SwissHoldings
Verband der Industrie- und Dienstleistungskonzerne in der Schweiz
Fédération des groupes industriels et de services en Suisse
Federation of Industrial and Service Groups in Switzerland

26 October 2015

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

Comment Letter on the Exposure Draft on the Conceptual Framework for Financial Reporting

Dear Sir/Madam,

SwissHoldings, the Swiss Federation of Industrial and Services Groups in Switzerland, represents 61 Swiss groups, including most of the country's major industrial and commercial enterprises. We very much welcome the opportunity to provide comments to this ED. Our response (in the appendix) has been prepared in conjunction with our member companies.

In summary, however, we wish to commend the IASB on achieving a full review of the whole *Conceptual Framework* rather than performing a piecemeal review. We consider that this is required so that one can assess how the different chapters interact.

We are also pleased that there is more emphasis on the concepts of "stewardship" and "prudence". Stewardship in particular is important as we consider that a key aim of financial reporting is to enable investors and other users to assess the management's performance in using the entity's resources.

In this connection, however, although such data should not be elevated to become part of the primary financial statements, we consider that the current draft misses an opportunity to cover disaggregated segment and "underlying/normalised /sustainable" performance measures. Many of our member companies consider such data to be information that their shareholders and analysts increasingly focus on in order for them to form a view and predict an entity's future performance and cash flows. We note that one Board member raised this as an alternative view when not supporting the current ED. We strongly recommend that this alternative view is taken into account in the final *Conceptual Framework* document and request that the Board reconsiders these objections to the current draft.

Furthermore, we are supportive of the emphasis that financial data recognised in financial statements must be "relevant". However, we consider that more guidance is still required to ensure a consistent approach. This is especially required when using the recognition indicator to determine whether or not the level of measurement uncertainty is so high that the resulting financial information, if recognised, has little relevance. This guidance on relevance could explain why there may need to be a different approach in assessing relevance for different types of assets and liabilities. For example, an item for which there exists considerable measurement uncertainty may still require recognition, such as in the area of financial instruments where there is usually a market based on accepted valuation techniques. However, recognition in cases of high measurement uncertainty may not be appropriate in a number of other areas, especially certain litigation matters where there is a binary outcome. In such cases recognition of an "expected" amount is

Postfach 402, 3000 Bern 7
Tel. +41 (0)31 356 68 68
sh@swissholdings.ch

Nägeligasse 13, 3011 Bern
Fax +41 (0)31 352 32 55
www.swissholdings.ch

unlikely to be the amount of the final settlement. Furthermore, in such a situation, it should be accepted that recognition of an initial estimate may often prejudice the entity in its legal actions.

We also disagree with the proposed approach for treating “other comprehensive income”. Our comment letter suggests that the analysis in this area in the *Discussion Paper* should be retained by categorising OCI into three categories, namely “bridging”, “mismatched measurement” and “transitory” items. We suggest that this approach is retained and therefore support many, but not all, of the ideas expressed in the alternative views of two Board members. Specifically we do not support the view that “transitory other remeasurement” items should be recognised immediately in the profit and loss statement.

Yours sincerely

SwissHoldings
Federation of Industrial and Service Groups in Switzerland

Felix R. Ehrat
Chair

Christian Stiefel
Director

cc SH Board

APPENDIX

ANSWERS TO SPECIFIC QUESTIONS IN INVITATION TO COMMENT

Question 1 – Proposed changes to Chapters 1 and 2

Do you support the proposals:

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

Why or why not?

Many of the changes proposed above in the ED were requested by us in our response letter to the *Discussion Paper*. Therefore in general we are supportive of the changes.

In particular, we welcome that the ED now has within its objectives of financial reporting, the need to use financial reporting to hold management to account and therefore there is more prominence given to stewardship of the entity. Furthermore, we welcome the explicit reference to prudence and the description as to when to apply it.

We support the two fundamental qualitative characteristics for useful financial information of faithful representation and relevance. We note that the draft *Basis of Conclusions* contains considerable discussion on why the term "faithful representation" is preferred to "reliability", however, the discussion on the term "relevance" seems to be spread over a number of chapters (eg Chapters 2 and 6) where there is a discussion about a trade-off between measurement uncertainty and relevance. Since this will be a potentially important aspect in determining whether an item is recognised in financial statements or not, especially for certain types of liabilities or assets, we suggest that the *Basis of Conclusions* should not just cover "relevance" in its comments on Chapter 6 but that the *Basis of Conclusions* for Chapter 2 also expands the qualitative characteristics of "relevance".

