An obligation that is wholly created by future activity arising out of past events is a future, not a present, obligation.

Note that the reference to "amount of the liability" in this question appears inappropriate, as the amount of the liability is a matter of measurement. It may be more appropriate to refer to "the economic resource to be transferred".

An entity's future actions may be relevant to the measurement of the effect of a constructive obligation. If a potential future payment is not accepted as a constructive obligation because the unfavourable consequences on non-payment are not sufficient, a future decision of the entity, whether intended or expected, also should not be sufficient to create a liability. Nevertheless, if it is clear that a liability exists, such payments could be considered. If the overall measurement of the liability is based on expected values, both intended and expected voluntary alterations of the payments should be considered in measurement.

We do not support view 1, but we have not reached a position on whether view 2 or 3 is preferable.

As to whether there is an obligation and consequently a liability in the cases described, we believe that the ability to or probability of transferring resources is less relevant than are the consequences to the entity. If a future transfer can, regardless of consequences, be avoided by the entity by no more than its own decision that does not have adverse consequences, then we would not consider it to be a liability. Under this view, it would become a liability only as a result of the consequences, which implies that the criteria to be applied should be the same as or similar to those for constructive obligations.

In Scenario 2 (3.73), the consequence of not paying the levy is that the entity must cease business before year end. This consequence would be clearly and directly caused by this non-payment and, given the size of the levy, would be unacceptable to the entity. That is true in all cases where the performance of the obligation is a pre-requisite for remaining a going concern. The question is whether "practically unconditional" has the same meaning as the criteria for a constructive obligation or whether the extension to "conditional on the entity's future actions" should be required to achieve that outcome.

Those preferring View 2 believe that View 3 could result in a present obligation with respect to a future (currently unintended and unexpected) voluntary benefit to a current customer, where the past event is that the counterparty became a customer in the past. This would imply that classification as a liability could be arbitrary.

Those in favour of View 3 believe that some allowance for the entity's future actions should be provided for constructive obligations and for consistency with the going concern concept.

We believe that it may be possible to reconcile support for Views 2 and 3 by means of an enhancement to the definition, perhaps drawing on some of the same concepts used in the definition of a constructive obligation. The use of the scenarios or examples in the Discussion Paper might be useful to determine where View 2 and View 3 would lead to a different outcome, thus leading to a more appropriate result.

Question 7 Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

IAA Comments

General Comments

If assets or liabilities meet their respective definitions, they should be considered assets or liabilities, respectively. Except in specified types of circumstances, they should also be recognised as such. Criteria for non-recognition belong in the section on recognition.

We believe that recognition interacts with and has implications for measurement. There are three possibilities:

- recognition in the financial statements;
- disclosure without recognition, which is needed where relevant and reliable measurement is not practical; and
- non-recognition without disclosure, which should be minimised.

If the measured value would clearly be not material, then measurement should not be required, and measurements that turn out to be non-material should not be required to be reported. Care is needed, however, to ensure that material totals are reported, even if their components are individually non-material.

Relationships

In 3.5, references to customary relationships and rights to preferred access to economic resources should be included. Perhaps this could be made by including a discussion of customer and supplier relationships. Examples include the treatment of future salary increases in the valuation of pension benefit obligations under IAS 19 and consideration of future non-enforceable premiums securing ongoing guaranteed insurance coverage.

Meeting definitions of both assets and liabilities

3.12 and 3.13 discuss how an item that can actually or potentially meet the definition of an asset and liability should be classified. We note that such a classification would not necessarily be permanent, but might change from an asset to a liability or *vice versa*. Again, the substantial issues involved are recognition, measurement and presentation.

This possibility, that an item may at different times meet the criteria for an asset or liability, should also be discussed (for example, depending on the current degree of fulfilment of the obligations of each party). This can occur if the contract is a combination of rights and obligations that cannot be separated. The Discussion Paper does not address the issue of how to determine whether the position is that the entity has a net economic resource or a net obligation. In the 2013 Exposure Draft, *Insurance Contracts*, we understand that the measurement applied to the contract determines whether the contract is currently a net right or a net obligation.

We believe that the Board should discuss whether the definition of an asset or liability should clarify whether classification as an asset or liability is ever an inherent characteristic of a contract or item, or is always the result of measurement under the applicable measurement attribute. For example, an insurance contract inherently obligates the insurer to perform certain duties on behalf of the policyholder, which is its inherent characteristic. The net value resulting from the measurement of insurance contracts that are measured under the buildings blocks may be negative (debit balance) if the value of future premiums exceeds the value of future benefits and expenses. One view is that the contracts are in an asset position. Another view could be that the carrying amount of such contracts should not be presented as an asset.

The definition in 3.23 combines a present situation with abilities that can reasonably be executed over time. In this case a discussion should be included that indicates that “present” does not refer only to the current moment but requires, under the concept of substance over form, a time

span including the reporting date in which the ability effectively can be executed. For example, equity dividends are typically paid on one date (the payment date), based on ownership at an earlier date (the closing date). It is not uncommon for some investors to buy *cum*-dividend and almost immediately sell *ex*-dividend and *vice versa*, possibly to take advantage of different tax situations of the two investors.

The point in 3.29 (c) should not be whether the knowledge is freely available, but whether it can be freely used. For example, patented information is freely available, but can only be used by the patent holder or under a license issued by the patent holder.

The assertion in 3.34 that, for a liability, there is always a corresponding asset is not true. Neither does it contribute to an understanding of the concept of liabilities. A very important example arises in the Insurance Contracts project, where there can be an obligation to future customers arising from contracts with past customers, where unknown future customers clearly do not possess such an asset. It is important to note that where there is a corresponding asset, it may not have the same value to a counterparty as the liability has to the liable entity.

Section 3.38(a), as worded, is not technically accurate. The word “expected” usually incorporates a notion of probability. If the expectation is not met, and if this does not negate the liability, then there is a potential for a residual liability. It would be better to replace “*expects to receive*” by “*receives*”.

In 3.39, it might be helpful to explain the difference between a legal obligation and a constructive obligation in terms of the source of the obligation. That is, a legal obligation arises out of a contract or some other legal requirement, while a constructive obligation arises from the behavior of the entity. Both have the same result -- the entity has a duty or responsibility that it cannot avoid. Note that the source of the obligation also may result in a difference in the compulsion causing the entity to obey -- in the case of a legal issue, the compulsion would be legal enforcement, while in the case of a behavioural issue, the compulsion can be either legal enforcement or a direct economic consequence, which does not provide an alternative to the entity than to obey.

Constructive Obligations

The resolution of the issue in 3.39-62 has implications for participating insurance contracts and pension plan accounting.

We are uncertain what the difference is between the case in 3.40(b) and economic compulsion. The appropriate question is what the consequences might be if the entity does not comply with its “duty or responsibility”. The consequences of non-compliance with an enforceable obligation may be equal to or worse than those of compliance, if someone enforces the obligation or there is a compensation for not obeying. (But what happens in a case where, for whatever reason, no enforcement is expected?) In the case of a non-enforceable situation the penalty might be damage to the reputation of the entity. In certain cases where there are strict business expectations (e.g., among reinsurers), it would mean that the entity is unable to continue its ordinary business activities. In this case the entity’s public reputation damaged by non-compliance with (non-legally binding) public statements may result in a significant adverse effect on its ability to achieve new or continue existing business volume in comparison with what it would have achieved as a result of compliance.

Economic compulsion is the need to undertake activities to obtain or maintain current business. We recommend that activities undertaken to significantly enhance ordinary business volumes should not be seen as a constructive obligation. However, anything needed to uphold current ordinary business, e.g. uphold business reputation, trustworthiness, anything needed for this business in general would constitute a constructive obligation. For example, the capacity for marketing would be excluded. As although a reduction in the effectiveness of marketing might reduce the amount of new business, it does not necessarily reduce the basic ability of the entity to continue its existing business relationships.

