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in Israel
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רואי חשבון
בישראל

1906/38827

December 8, 2015

International Accounting Standards Board
30 Cannon Street
London EC4M6XH
United Kingdom

Dear Sir/Madam,

Re: **Exposure Draft ED/2015/3– Conceptual Framework for Financial Reporting**

We appreciate the opportunity to respond to the Exposure Draft ED/2015/3- "Conceptual Framework for Financial Reporting" issued by the International Accounting Standards Board (IASB). This response represents the views of the Institute of Certified Public Accountants in Israel.

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. proposals to state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form;

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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?

<u>Response to question 1:</u>

a. We believe that although assessing management's stewardship is not a main objective of financial reporting, financial statements do help users in assessing it and therefore more prominence can be given to it.

   It should be noted that new standard setting will have to consider this respect together with other basic attributes of financial reporting such as neutrality, verifiability, etc.

b. We support the proposal; we believe the notion of prudence has always been a factor in making accounting judgements under uncertain conditions.

c. We support the proposal.

d. We agree with concept of incorporating measurement uncertainty as part of "relevance". However, such incorporation is not aligned with current standards that use measurement uncertainty as part of "reliability" notion. To illustrate: IAS 8.14(b) requires an accounting change to result "in the financial statements providing reliable and more relevant information about the effects of…". The proposed change would have replaced the "reliable" notion above with "faithful representation" and would have required the entity to consider whether a considered accounting change is "more relevant", factoring any measurement uncertainty into the result. This can result with different outcome in many cases, as compared to the current guidance, because the measurement uncertainty (which is a usual characteristic of fair value measurement, for instance) may weigh down the result NOT to be in the "more relevant" section.

e. We support the proposal.

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?

Response to question 2:

a. We agree with the description of the reporting entity.

b. When dealing with the boundaries of the reporting entity we have the following comments:

   1. We do not agree with paragraph 3.23. Although we agree that in general, consolidated financial statements are more likely to provide useful information to users of financial statements than unconsolidated financial statements, we believe that in certain circumstances unconsolidated financial statements are more helpful, e.g. when evaluating solvency, when assessing distributable profits, etc. - **and this should be mentioned in the Conceptual Framework.**

   2. Paragraph 3.17 refers to instances where combined financial statements are prepared for two or more entities that do not have a parent-subsidiary relationship with each other. Sometimes it may also be necessary to prepare combined financial statements for prior periods (comparative information) for two or more entities that, although having parent-subsidiary relationship in the current period, they did not have such relationship in past periods - as may be the case in some business combinations between entities under common control (an issue which is still in development stage under the IASB's research program and therefore, as long as there is no standard setting in this area, in accordance with IAS 8.11 preparers are referred to the Framework). Therefore, paragraph 3.17 should be amended so that it would recognize that combined financial statements could also be relevant for comparative information when two or more entities <u>did not have a parent-subsidiary relationship in a certain past period</u>.

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?

Response to question 3:

We agree with the proposed definitions of elements. We believe that certain clarifications should be made in accordance with our response to question 4.

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?

Response to question 4:

According to paragraph 4.32, an entity has a present obligation to transfer an economic resource if, amongst others, the entity has no practical ability to avoid the transfer. "no practical ability" implies a sort of a threshold that must be met in order for a liability to exist. However, paragraph 4.27 states that "it need not be certain, or even probable, that the entity will be required to transfer an economic resource…" – thereby implying a very low threshold for a liability to exist. We believe that the IASB should clarify the interaction between those two paragraphs which may be understood as contradictory.

Furthermore, we believe that paragraph 4.30, which states that an obligation of an entity to transfer its own equity claims to another party is not an obligation to transfer an economic resource (and hence - is not a liability) **constitutes a major revolution with respect to current IFRS requirements (e.g., the requirement to present payments on account of shares to be issued, warrants and options for the entity's shares as a liability when they are not stated in a fix amount for a fix number of shares ("fix-for-fix")). If the IASB's intention in this respect is as pervasive as stated in paragraph 4.30, this issue should be clearly addressed and elaborated in the Basis for Conclusions, especially considering that the major project of "Financial Instruments with Characteristics of Equity" is still under way.**

In addition, paragraph 4.32 is intended to explain the concept of "no practical ability to avoid the transfer". However, the proposed Conceptual Framework does not describe the concept or its principles but rather uses an example instead of explaining the concept. We believe that, as in other issues, the Framework should first establish the concept and rules that define the circumstances in which an entity has no practical ability to avoid a transfer, and then use examples to illustrate the concept. The concept cannot really be established just by giving an example.

<u>Question 5 - Other guidance on the elements</u>

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.

<u>Response to question 5:</u>

We have no further comments regarding this issue.

<u>Question 6 - Recognition criteria</u>

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?

<u>Response to question 6:</u>

We agree with the proposed approach to recognition.

<u>Question 7 - Derecognition</u>

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?