Question 2 – Description and boundary of a reporting entity

Do you agree with:

- *(a) the proposed description of a reporting entity in paragraphs 3.11-3.12; and*
- *(b) the discussion of the boundary of a reporting entity in paragraphs 3.13–3.25?*

Why or why not?

We generally agree with the wording in paragraphs 3.11 and 3.12 defining a "reporting entity", however, we have the following comments:

- We do not consider that it is appropriate to use the term "subsidiary" when what is actually meant is a "controlled entity", which as the ED mentions, could be all or part of an unincorporated entity or legally incorporated entity. We consider that in common parlance there is an expectation that a "subsidiary" is a legally incorporated entity. As a result we also suggest that the *Conceptual Framework* should avoid the use of the term "parent".
- As a result we suggest that paragraph 3.19 avoids the use of the term "parent" since an unconsolidated "entity" would suffice.
- We are pleased to see that in paragraph 3.17 there is mention of "combined" financial statements. What is not clear to us, however, is whether or not such combined entities could fall into the definition of a "controlled entity" or whether or not IFRS is intended to cover the accounting for "combined" financial statements.

We suggest that paragraph 3.13.is extended to clearly state that control is the guiding principle when determining "boundaries" of financial statements.
It may also be appropriate to add that whether consolidated or unconsolidated financial statements are being prepared depends on their purpose.

Generally, however, we consider that Chapter 3 is one of the weakest in the whole ED and does not appear to have been written with the same rigour or use the same terminology as the rest of the ED. The items indicated above are just some examples of this, so this chapter of the *Conceptual Framework* and *Basis of Conclusions* should be thoroughly reviewed again to clarify amongst others the points raised above and ensure consistency with the rest of the document.

Furthermore, we note that in paragraph 3.4 there is a discussion that "the objectives of financial statements is to provide information about an entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources." Please refer to our comments to Question 11 which addresses our views that it would be desirable in the final *Conceptual Framework* to include more discussion on disaggregated "segment" data and other data which helps to explain an entity's "underlying" or "sustainable" performance. Whilst we do not consider that such data should be mandated to be part of the primary financial statements it is nevertheless often more useful to users of financial statements than the total financial statements of a large and complex entity.

Question 3 – Definitions of elements

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

(a) an asset, and the related definition of an economic resource;

(b) a liability;

(c) equity;

(d) income; and

(e) expenses?

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

Question 4 – Present obligation

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

Question 5 – Other guidance on the elements

Do you have any comments on the proposed guidance?

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

Question 6 – Recognition criteria

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

Question 7 – Derecognition

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

Since there is considerable overlapping in the comments that we wish to make, we have decided to group together below our responses to Questions 3 to 7:

Generally we agree with the definitions of the elements, mentioned above, however, we consider that consideration should be given to the following areas:

<u>Deletion of the notion of “expected” cash flows</u>

We are supportive of the change from the notion of “expected” cash flows to “the notion of having the potential to produce” cash flows. Whilst we can agree to this change, we consider, however, that this will potentially have far reaching consequences as the deletion of “expected” will most likely result in there being no place in the standards for such statistically derived terms as “expected”, ”average”, “mean”, ”median” etc.

Our understanding of the consequences of this is, that in order for an asset or liability to be recognised, there will be much more emphasis on assessing whether or not the amount to be shown in the financial statements is “relevant” and is a “faithful representation” of the element.

We interpret this to potentially mean that there will be less focus on being forced to produce estimates in cases where there is large measurement uncertainty (eg in the case of binary outcome litigations where the average or median estimate of different outcomes is arguably not relevant as in many cases it will certainly be substantially different to the actual outcome).

If our understanding is correct, and recognising amounts which are not relevant is no longer required, we welcome this new approach as we see that it may be a way out of the current impasse in dealing with these types of situations.

However, we consider that more guidance is still required to ensure a consistent approach. This is especially required when using the recognition indicator to determine whether or not the level of measurement uncertainty is so high that the resulting financial information, if recognised, has little relevance. This guidance on relevance could explain why there may need to be a different approach in assessing relevance for different types of assets and liabilities. For example, an item for which there exists considerable measurement uncertainty may still require recognition, such as in the area of financial instruments where there is usually a market based on accepted valuation techniques. However, recognition in cases of high measurement uncertainty may not be appropriate in a number of other areas, especially certain litigation matters where there is a binary outcome. In such cases recognition of an “expected” amount is unlikely to be the amount of the final settlement. Furthermore, in such a situation, it should be accepted that recognition of an initial estimate may often prejudice the entity in its legal actions.