The guidance in 3.50(c) is not applicable to business expectations, for example, within a class of entities (e.g., reinsurers) where business behavior is common knowledge to market participants. One entity might feel forced to cope with market expectations in its dealings with another entity because it knows that otherwise it will no longer be able to conduct business with any other entity. That is, the incentive to comply with market expectations does not relate to the particular business counterparty of the moment, but rather with the community of all such entities in the class of entities. The relevant question is, why does the counterparty rely on the compliance of the entity? There must be some power that will, as a consequence of the failure to comply, result in at least as much damage to the entity as complying with the duty or responsibility would. We understand that this damage needs to be very specific, i.e., that it is possible to predict that a significant portion of ordinary business will be damaged as a direct consequence of the reaction to not complying with the duty or responsibility, and not as in case of economic compulsion.

The following is an example. An insurer voluntarily paid an extra bonus of CU100 on maturity of contracts in a line of business that was closed to new business 20 years ago. It then decided not to pay such an extra bonus in future years to the few remaining contracts. All conditions of a constructive obligation are fulfilled. Nevertheless, not paying the amount has no consequences for the insurer. Therefore, it should not be accounted for as a constructive obligation.

The key issue involves the use of the words “duty” and “responsibility”, as distinct from, for example, “current intention”. These imply there is some form of enforceability and should be expanded upon. Alternatively, as discussed in 3.55-3.61, the requirement of the extent or type of enforceability could be explicitly indicated. We believe that non-compliance with constructive obligations should have discernible and direct adverse consequences to the entity that in amount are at least as great as the value of the constructive obligation itself. Although there may be some offsetting cost, as in 3.60 (a), to be considered a constructive obligation, the penalty should be sufficiently severe.

We agree with 3.59, in that the circumstance creating a constructive obligation is not relevant. It can also be created by the occurrence of an uncertain event. What is relevant are the consequences to the entity, not their origin. In addition, there is a difference between a constructive and a stand-ready obligation. The latter includes the provision of services as a defining criterion, while the former involves the more complex issue of enforceability.

We also note that the consequences of failing to fulfill a constructive obligation can change over time and are relative to current market practice rather than an absolute test. Using the example of participating insurance contracts as above, there may previously have been a constructive obligation, but as the business declines the remaining obligation may no longer exist. Similar issues have arisen with certain pension programs, as employers have found it increasingly acceptable to wind up their defined benefit plans.

To summarize, we believe that a constructive obligation

1. would cause significant damage to the entity (in terms of its relationship with an identifiable party or class of parties) if the entity does not fulfill the constructive obligation; and
2. is associated with an economic motivation to the entity to fulfill the constructive obligation, since the entity would otherwise be expected to be subject to adverse economic consequences with a severity which is expected to be at least the cost of fulfilling the constructive obligation and the consequence results directly from non-fulfillment of the constructive obligation.

Present Obligation

A further alternative regarding “present obligation” (3.62-3-97) is to take the widest possible view for the purpose of recognition and to measure on a risk-adjusted expected value basis. We comment on this further in section 4.

Specific Comments

We believe that it is important for the discussion in the second sentence of 3.102(b) to address a class of contracts that takes the form of a cession, that is, where economic consequences of rights or obligations from type A contracts are taken away from the entity by contracts of type B, because the latter transfer the economic consequences to the counterparties under contracts of type B. In the Insurance Contracts project (mirroring and reinsurance), the IASB has not viewed the ceded rights and obligations together with the cession as a whole, but mirrored the measurement of those ceded items by the measurement of the cession. It would be useful to indicate whether such situations are to be resolved by considering the contracts as a single contract or whether the consequential accounting mismatch is avoided by mirroring the measurement. The difference between a transfer of the rights and obligations (a sales transaction) in the case of a cession is that the rights or obligations remain the responsibility of the entity, but the economic consequences are reimbursed or withdrawn. We understand that the IASB does not permit off-setting for such a cession, but requires measurement with identical outcomes of the ceded item and corresponding cession. The guidance for reimbursements in IAS 37 shows a similar thought, but is not fully consistent with this approach.

In 3.102(e)(ii), special care is needed. This case is similar to the case of constructive obligations and conditional obligations at the discretion of the entity. For consistency, the “practical ability to exercise” should be replaced by the outcome in both of these similar cases.

The discussion in 3.108 comes to an equivalent view to that taken in the Insurance Contracts project. If some conditional items, which would not on a stand-alone basis be considered as liabilities, but are part of a wider relationship that is a liability, then those items should be considered in measurement, particularly if the measurement is on an expected value basis. Otherwise, important aspects of the contract considered by the expected value approach might be omitted. However that is a measurement, rather than a classification issue.

Executory contracts are discussed on a very simplified basis. It is assumed that profit is proportional to the provided services. However, in the case of regular services under a contract with regular payments, that may not be the case. Consider a contract that provides for a decreasing level of services, but with periodic payments that decrease more rapidly, so that higher profits emerge at the beginning than at the end of the contract. In the Revenue Recognition project and the Insurance Contracts project care is taken to ensure that the entities nevertheless recognise profit in proportion to services provided. We do not believe that the Conceptual Framework project should discuss executory contracts on the basis of simplifications made in some IFRSs. Rather, the discussion should be conceptual in nature, focusing on the principles involved.

Section 4 Recognition and derecognition

Question 8 Paragraphs 4.1–4.27 discuss recognition criteria. In the IASB’s preliminary view, an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability because:

- (a) recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or
- (b) no measure of the asset (or the liability) would result in a faithful representation of both the asset (or the liability) and the changes in the asset (or the liability), even if all necessary descriptions and explanations are disclosed.

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

IAA Comments

We agree that all assets and liabilities should be recognised, with limited exceptions, as noted by the IASB in its preliminary view. Non-recognition with disclosure should usually be restricted

to matters where measurement is not practical, such as a material one-off lawsuit. Non-recognition without disclosure should only be available on the grounds of non-materiality.

We agree that exemptions from recognition should be a matter for individual IFRSs, although discussion of the reason for the deviation from the principles in the Conceptual Framework should be provided. For example, insurance contracts would not be recognized under the strict criteria indicated in 4.26. Since bearing uncertainty is the *raison d'être* of insurance, and because there are typically many similar contracts that are managed together, a significant reduction of the overall deviation risk results (i.e., the actual outcome is expected to be reliably close to the estimate of the mean than otherwise); the IASB has not allowed an exception in this case from the general duty to recognize the liabilities. More generally, we believe that problems in individual estimation situations should not be a barrier to recognition, if bulk estimation ameliorates those problems sufficiently.

We are concerned that the Conceptual Framework should, for the purposes of recognition, not only consider assets and liabilities in isolation, but also their interactions with other assets and liabilities, whether similar or dissimilar. Just as classification as an asset or liability can allow for some aggregation or separation of items, so too should recognition allow for interdependencies among items. In particular, if recognition depends on the ability to measure the item reliably, this measurement should consider not only experience data derived from that particular case (which in many contexts will often not exist), but also all relevant experience data from which the entity can develop at reasonable cost. Further, if the probability of occurrence of an (adverse) event is extremely low, but consideration should also be provided where the entity is exposed to a large number of such events so that, as a pool, the outcome will probably be close to the expected value of the pool.

If an item would be unrecognized because, in isolation, it cannot be recognised, but is linked (for example, by hedging or cession) to another item so that the combined effect should be recognised, to avoid accounting mismatch it is important to recognize both, either separately or in combination. If the items are recognized separately, it is important that the sum of the measurements should faithfully represent the combination.

For example, consider the higher layers of an excess-of-loss reinsurance program. The uncertainty as to whether these layers will be called upon and, if so, for how much, can be so extreme that, taken in isolation, they would be ineligible for recognition. In aggregate, however, they both limit the variability of and reduce the direct insurer's retained cost. In the Insurance Contracts project, the IASB has appropriately taken the view that the risk adjustment for the reinsurance asset should be measured on the basis of the extent to which it reduces the risk in the direct insurer's gross liability.

A further issue is materiality. The larger, in the context of the entity, the asset or liability (individually or in aggregate), the more important it is that it be recognised. This is particularly so of liabilities. While few users would be greatly concerned if potential liabilities of a few tens of thousands were not recognised in the context of an entity worth billions, much more effort should be expended if the potential value of the liability exceeds the value of the entity. If the matter is sufficiently significant, it is usually possible to develop a criterion that considers extreme outcomes, particularly if they apply to a large number of otherwise independent contracts, particularly if the contracts are positively correlated.

We note that this issue overlaps with measurement issues with regard to stand-ready obligations. For example, if an insurance entity has a stand-ready obligation to provide coverage for property damage from a windstorm, a framework for an appropriate approach would provide perspective regarding how that entity's financial statements should be affected by a threatening windstorm that has not yet occurred at the reporting date. Is this a recognition issue or a measurement issue? In either event, our view is that it would not be appropriate to incorporate estimates of a threatening event in the balance sheet / statement of comprehensive income until it has happened, as the service (insured event) has not yet occurred. As background, a range of financial effects of each possible event that would otherwise have to be estimated that would

have to be measured at the reporting date which, by the time the financial statements are published, will likely be replaced by an actual event (or non-event). Any estimate at the time the event is threatening will tend to be unreliable, and hence would fail to meet the faithful representation criteria. A further complication is that any value assigned to the impending event would overlap with the stand-ready obligation – resulting in double counting. As this example shows, we believe that the Conceptual Framework would benefit from a discussion of how to deal with threatening or possibly impending events at the reporting date relative to reporting of subsequent events (e.g., through disclosure).

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?

IAA Comments

We agree. However, the use of words like “expected” and “probable” in definitions and recognition/derecognition criteria can lead to confusion, as some people read them as applying a probability concept. Likewise, if the IASB were to adopt the risk/rewards approach of 4.36(b), the phrase “most of” may be open to similar confusion.

Care is needed to clarify that the movement of an item from an asset to liability or vice versa does not mean derecognition and subsequent recognition. Rather, derecognition refers only to the fact that an item is no longer recognized at all.

It might be difficult to decide whether a liability continues without derecognition or the existing liability is derecognized and a new liability is recognized as result of the derecognition. For example: In non-life insurance, the stand-ready obligation to pay valid claims is one liability. Is the liability arising as a consequence of the occurrence of an insured event part of the existing liability or a new liability? The claim for actual compensation is independent of the continuation of the stand-ready obligation and of the insurance contract. Legally, it is a stand-alone obligation to the claimant (who is not necessarily the policyholder) and is managed by insurers in that way. In many cases, the stand-ready liability continues in parallel to the claim liability for a time, while the claim liability can be settled before or after the stand-ready liability expires.

It is not always appropriate to refer to cases of derecognition as transactions. Often, liabilities or assets simply cease as a result of the passage of time or completion of services according to contractual terms so that the liability becomes zero and is not expected to emerge again. In other cases, such as incurred but not reported (IBNR) claims in insurance contracts, it may not be clear when the liability ceases, since this depends on the non-occurrence of un-notified events that may only be determinable for a very long time, where there remains a progressively reducing probability of further claims. Applying the same criteria to recognition might not be useful. A second example is the liability for future bonus allocations under a group of participating insurance contracts. These allocations can result in recognition issues, since they can exist for a very long time and cannot be associated with an individual transaction under a specific contract.

Section 5 Definition of equity and distinction between liabilities and equity instruments

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?

IAA Comments

While we agree, we believe that commitments and options to issue equity in the future should be adequately disclosed, so that current and potential equity-holders can form a proper view of the potential for future dilution of their holdings.

Section 6 Measurement

We have several general comments on measurement, which we believe are more appropriately introduced up front in this section as a preface to our views on measurement. For convenience, we present them here and more fully in our response to Question 15.

Financial Position, Profit and Revenue

We believe that these three concepts (financial position, profit and revenue) are central to how many users seek to understand financial reports. As a result they deserve to be explored more fully in the Conceptual Framework. The inherent tension between faithful representation of financial position and profitability should be discussed in the Conceptual Framework to avoid individual IFRSs taking contradictory positions.

Liabilities

We believe that while the IASB has significantly developed the conceptual basis for liabilities in the Insurance Contracts project, the lessons learned in that project have not yet been fully transferred into the Conceptual Framework project.

The differentiation between measurement at cost, at current market prices or on another cash flow based approach does not fully address the issues involved. For example, ED/2010/1 differentiates between values, which could be referred to as fulfilment value, exit value and settlement value. Amortised cost is no more than a simplified (i.e., assumptions frozen at acquisition) version of the fulfilment value of the Insurance Contracts project (including its contractual service margin) or the Revenue Recognition project.

The objective of measurement to present “how efficiently and effectively the entity’s management and governing board have discharged their responsibilities to use the entity’s resources” can only be achieved if the measurement reflects the actual alternatives available to management. Therefore, ED/2010/1 allows all three approaches (note that current IAS 37 requires a “rational” choice, with all such alternatives to be considered, while some believe that IAS 37 requires only a neutral expected present value of future cash flows) while the Insurance Contracts project and the Revenue Recognition project only allow fulfilment values. Amortised cost and the requirement to distribute revenue in proportion to services provided as in Revenue Recognition and the Insurance Contracts project (and earlier in IAS 39 for applying Level 3 valuation techniques to determine fair value) are, as outlined in the Board papers of the Revenue Recognition project about the prohibition of initial gains, a consequence of lacking objectivity and certainty in measurement based on projected cash flows, particularly if the future uncertainty is not relevant for the current period under the business model.

This differentiation demonstrates that it is not always practical to apply the same measurement approach to all items. It also shows that the criteria to be applied in determining which measurement approach should be the most appropriate one for each item.

Generally, we differentiate two forms of measurement attributes, one that can be observed based on an economic value, e.g., fair value, exit value, entry value, fulfilment value, and settlement value, while the other is based on expected or most likely cash flows. For the first type, we believe that, as a starting point for development of IFRSs, a risk-adjusted expected present value approach would be most appropriate, subject to simplifications in the particular IFRS. The perspective determines the measurement attribute. For example, is the item assumed to be fulfilled by an average third party that is expected to acquire the item (fair value) or by the current owners (fulfilment value)? Settlement value is derived from the fair value, referring to a transfer with a specific known party and considers the particular situation and valuation attitude of that party.

A further aspect of a measurement attribute is the relevance of the measurement of the range of possible outcomes, e.g., under the particular business model of the entity. If it is (at least partly) not relevant, the measurement attribute would introduce an additional element (the contractual service margin in the Insurance Contracts project), which represents the initial amount of expected profit, released into profit and loss in proportion to the transfer of services. In such cases the initial value could be simply released according to services provided, omitting the need to calculate the risk-adjusted expected present value of cash flows, except in the case of onerous contracts. Effective interest approaches are no more than a normal cash flow approach with a profit margin, where changes in the discount rate are off-set against the profit margin.

Fair Value

We are concerned that observed prices, whether or not reliable or relevant, may not always be a useful measurement approach. These concerns relate to the presumption that, when an observed price situation is observed, it over-rides the other considerations in fair value. Where measurement of fair value is based on estimates using Level 3 assumptions, a margin should distribute gains over time. We believe that it is important to make fair value and other applicable current value approaches generally available, at least as basic values, while actual profits are allocated over time by an additional element, where this is appropriate to the business model of the reporting entity.

The discussion in 6.22 relates to the faithful measurement of items considered in isolation. It does not consider the problem of accounting mismatches. We do not believe that applying the same measurement approach to similar items, regardless of context, is appropriate if there is a potential for accounting mismatches. Only the use of consistent approaches across matched items can avoid an accounting mismatch.