An additional point that could be covered is whether or not it is appropriate to establish a liability for the foreseeable legal costs of defending existing legal cases. Since the legal cases are already existing events at the balance sheet date we consider that there could be justification for establishing a provision to cover foreseeable legal costs since their measurement uncertainty will be considerably less that the outcome of the legal case itself.

Definition of an asset – rights

Paragraph 4.8 provides extensive guidance concerning "rights" including in paragraph 4.8 (c) a description that there are "other rights that give the entity the potential to receive future economic benefits that are not available to other parties…".

Please provide clarity as to whether or not it is intended for some or all of the following to be identified as rights potentially resulting in assets at each reporting date:

- rights to obtain comparably higher discounts from suppliers due to the relative bargaining power of the entity
- rights to continue to sell to customers on comparably better terms due to long-term relationships with a customer
- rights related to licensing and royalty transactions which have been negotiated on terms that are more favourable than competitors could currently negotiate
- rights resulting from comparatively higher marketing, advertising, development activities compared to peer entities
- etc

We note that there is currently a requirement to treat some of the above as separately identified assets when assessing the accounting for a purchase price allocation related to a business combination, however, many of the above would only be considered to be assets if acquired outside of a business combination but are not currently considered to be separately identifiable rights resulting in assets in other circumstances.

We suggest that the final *Conceptual Framework* discusses and provides comments as to why such items only need recognition in the specific circumstances mentioned above.

Liabilities

Generally we are supportive of the direction in the ED for defining a liability. It is important however to stress that only liabilities that can be reliably measured and are relevant should be recognized otherwise the deletion of the probability threshold may lead to attempts to incorrectly recognize additional liabilities.

Our response to the *Discussion Paper* was that there should not be too narrow a definition of a liability and certainly constructive obligations should be considered liabilities. We consider that with the guidance suggested in the ED that a liability should be established for all obligations where there is "no practical ability" to avoid an economic transfer is acceptable to us.

Executory contracts

We are generally supportive of the guidance for executory contracts. We suggest, however, that this should be expanded to cover the impacts related to cancellation of such contracts as, in many cases, the purchase order representing the executory contract will contain penalties for cancellation or otherwise changing the terms of the executory contract.

We suggest that guidance is provided in the final *Conceptual Framework* covering when such assets or liabilities should be recognized.

Question 8 – Measurement bases

Has the IASB:

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

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

In general we agree with the ED conclusion to only have two measurement bases. Despite this, we suggest that the *Basis of Conclusions* either explains how the following items can be accommodated within this two model framework (as although they appear to be recognised at current values these values neither fit the definition of fair value or fulfilment value) or otherwise indicates that these areas may need to be reassessed in the light of the new requirements:

- deferred taxes
- net pension liabilities

We also agree that the ED appropriately describes the advantages and disadvantages of the various measurement bases as set out in Table 6.1 and related text.

We consider, however, that the *Basis of Conclusions* paragraph BC 6.25 concerning describing value in use should be expanded, in particular, to not only include reference to guidance in IAS 16 *Property, Plant and Equipment* but should also refer to guidance on value in use in IAS 36 *Impairment of Assets*. IAS 36 includes very specific guidance on what to consider when using a cash flow model for value in use purposes. This includes specifying that when using cash flow derived values for arriving at value in use a pre-tax discount rate should be used and that no improvements in the tangible or intangible asset can be taken into account.

These very specific guidelines can lead to inconsistencies in measurement approaches for assets acquired in business combinations and their subsequent measurement.
Assets acquired in a business combination under IFRS 3 need to be measured at fair value whereas impairment testing at subsequent reporting dates may need to use value in use calculations. The differences in the cash flow techniques used for accounting for an acquisition and then subsequently can produce significant valuation differences when reporting immediately after the business combination. We can see no reason for the differences in approaches so we would welcome a thorough analysis of the mechanics to value cash flows in a fair value and value in use setting in *the Basis of Conclusions.*

We suggest, however, that the *Conceptual Framework* should not give specific guidance as to how to determine the discount rate to be used in fair value or value in use models as we understand that this will be covered by a separate project.

Question 9 – Factors to consider when selecting a measurement basis

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

We agree with the way that the *Conceptual Framework* lists the factors to consider when selecting a measurement basis.

Question 10 – More than one relevant measurement basis

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

We agree with the approach discussed in the *Conceptual Framework* on this topic.

Question 11 – Objective and scope of financial statements and communication

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

We note that in paragraph 3.4 there is a discussion that "the objectives of financial statements is to provide information about an entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources."

We note that the ED does not expand the objective and scope of financial reporting to give more focus to the importance of disaggregated segment data and "sustainable" or "underlying" performance measures when discussing presentation and disclosure requirements.