For example, consider an entity with an asset and a liability that have the same (known) cash flows. If the asset is valued using the discount rate implied by its purchase price while the liability is valued using current discount rates, any increase in current discount rates will generate an accounting profit, while any decrease will generate a loss. Since the cash flows match, any resulting profit and loss would be spurious and misleading to the users of the financial statement.

Conversely, using different measurement bases could mask real profits and losses, as when discount rates change and the mean terms of the asset and liability cash flows are different.

Consider another example. The entity has an asset and a liability that not only have the same expected present value of cash flows, but also the same cash flows in each scenario. If a risk-adjusted expected present value approach is applied for each, the measurement of the asset results in a risk adjustment that reduces the value, while in the measurement of the liability the risk adjustment increases the value. Hence, the difference between both balance sheet amounts is the sum of the absolute value of the two risk adjustments because the risk adjustments affect assets and liabilities in the opposite directions. In the Insurance Contracts project, the IASB deals with this problem by requiring that, for example, for participating business and reinsurance ceded, the matched amounts are given the same value, while unmatched amounts are valued in the normal way. This results in a reinsurance asset that is increased by a risk adjustment to be consistent with the risk-adjustment for the ceded liability, while the liability for participation is reduced to be consistent with the assets reduced by the risk adjustment.

If items are contractually linked, it is necessary for the measurement approach to appropriately reflect the contractual linkage.

Question 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?

IAA Comments

We broadly support the criteria set out, but believe that one vital element is not sufficiently emphasized. That is an inadequate discussion of the interaction between assets and liabilities, as in the case where assets are held to back liabilities. We believe that the measurement bases for those assets and liabilities should be compatible, as discussed below. A particular example

is where the interaction is direct, as in the mirroring approach in the 2013 Exposure Draft, *Insurance Contracts*.

By compatibility, we mean that movements in the difference between those assets and liabilities should make economic sense. For example:

- If the expected asset and liability cash flows are matched, changes in the interest environment should have a minimal impact on the difference;
- If the expected asset and liability cash flows are mismatched, changes in the interest environment should have an appropriate impact on the difference; and
- If something has differential impacts on the expected asset and liability cash flows, there should be an appropriate movement in the difference.

Priority of Elements

In 2.2, there is a distinction between (a) financial position and (b) changes in financial position (financial performance), but there is no discussion of their relative importance, the extent to which this is determined by context, and how conflicts should be resolved. The long-standing debate about the primacy of the income statement over the balance sheet or *vice versa* should be discussed or it should be clarified that this depends on the financial situation of the entity, the view of the user or is a matter for individual IFRSs to sort out.

A discussion of the consideration to be given to faithful representation of financial position and faithful representation of financial performance should be included. Such conflicts typically arise out of uncertainty and relate to efforts to minimise uncertainty in measurement. We discuss this further in our comments in Section 6.

This also raises the need for a discussion of the concepts of *financial position*, *profit* or *profitability* and *revenue* in the Conceptual Framework. It is clear, from the IASB discussions on insurance contracts, that revenue has a key role in the IASB's thinking, but it is largely ignored in this DP. The limited discussion of financial position and profit means that there is no imperative for consistency between asset measurement and liability measurement and for consistency between income measurement and expense measurement. While we recognise that the general policy of the IASB is to measure each item independently except in cases of direct, specifically contractual relationships between items (e.g., hedging, cession, participation features, and reimbursements), we suggest that consideration be given to the potential for accounting mismatch more generally.

Where the business model dictates that financial assets are held as backing for financial liabilities, both financial position and financial performance would be distorted if, for example, the assets are measured at fair value and the liabilities are measured using locked-in discount rates (or *vice versa*). This need for comparability has only been recognised for special cases in the Insurance Contracts project. The most appropriate way of achieving this comparability remains a source of concern.

The IASB could improve the understandability of measurement by bringing the measurement approaches that it adopts together in a common conceptual system that combines conceptually clean approaches (e.g., observable values and measurement by estimating risk-adjusted expected present values) plus a clear concept of earnings patterns (based on the first approach or using defined patterns). An approach that recognises earnings using defined patterns should be distinguished from those based on risk-adjusted expected present values.

All other approaches can be understood as simplifications or special cases. For example:

- Fair value uses market data to infer risk adjustment;
 - Fulfilment value uses the entity's own risk tolerance;
 - Amortised value uses assumptions implied by the acquisition price;
 - Impairment adjustment reverts to current values and eliminates any implied profit margin;
- and

- Cost less depreciation starts from the assumptions implied in the purchase price and assumes a release based on an initially determined release pattern, which is a simplification of a release pattern based on actually occurring use or provision of services.

In many cases timeliness may have an important impact on measurement. If the measurement is so complex that it requires many inputs, each of which needs review, validation, and consistency with other inputs, then timeliness and reliability becomes an issue. Current complex measurement approaches for life insurance contracts mean that measurement as at 31 December must be based on input parameters (possibly including the status of the contracts to be accounted for) as of mid-December or earlier to meet reporting deadlines of a few weeks after the reporting date. Simplifications may be needed to enable timeliness to be achievable in practice.

Cost constraints can also be accommodated by proper combination of the different features. If, for example, the risk-adjusted expected present value cannot be determined in a way that the quality of outcome justifies the significant cost and resources, it may be possible to apply a release pattern of earnings (without the need to determine risk-adjusted expected present values), but when there are indications that the risk-adjusted expected present value will be greater, it is appropriate for the extra effort needed and the larger amount is presented. That is the concept in the Revenue Recognition project. In the Insurance Contracts project, the effort to determine the risk-adjusted expected present value is required for long-duration contracts and outstanding claims.

Question 12 The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73–6.96. The IASB's preliminary views are that:

- (a) if assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost-based measurements normally provide information that is more relevant and understandable than current market prices.
- (b) if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.
- (c) if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.
- (d) if an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

IAA Comments

We largely agree with these views but, depending on the context, other measures may also provide relevant information. We make the following more specific comments.

- Cash-flow-based estimates are also likely to provide relevant information about such assets. Indeed, while amortised cost is a cost-based approach, it can also be thought of in terms of cash flows. Amortised cost is the present value of contractual cash flows, discounted using the rate implied by the price at acquisition. This discount rate can, in turn, be regarded as the risk-free rate at acquisition, with a combined risk and liquidity adjustment. This property can be used to infer the market price of risk and liquidity and may be helpful in later assessments of fair value, in the absence of transactions in an orderly market.
- Cash-flow-based estimates are also likely to provide relevant information about such assets.
- If financial assets have significant variability in cash flows, whether because they have no set terms, the terms are conditional, or there is a likelihood of default, current estimates are more likely to provide relevant information about such assets than historical measures.

- If assets are held to back liabilities, consistent measurement bases should be used, to avoid spurious profit movements (performance indicators), under changing interest rates, when expected cash flows are matched by duration, and spurious stability when they are not.

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.

IAA Comments

We agree with these views.

In addition, we would like to indicate several issues arising from the Liabilities, Revenue Recognition and Insurance Contracts projects. 6.100 refers to “cost-based” measurement, although it is not really clear what that refers to. Indeed, in the Insurance Contracts project, insurance contracts are measured at cost initially and to some extent subsequently. (In the IAA Comment Letter on the 2013 Exposure Draft, *Insurance Contracts*, we recommended full consistency with Revenue Recognition in that regard). Subsequent development is subject to release patterns, which are either actuarial or based on simpler keys. As in the case of Revenue Recognition, the release pattern is only superseded if the cash flows measurement basis gives a higher liability.

It might be helpful for the Conceptual Framework to distinguish between liabilities that:

1. are accepted in return for a consideration; and
2. occur without receiving a consideration,

and between liabilities:

- a. whose cash flows can be measured reliably without significant estimation uncertainty, for example based on explicit contractual terms; and
- b. whose cash flows are subject to significant uncertainty.

Taking these in turn:

- Class 1(a) should be measured based on a basis similar to either Revenue Recognition project or ED/2010/1.
- Class 1(b) should be measured on a basis similar to that used in the Revenue Recognition project. If practical, cash flow estimates should be provided as additional information.
- Class 2(a) should be measured according to ED/2010/1.
- Class 2(b) presents the greatest difficulties. If sufficiently reliable estimation is available, ED/2010/1 is appropriate, with disclosure in other cases. If there are similar liabilities, it is often possible that the (estimated) expected value would constitute a more reliable representation of the total outcome rather than using a perspective on the individual item.

The definition of “stated terms” is not as clear as it might be. For example, court decisions can create liabilities with stated terms (that is, as stated by the court), without being based on a

contract or a sale. Liabilities that will be quantified by a future court decision remain uncertain until the terms are laid down by the court. For cost based measurement, it is less relevant whether there are stated terms than whether the liability was acquired in return for a specific price. We assume that “stated terms” means merely “entirely certain regarding outcome”. Examples would be a court award of 10 annual payments of CU 100, or a life contingent annuity of CU 100 per year.

A kind of “at cost” measurement is also possible if the initial measurement is based on an estimate (which could also be an estimated entry value) and the subsequent development is based on Revenue Recognition. For example, consider the situation where an insurer releases CU 1,000 in a period from stand-ready obligations to cover the expected claims of the period. One possible outcome is that there have been insured events worth CU 800 in the period. However, the insurer will not know this immediately. The initial value of the (incurred but not reported) claim liability would be CU 1,000, which is released in line with Revenue Recognition, as claims are presented and their value becomes progressively clearer. In this case, the minimum amount (in accordance with ED/2010/1) is the value of the claims. Alternatively, if actual claims incurred are CU 1,200, a loss of CU 200 is progressively booked, as it becomes clear that the cost of claims will exceed the released CU 1,000.

The desirability of cost-based measurement is, for us, not only based on whether the item is tradable, as suggested in 6.103. We believe that, where trading is not realistic, an entity-specific fulfilment value would be equally appropriate, while in cases where trading is a realistic possibility a fair value may represent a superior way to provide useful information. In both cases the closeness to a cost-based or a cash flow projection depends on the predictability of the cash flows.

The discussion about representation of risk in 6.105 does not recognise that, if a liability is not tradable, an observed market price might not reflect the particular risk profile of the liability, while an entity-specific estimate of the risk exposure might more faithfully represent the risk in the liability. The reflections of risks and uncertainties in market prices, specifically in a stressed or over-heated market, might deviate significantly from the risks to which the entity feels it is exposed in fulfilling the liability. The same also applies to assets.

In the case of measurement attributes referring to economic values, we believe that any measurement that is not directly derived from observable inputs, either current market prices, incurred cost or received consideration, should conceptually start from a risk-adjusted expected present value of future cash flows. This should be distinguished on the basis of the perspective of measurement – the average market participant in case of tradable items – or the perspective of the fulfilling entity in all other cases. Any departure from this principle should only be the result of simplification, such as ignoring the time value of money for differences between cash inflow and outflow of less than a year.

We do not believe that own credit risk is a valid element of measurement of a liability, except in a cost-based measurement when securities are issued, when it is implicit in an issue price and subsequent amortisation and, possibly, for liabilities that are likely to be traded, i.e. where the entity actually can benefit from its bad credit standing regarding that liability.

Illiquidity, as discussed in 6.117, should be considered if the measurement of cash flows considers liquidity effects. The danger is that the effect of illiquidity of a contract could be double-counted, once in the cash flows and again in the discount rate. If, for purposes of a simplification or the poor quality of estimates of illiquid discount rates, liquid discount rates are applied, it should also be a requirement that assumptions about liquidity are not considered in the estimates of cash flows. If a liability is liquid because the entity is obliged to repay amounts on demand, that liquidity is adequately represented in the discount rates and it would be double counting to consider premature repayments.

The discussion of entity perspective and market perspective does not consider that two separate issues are involved.

1. Is it assumed that the liability is settled by a market participant, so that the average cost among all market participants should apply as a basic assumption in the estimation of future cost, or by the entity itself, so that the expected cost of the entity should apply in estimating the fair value?
2. Whose risk aversion is relevant, that of the average market participant or that of the entity? It does not make much sense to apply the risk averseness of the entity to a measurement that assumes the liability is settled by a market participant – that would be represented by the “average” in the market. If it is assumed that the liability is fulfilled by the entity, there could be reasons to apply the risk aversion of an average market participant. That would provide useful information for a market participant in making a decision to buy or sell shares of the entity. Conversely, the entity perspective will align more closely with what it charges for accepting liabilities and consequently better for an onerous contract value, if applicable.

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 (i.e. the asset or the liability is highly leveraged).

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

IAA Comments

We agree that there may be situations where market prices provide the most relevant measure for some assets and liabilities.

However, we note that there are also situations where cash flows are relatively stable while a settlement value may not be. For example, expected pension program cash flows may be relatively stable in contrast to a valuation of those cash flows based on market interest rates will be more volatile.

It is not clear from this question whether the IASB has reached a preliminary view as to whether it is the variability of the cash flows or the market value that is more important in setting the approach to measurement.

Question 15 Do you have any further comments on the discussion of measurement in this section?

IAA Comments

Uncertainty of Measurement

Paragraph 6.75 notes that the IASB has to decide on how to deal with uncertainty in the measurement of assets and liabilities. The Discussion Paper goes on to identify alternative approaches that the IASB could use to base its decision on how to deal with uncertainty.

The IASB may wish to consider whether the following factors are important in deciding on how to deal with uncertainty in specific cases or whether there are some general concepts that can be established:

- Consistency of measurement approach between assets and liabilities; and
- The relative effect of different measurement approaches on the balance sheet and income statement.

In this review of the Conceptual Framework we believe the IASB should consider how financial statements could convey better the degree of uncertainty and variability associated with items in accounts.

Currently, unwary users of accounts who see entries in the financial statements described as “cash” equal to \$x and “liabilities for insurance contracts” (or pension obligations, long term lease obligations, decommissioning liabilities or underground mineral reserves) equal to \$y may not understand that the “accuracy” of y may be nowhere near the accuracy of x.

We note that this is a very difficult problem for both presentation purposes, particularly in the context of financial statements that require point estimates, and for disclosure purposes.

Value of Uncertainty

Uncertainty has economic value. This is evident most obviously in bond prices, where the discount rate increases with perceived risk, even after adjusting for expected defaults. It also forms the basis for prices for insurance contracts, where policyholders pay to reduce the financial impact of uncertain outcomes, and insurers earn their profit by pooling risks and, thereby, reducing relative uncertainty.

Recognising the value of uncertainty, in insurance contracts and similar contexts, also serves an important purpose for revenue recognition. If an entity earns profit by bearing risk, then revenue recognition principles require that it should earn that profit in proportion to release from that risk, that is, as the value of uncertainty reduces and changes. If there is no risk adjustment, whether explicit or implied elsewhere in the measurement, profit may be recognised before it is earned.

Expected Value

In statistical theory, the term *expected value* is defined as the probability weighted average of all possible values. In this usage, the emphasis is on *expected* and *value* simply refers to numeric value. In economics, *value* has a rather richer meaning, and refers to worth – the value placed upon something by someone, as in *market value*, *fair value*, etc. It has connotations similar to that of a price – what someone would be prepared to pay. For this reason, the use of *expected present value* has a potential to cause confusion, between the statistical and economic perspectives. For this reason, we have used the longer phrase *risk-adjusted expected present value*, to emphasize that the valuation technique should focus on the underlying economic value.