We note that IASB member, Mr. Patrick Finnegan, has also raised these points in his alternative views resulting in his dissent of the ED. We also covered these points in our response to the *Discussion Paper*.

We do not advocate that segment data and data to help users arrive at "underlying" performance should be elevated to become elements of the primary financial statements. Nevertheless we consider that in order to assess the prospects for future cash flows, not only entity totals should be included in the list of financial data that is necessary to be provided in financial statements but also "disaggregated segment data" and data that is necessary to arrive at management's assessment of "underlying" performance. Such information is often of fundamental importance to users of financial statements in assessing future cash flows and management's stewardship of the entity. We therefore suggest that paragraph 3.4 and Chapter 3 is amended to include these aspects.

Question 12 – Description of the statement of profit or loss

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

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

We disagree with the way the *Conceptual Framework* currently describes the statement of profit and loss and tend to agree with the alternative views expressed by Board members Mr. Cooper and Mr. Finnegan. We consider that there is a lot of merit to the categorization of OCI items into those that are "bridging", "mismatched measurement" and "transitory" items as discussed in the *Discussion Paper*. We consider that such an approach would bring more of a conceptual approach into defining OCI and would thereby result in more consistency in applying the OCI approach from entity to entity irrespective of the industry that they are from.

We disagree, however, with the proposal in this alternative view that "other remeasurement" (which we assume are the "transitory" items in the *Discussion Paper)* should be immediately recorded in profit and loss. We assume that the main item in this category would be actuarial gains and losses. We would propose that such items are also recorded in OCI.

We consider recycling into profit and loss is certainly appropriate for the "bridging" and "mismatched measurement" items as soon as there is a "triggering" event related to the items. Where material this recycling should be separately disclosed in order to avoid a distortion of the results related to these “out-of-period” items.

Such a recycling approach could also be appropriate for the “transitory” items although this will require more detailed analysis.

Question 13 – Reporting items of income or expenses in other comprehensive income

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

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

We disagree with the way that the *Conceptual Framework* proposes to use OCI. Please see our answer to Question 12 above.

Furthermore, we consider that the nature of the entity’s business activities could also play a role on deciding what the primary source of information about an entity’s financial performance is and which items should be presented in OCI.

Question 14 – Recycling

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

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

In principle we agree with the conclusion in the *Conceptual Framework* that all items included in OCI should eventually be recycled into the primary profit and loss performance statement.

As noted above, however, we request that further guidance should be provided for determining the basis for recycling of certain “transitory” items (eg post-retirement benefits which often are settled and built up on a continuous basis. One solution could be to only recycle when the entity which supports the post-retirement benefit is either liquidated or otherwise disposed).

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

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

Generally we are very supportive of the analysis of the proposed changes needed to various standards due to the new *Conceptual Framework*. In particular we are very pleased to see that the current unsatisfactory situation related to IFRIC 21 *Levies* will be resolved.

We consider that application of the new *Conceptual Framework* could have far reaching consequences in many other standards however this will require further detailed analysis.
However, as indicated above, we consider that the new emphasis on “relevance” will potentially substantially change the current guidance requiring recognition of certain expected values particularly in such areas as litigation and tax obligations. IAS 12 and 37 should therefore be given priority review.

Question 16 – Business activities

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

Generally we agree that the "business model" should not be overly emphasized in the financial statement preparation and are therefore supportive of the approaches outlined in paragraph BCIN. 33.

As indicated several times above however, we consider that more emphasis should be given in the *Conceptual Framework* to requiring disclosure of segment data resulting from an entity's business model and the business model could have some impact on what is allowed to be recognized in OCI.

Question 17 – Long-term investment

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

We agree with the approach taken in the *Conceptual Framework* not to provide any added focus to long-term investments.

Question 18 – Other comments

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

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

Although not expressly solicited in the questions to respond to in the ED, we wish to draw your attention to our comments on Chapter 8 which we consider is also one of the weaker chapters in the document and it is a pity that it is not being completed with more rigour.

For example, there is an urgent need to provide a better conceptual basis to the current guidance and anomalies that applying IAS 21*The Effect of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies* can produce in consolidated financial statements when there are governmental restrictions creating "false" foreign exchange markets. In this respect we consider that it may be useful for the *Conceptual Framework* to explore whether or not there may be grounds for using a capital maintenance approach solely for the production of financial statements within the jurisdiction that is impacted by these government restrictions but applying a different approach to the financial statements coming from such jurisdictions in consolidated financial statements prepared outside of such jurisdictions.

This aspect, and potentially other capital maintenance topics, should be addressed with some urgency.