This is not to say that an explicit risk adjustment is always possible to arrive at. Market value and fair value, for example, both incorporate implied market assessments of the value of risk. Similarly, other price-based measures incorporate an economic value, as assessed by the parties to the transaction. In amortised value, the value of risk is allowed for in the discount rate, along with default and liquidity. It is also possible to use probabilities, which are made risk neutral by reflecting risk averseness, in assessing the average of weighted possible outcomes – the result is not the expected value but an implicitly risk adjusted value. In all of these cases, incorporating an explicit risk adjustment would be double counting.

A further complication is that probabilities are themselves usually uncertain. This implies uncertainty in the (statistical) expected value and an even greater relative uncertainty in the risk adjustment (the value of uncertainty). In such circumstances it is a matter of judgement as to whether an explicit risk adjustment adds value to the presentation of the measurement or if there is an alternative, such as disclosures, to indicate the degree of uncertainty. Conversely, this is also the case when uncertainty is low. We note that the cost of analysing uncertainty and assessing its value may exceed the value it adds.

Market Value and Fair Value

We are concerned with the possible implication of paragraphs 6.45 to 6.47 and IFRS 13, paragraph B13, which indicates that, when a market value exists, it automatically represents a fair value.

Paragraph 6.46 of the discussion paper covers the requirement in the definition of fair value for an 'orderly transaction' suggesting that the term

“implies that neither participant is desperate or otherwise has an unusually weak bargaining position through being forced to sell or buy quickly because of financial distress or other factors.”

While it does not directly relate to fair values, IAS 19 includes a requirement for a deep market in corporate bonds before the yields on those bonds can be used as the basis for a discount rate. There are of course many markets that may not be deep or fully rational and where the market value may not be completely reliable, even if participants in the market are not desperate.

Paragraph 6.50 suggests that an entry price may be appropriate where the conditions allowing the use of an exit price do not exist.

We believe that the risk-adjusted expected present value of future cash flows should also be considered if the market value is not reliable. While the cost of developing such a measurement may be too great for it to be required to be included in the balance sheet in all cases, we believe that it may be more appropriate than the use of entry value in some cases where exit value is not available. There should be a fair value or fair value compatible option, available to preparers, for the measurement of all assets and liabilities, provided that this option is used in a consistent and systematic way to avoid accounting mismatch. However, we understand that the objectivity of an observed price may have, all else equal, priority over an estimated value. But there should be a point where the evidence from estimates overcomes the evidence from observation, where the observed figures are less than relevant or if observed prices are clearly irrational.

We recognise, however, that it can be costly to develop a view of likely future cash flows for certain types of asset and liabilities, and that fair value, as we understand it, can be regarded as overkill relative to the benefits to users in many contexts. It is therefore appropriate for simpler measurement approaches to be used when appropriate.

Financial Position, Profit and Revenue

Measurement should be considered in the context of how it will be used. There are three key performance indicators that are relevant to virtually all users: financial position, profit and revenue.

- Financial position provides users with an understanding of the resources of the entity and its obligations. Particularly in the case of long-term business relationships, the financial position, which also has a predictive character, is important information for users.
- Profitability is an entity's ability to generate value for its owners. The profit from the current period is the key indicator of current performance and is the basis on which estimates of future profitability lies. These estimates form the basis for a most important factor used by investors to impute a value to the entity.
- Revenue is one measure of an entity's size and performance and, together with its inverse, incurred cost, is the basis for the measurement of profit. Unless revenue and incurred costs are measured consistently, any assessment of profit and profitability is flawed.

Given their crucial importance, we believe that these concepts should be thoroughly explored in this review and in the Conceptual Framework itself. We believe that many of the problems in developing accounting standards, particularly in contexts where it is necessary to estimate uncertain future flows of resources arising from past events, arise out of a lack of such a conceptual foundation. "Profit" and "revenue" are freely used, but have not been adequately explored.

The presence of uncertainty typically results in a tension between the estimation of financial position and profit. Ideally, both should be estimated in a way that minimises their uncertainty. However, it is seldom the case that estimates that minimise the uncertainty of financial position also minimise the uncertainty of profit, and *vice-versa*. It is necessary either: to accept a degree of inconsistency between the two; or to assign priorities and develop a compromise.

This tension and its resolution should be further explored, if the Conceptual Framework is to adequately do its job of assisting the IASB in developing IFRSs. The work done on the Insurance Contracts project covers much of this ground.

Unique Characteristics of Liabilities

Paragraph 6.107 of the Discussion Paper discusses the difficulty in transferring a liability to a third party, hence limiting the situations where a market value of the liabilities may be appropriate. In addition to the issue of consent noted in the paragraph 6.107 other challenges with using a market value to measure liabilities include:

- Uncertainty has an asymmetrical impact on assets and liabilities. In a risk-averse world, uncertainty reduces the value of assets and increases the value of liabilities. This means that, other things being equal, the value of a liability to the obligor is greater than the value of the corresponding asset to the obligee. These two values only converge when the liability is settled in an orderly transaction.
- Market prices are what bring together different market participants. Even though they may have different perspectives and expectations, it is often possible to find a mutually acceptable price. But if an entity has an asset and a liability with similar risk exposure, the asset will be measured below the expected value of cash flows and the liability above. This can result in a significant accounting mismatch. To avoid this mismatch it is necessary to measure linked items allowing for the linkage so that neither the asset value overstates its value in isolation nor the liability value understates its value in isolation (as, for example, in the measurement of reinsurance and participation in the Insurance Contracts project).
- Default risk is similarly asymmetrical. While the risk of default reduces the value of an asset, the situation with a liability is often more complicated. If the obligor defaults, the obligee retains a claim against the obligor and can pursue that claim, ultimately into insolvency and liquidation of the obligor. Any reduction in the value of a liability on account of the probability of default can give a misleading impression of the financial position of the obligor.

Section 7 Presentation and disclosure

Question 16 This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the Conceptual Framework. In developing its preliminary views, the IASB has been influenced by two main factors:

- (a) the primary purpose of the Conceptual Framework, which is to assist the IASB in developing and revising Standards (see Section 1); and
- (b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8), including:
 - (i) a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;
 - (ii) amendments to IAS 1; and
 - (iii) additional guidance or education material on materiality.

Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the Conceptual Framework on:

- (a) presentation in the primary financial statements, including:
 - (i) what the primary financial statements are;
 - (ii) the objective of primary financial statements;
 - (iii) classification and aggregation;

- (iv) offsetting; and
 - (v) the relationship between primary financial statements.
- (b) disclosure in the notes to the financial statements, including:
- (i) the objective of the notes to the financial statements; and
 - (ii) the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information.

Why or why not? If you think additional guidance is needed, please specify what additional guidance on presentation and disclosure should be included in the Conceptual Framework.

IAA Comments

We broadly support the provision of guidance as outlined, and have the following further comments.

- Table 7.1 indicates that non-adjusting events should be disclosed. We believe that it would be helpful to have a comprehensive discussion of post-balance-date events in the Conceptual Framework, especially with a focus on the principles governing whether such events should be reflected in measurement; notified and quantified; or notified without quantification.
- Similarly, we believe that the Conceptual Framework should include a discussion of the principles governing when the value of uncertainty should be explicitly quantified and included in measurement; included implicitly in measurement; explicitly quantified and disclosed; and disclosed without quantification. When the value of uncertainty is explicitly quantified, we believe that it is important that it should be disclosed, whether as a separate component of measurement or in the notes, with the basis of its assessment adequately disclosed.
- We strongly support the view that disclosure should be selective. Key information should not be drowned in a sea of detail.
- Measurement complexity is another consideration in determining whether certain disclosures can be provided in a way that is useful. A complex discussion of the details of the estimation process should not be required, when the only way to provide proper understanding requires overly voluminous 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?

IAA Comments

We believe that additional guidance outside of the Conceptual Framework on materiality is desirable.

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?

IAA Comments

We agree that communication principles should be included in the Conceptual Framework and broadly support those set out in 7.50, and make the following comments.

- We believe that the last sentence of 7.50(d) is too weak. IFRSs should actively encourage appropriate cross-referencing.
- We agree with the sentiment in 7.50(f) that comparability across reporting entities and across time is important. However, we believe that it is even more important that there should be comparability between different components within the reporting entity. It is particularly important when there is a relationship between different elements. If these are not presented comparably (e.g. assets at amortised cost *versus* related liabilities at fulfilment value), it is vital that the disclosures should provide a basis for reconciliation.

Section 8 Presentation in the statement of comprehensive income—profit or loss and other comprehensive income

Question 19 The IASB's preliminary view that the Conceptual Framework should require a total or subtotal 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 amending Standards?

IAA Comments

We believe that the concept of profit or loss is both widely accepted and useful to users of financial statements, and should be a universal requirement.

We also believe that total comprehensive income is useful to users of financial statements, and should be a universal requirement. Therefore, if possible, discussion of the basis for other comprehensive income should be included to serve as a basis for decisions within individual IFRSs.

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, i.e. 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?

IAA Comments

We agree that some items of income and expense previously recognised in OCI should be recycled into P&L. Whether this extends to all OCI depends on the criteria adopted for the use of OCI, as discussed under Question 21.

All mismatches and bridging items should be recycled. For such items, we believe that it is essential to pass recycled amounts back through OCI, to avoid double counting in total comprehensive income.

It should also be a requirement to maintain and disclose a running total of recyclable OCI and to relate this to the corresponding items in the statement of financial position. If, for example, assets are at Fair Value through OCI (FVOCI), accumulated unrealised capital gains or losses should be disclosed.

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.

IAA Comments

Fair Value through Profit and Loss (FVPL)

The discussion (8.40-8.94) leading up to this question pre-supposes that, where there are re-measurements and bridging items, those parts of the income and expense items will be passed through OCI. It does not envisage that, in some circumstances, a better approach would be to avoid the inconsistencies that give rise to the need for OCI, by adopting a unified approach to measuring assets and liabilities. An entity should be permitted to manage and report its financial affairs on a basis such that it avoids situations where use of OCI and its recycling enhances the relevance of profit or loss (Principle 2) and, hence, has no need of the undoubted complications that OCI introduces.

The most obvious example of where this might apply is a financial institution that measures its assets and liabilities uniformly on an FVPL basis. While it may not be appropriate or desirable for all entities to do this, they should not be prevented from doing so, if such an approach is consistent with their business model.

Business Model

As a general rule, financial statements should reflect the business model of the reporting entity. Accounting standards should not dictate the business model. If similar entities embrace different business models, consideration may need to be given to facilitating like-for-like comparisons for users of the financial statements. For example, disclosure may be one approach to aiding such comparisons.

In particular, the IFRS 9 2012 ED and the Insurance Contracts 2013 ED propose to create an FVOCI asset category and matching liability measurement that, between them, generate a need for the use of OCI where none would otherwise exist. This was done to accommodate those insurers that have traditionally valued portfolios of largely fixed interest assets at amortised cost, but would impose massive disruption for other insurers that value their assets at FVPL. In our response to the Insurance Contracts ED, we proposed that there should be an option for those insurers to continue to use FVPL for assets, and to pass liability changes fully through P&L, rather than splitting out the effect of liability discount rate changes into OCI.

OCI Model

We incline to support the broader Approach 2B, that would allow transitory re-measurements be shown in OCI.

We recognise that whether to recycle or not is a topic which has and continues to be an active issue among accountants. We approach the topic from a user perspective and therefore support “Principle 3: an item that has previously been recognised in OCI should be reclassified (recycled) to profit or loss when, and only when, the reclassification results in relevant information”. We also support the thinking expressed in paragraphs 8.86 to 8.93 which, by way of example, consider re-measurement of a net defined benefit pension liability or asset and conclude in 8.92 that “... it is difficult to identify a suitable basis for recycling that is both operational and provides relevant information.” However, we note, that in absence of a proper definition of the difference between P&L and OCI it is difficult to define a clear line for recycling. If, under the business model, the P&L is the main information needed to understand the business, recycling would distort that information. If OCI is used to eliminate accounting mismatches, recycling is needed. If the appropriate view is based on total comprehensive

income, recycling results in double counting, unless amounts recycled to P&L are simultaneously reversed in OCI. If the appropriate view is based on P&L and OCI taken separately, recycling is relevant. Hence, for the time being, there is no conceptual solution possible, but the decision about recycling needs to be made in individual standards.

Section 9 Other issues

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.

IAA Comments

Chapter 1 – Objective

In this chapter, reference is made to “investors, lenders and other creditors”. While their needs do not differ greatly in most cases, we are concerned that there are other users who should also be included in this scope. Examples include employees, customers, suppliers, guarantors, government regulators, rating agencies and insurance policyholders. These could be encompassed by using “other stakeholders” in place of “other creditors”.

Chapter 3 – Qualitative Characteristics

Uncertainty

An important factor in understanding some complex phenomena is their uncertainty. Where there is significant uncertainty, a representation that omits any reflection of that uncertainty (possibly by means of disclosure) cannot be a faithful representation. We believe that this is sufficiently important that this should be discussed, possibly immediately after QC15. A suitable wording might be:

“Some phenomena are inherently uncertain. Where there is material uncertainty, a faithful representation reflects that uncertainty. How this is best done depends on the particular context and should be considered in the context of individual standards.”

In our view, a neutral measurement is one that makes due allowance for uncertainty. This is not bias, since the market as a whole and individual market participants place a value on uncertainty. We agree that neutrality is a more appropriate objective than prudence as traditionally understood, since it is less open-ended.

In Fair Value, uncertainty is allowed for as the value that the market places (or should place) on uncertainty or in level 3 an adjustment for risk is to be estimated. In the draft Insurance Contracts standard, there is explicit allowance, in the form of a risk adjustment, that reflects the value that the entity places on uncertainty.

Reliability

In 2010, Chapter 3 replaced reliability with the qualitative characteristic of faithful representation – information is useful if it faithfully represents what it purports to represent. We note that the need for reliability has been useful in the past and in some contexts reliability may be essential to recognition and not merely an enhancement. Our concern is whether reliability is sufficiently

considered in the use of faithful representation. An example of where “reliability” is a useful concept that is not adequately replaced by “faithful representation” is with regard to the Insurance Contracts ED’s proposal to value a threatening natural disaster at the reporting date based on information at that date. Such a value is generally not reliably measurable due to uncertainty at the reporting date that is greatly reduced by the time of the publication of the financial reports. Hence the term “faithful representation” does not sufficiently fill the void left by removal of the “reliability” criteria.

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?

IAA Comments

We believe that the business model is an important concept that should be considered in the Conceptual Framework. Having some appreciation of the business model (models) used in particular circumstances may assist the IASB in developing standards that provide relevant and useful information to users of financial statements.

However, that said, accounting standards should accommodate different business models, while still ensuring comparability between reporting entities, rather than seeking to impose a particular model.

This emphasis is a result of our involvement in the Insurance Contracts project. In insurance, there are a number of markedly different business models around the world. While the differences in some other industries may be less severe, in concept the business model should be the starting point. For example, ED/2010/1 provides measurement guidance for different business models.

The business model should determine whether the most appropriate measurement basis is cost-based (profit-release based on performance of service) or current cash flow-based, and whether it is from a market participant or an entity perspective.

For example, some insurance entities take a conservative approach to investment, purchasing largely fixed interest securities that are expected to generate cash inflows that match the expected cash outflows of claims and other benefits. These have traditionally valued their investments at amortised cost and valued their liabilities using historical discount rates based on those investments (or, in some cases, with no discounting at all). Others take a far more active approach to investment, including trading fixed interest securities, investing substantially in property and equity investments; and valuing their liabilities using current discount rates. In this latter case, a static measurement approach is less relevant.

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?

IAA Comments

We agree that the unit of account should be addressed in the context of particular standards. We believe that the unit of account is not necessarily fixed across all measurements under a particular standard. Rather it should be a flexible concept that accommodates the needs of different measurements or different aspects of a measurement.

It is also important to distinguish between:

- the unit of account, which, for example, sets the extent over which asymmetric measurement (e.g., releasing profits over time while showing losses immediately) of deficient and profitable items are aggregated; and
- the extent over which data is analysed for statistical measurement purposes.

If expected present values of cash flows are used, the data used for estimating the expected value will not necessarily be a result derived only from a group of existing contracts. For example, in the case of insurance contracts, the estimate of future administration cost will not be based on the expected administration cost of a given group of contracts but on assumptions regarding how certain types of cost will develop in future. The estimate of a given cash flow type is, itself, not subject to the concept of unit of account. Further it is necessary to differentiate between unit of account and technical aggregation of units of account for calculation purposes. Aggregation is performed in such a manner that the outcome is a good estimate of the sum of the measure of all units of account. This technical aggregation is a part of the estimation process, but not intended to influence the way a particular accounting concept is reflected. It is not helpful for the IASB to provide guidance in its Conceptual Framework or in individual IFRSs in such technical areas.

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?

IAA Comments

We have not identified any other situations.

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.

IAA Comments

No comments

Appendix A

Full Member Organizations - 65

Caribbean Actuarial Association
Consejo Profesional de Ciencias Económicas de la Ciudad Autónoma de Buenos Aires (Argentina)
Actuaries Institute Australia (Australia)
Aktuarvereinigung Österreichs (AVÖ) (Austria)
Institut des Actuaire en Belgique (Belgique)
Aktuarsko Drustvo U Bosni I Hercegovini (Bosnia and Herzegovina)
Instituto Brasileiro de Atuária (IBA) (Brazil)
Bulgarian Actuarial Society (Bulgaria)
Canadian Institute of Actuaries/Institut Canadien des Actuaire (Canada)
China Association of Actuaries (China)
Actuarial Institute of Chinese Taipei (Chinese Taipei)
Asociación Colombiana de Actuarios (Colombia)
Institut des Actuaire de Côte d'Ivoire (Côte D`Ivoire)
Hrvatsko Aktuarsko Drustvo (Croatia)
Cyprus Association of Actuaries (Cyprus)
Česká Společnost Aktuárů (Czech Republic)
Den Danske Aktuarforening (Denmark)
Egyptian Society of Actuaries (Egypt)
Eesti Aktuaaride Liit (Estonia)
Suomen Aktuaariyhdistys (Finland)
Institut des Actuaire (France)
Deutsche Aktuarvereinigung e. V. (DAV) (Germany)
Hellenic Actuarial Society (Greece)
Actuarial Society of Hong Kong (Hong Kong)
Magyar Aktuárius Társaság (Hungary)
Félag Íslenskra Tryggingastærðfræðinga (Iceland)
Institute of Actuaries of India (India)
Persatuan Aktuaris Indonesia (Indonesia)
Society of Actuaries in Ireland (Ireland)
Israel Association of Actuaries (Israel)
Istituto Italiano degli Attuari (Italy)
Institute of Actuaries of Japan (Japan)
Japanese Society of Certified Pension Actuaries (Japan)
The Actuarial Society of Kenya (Kenya)
Latvijas Aktuaru Asociacija (Latvia)
Lebanese Association of Actuaries (Lebanon)
Lietuvos Aktuariju Draugija (Lithuania)
Persatuan Aktuari Malaysia (Malaysia)
Colegio Nacional de Actuarios A. C. (Mexico)
Association Marocaine des Actuaire (Morocco)
Het Actuarieel Genootschap (Netherlands)
New Zealand Society of Actuaries (New Zealand)
Den Norske Aktuarforening (Norway)
Pakistan Society of Actuaries (Pakistan)
Actuarial Society of the Philippines (Philippines)
Polskie Stowarzyszenie Aktuaruszy (Poland)
Instituto dos Actuários Portugueses (Portugal)
Russian Guild of Actuaries (Russia)
Udruženje Aktuara Srbije (Serbia)
Singapore Actuarial Society (Singapore)
Slovenska Spoločnosť Aktuarov (Slovakia)

Slovensko Aktuarsko Drustvo (Slovenia)
Actuarial Society of South Africa (South Africa)
Institute of Actuaries of Korea (South Korea)
Col.legi d'Actuaris de Catalunya (Spain)
Instituto de Actuarios Españoles (Spain)
Svenska Aktuarieföreningen (Sweden)
Association Suisse des Actuaires (Switzerland)
Society of Actuaries of Thailand (Thailand)
Institute and Faculty of Actuaries (United Kingdom)
American Academy of Actuaries (United States)
American Society of Pension Professionals & Actuaries (United States)
Casualty Actuarial Society (United States)
Conference of Consulting Actuaries (United States)
Society of Actuaries (United States)

Appendix B

Members of the IAA Insurance Accounting Committee

Chairperson:

Francis Ruygt

Co-Vice-Chairpersons:

Micheline Dionne
David John Finnis
William C. Hines

Members:

Gunn Albertsen	Den Norske Aktuarforening
Victor Hugo Cesar Bagnati	Instituto Brasileiro de Atuária (IBA)
Daniel N. Barron	Israel Association of Actuaries
Guy Castagnoli	Association Suisse des Actuaire
Antonella Chiricosta	Istituto Italiano degli Attuari
Simon R Curtis	Canadian Institute of Actuaries/Institut Canadien des Actuaire
Alexander Dollhopf	Svenska Aktuarieföreningen
Ann Duchêne	Institut des Actuaire en Belgique
David John Finnis	Actuaries Institute Australia
Xing Feng Gong	China Association of Actuaries
Rokas Gyls	Lietuvos aktuariju draugija
Jozef Hancar	Slovenska Spolocnost Aktuarov
Maximilian Happacher	Deutsche Aktuarvereinigung e. V. (DAV)
Armand Maurice Ibo	Institut des Actuaire de Côte d'Ivoire
Satyan Jambunathan	Institute of Actuaries of India
Dragica Jankovic	Udruzenje aktuara Srbije
Burton D Jay	Conference of Consulting Actuaries
Gareth L Kennedy	Casualty Actuarial Society
Ad Kok	Het Actuarieel Genootschap
Christoph Krischanitz	Aktuarvereinigung Österreichs (AVÖ)
Yin Lawn	Actuarial Institute of Chinese Taipei
Kristine Lomanovska	Latvijas Aktuaru Asociacija
Ana Maria Martins Pereira	Instituto dos Actuários Portugueses
James B Milholland	Society of Actuaries
Brian Joseph Morrissey	Society of Actuaries in Ireland
Yoshio Nakamura	Institute of Actuaries of Japan
Manuel Peraita Huerta	Instituto de Actuarios Españoles
Andreja Radic	Hrvatsko Aktuarsko Društvo
Nithiarani Rajasingham	Singapore Actuarial Society
Ravi Clifton Rambarran	Caribbean Actuarial Association
Thomas Ringsted	Den Danske Aktuarforening
Jaanus Sibul	Eesti Aktuaaride Liit
Henry W Siegel	American Academy of Actuaries
Maxime Simoen	Institut des actuaire
Mateja Slapar	Slovensko Aktuarsko Društvo
John Laurence Smith	New Zealand Society of Actuaries
Pentti Soinen	Suomen Aktuaariyhdistys
Arseny Leonidovich Timakov	Russian Guild of Actuaries
Peter Andrew Withey	Actuarial Society of South Africa
Derek John Wright	Institute and Faculty of Actuaries
Jana Zelinkova	Ceská Spolocnost Aktuárů
Jesús Alfonso Zúñiga San Martin	Colegio Nacional de Actuarios A. C.