<u>Response to question 7:</u>

We agree with the proposed discussion of derecognition.

<u>Question 8 - Measurement bases</u>

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?*

Response to question 8:

a. We agree with the measurement bases identified by the IASB.

Notwithstanding our support in this respect as stated above, consideration should be given to the following issue:
The introduction to the Conceptual Framework (page 7) states that "The Conceptual Framework is not a Standard and does not override specific Standards. Hence, the proposed changes to the Conceptual Framework will not have an immediate effect on the financial statements of most reporting entities". **However, it seems that the definition of "Value in Use" (VIU) will have an immediate effect on substantially all the entities carrying an asset of inventories at Net Realizable Value (NRV) when cost exceeds NRV under IAS 2 . Most of these entities use NRVwithout discounting it. Since NRV is apparently part of VIU measurement under the proposed Conceptual Framework, since the proposed framework states that VIU measurement must be discounted, and since there is no requirement or guidance in IAS 2 to allow otherwise - the immediate result is that all such entities will be compelled to use discounted NRV for inventories.**

b. Paragraph 6.7 describes specific circumstances (consumption and impairment) in which the historical cost of a non-financial asset is adjusted. We believe there are also other circumstances that result in the adjustment of the historical cost of a non-financial asset. For example, when the statement of financial position of a foreign operation is translated for the purposes of consolidation or applying the equity method, changes in the exchange rate affect the historical cost of the non-financial assets of the foreign operation.

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?

Response to question 9:

In general we agree with the factors to be considered when selecting a measurement basis. We have the following specific comment: Paragraph 6.55 states that "…if no measurement basis for an asset or a liability would provide relevant information, it is not appropriate to recognize the asset or liability." We believe that the IASB should provide further explanation of this conclusion and provide an example of a situation in which this might be applied and the proposed solutions.

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?

Response to question 10:

We agree with the approach discussed.

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?

Response to question 11:

It seems to us from the literal reading of the objective paragraph that the current proposed objective in the ED is focused more on the assessment of future cash flows rather than focusing on both future cash flows and past performance of the entity.

With respect to the discussion of the useful information, which is disclosed in order to meet the proposed objective, we believe that the main objective of such disclosures should be to make financial statement disclosures more effective and efficient so that both preparers and users would find it valuable. In order to meet such objective, the Conceptual Framework should provide in the first place useful guidelines that will enhance the overall quality of financial reporting. Although, we agree with the limitations, or constraints, on disclosures as articulated in the ED, such as relevance, cost, and limited future-oriented information, we are concerned that such objective, as mentioned above, would not be met.

In particular, we find the feedbacks received in the IASB's Discussion Forum on Financial Reporting Disclosure, which was held in January 2013, according to which almost all respondents agreed (i.e. over 80%) that there is a disclosure problem to be quite disturbing. **Therefore, we believe that a 'fundamental change' is required. In other words, we do not believe that the objectives provided in the ED will assist neither in solving the problems nor in improving it.**

Although IAS 1.30A has been recently added to prevent situations in which immaterial information obscures material information, we believe that the primary rightful place of this principle is in the Conceptual Framework. Moreover, this most important principle may be included in the Framework in a broader and more meaningful way to also prevent, for example, inclusion of information which may be material to the entity by its nature but is not the kind of information that should be included in financial statements under current IFRSs (such as parts of an entity's business plans, prospective business assumptions, business strategies, etc.). **Needless to say, inclusion of such information in financial statements also may obscure (in spite**

of its materiality to the business) material information that has to be included in financial statements.

<u>Question 12 - Description of the statement of profit or loss</u>

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.

<u>Response to question 12:</u>

We do not support the description of profit or loss as the primary source of information about an entity's financial performance for the period. However, we support the notion of “Financial Performance" to depict both Profit or Loss and Other Comprehensive Income (OCI).

<u>Question 13 - Reporting items of income or expenses in other comprehensive income</u>

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?

<u>Response to question 13:</u>

Over the last decades, the financial reporting standards have begun to use Other Comprehensive Income (OCI) as a tool for recognition of certain income and expenses. Although many years have passed since the first use of this tool, we feel that the IASB has not yet dealt directly with the infrastructure that differentiates the cases in which items are to be recognized in P&L or in OCI. We feel that new items are added from time to time to OCI in a way that some would call sporadically and without structured methodology.

We understand that providing a definition of profit or loss and OCI are long-standing areas of controversy in financial reporting, where finding a consensual way forward may be really difficult as the question of defining the line between profit or loss and OCI has incurred quite a lot of “headaches” for standard setters. However, although we perfectly understand the difficulties faced, **the problem remains too important to be ‘worked around’ rather than faced and settled appropriately**.

A possible approach to differentiate between profit or loss and OCI may be by the attribute of realization. According to such approach, those changes in assets or liabilities that meet the threshold of realization for inclusion in profit or loss (as such threshold will be established) will be included there, while other changes not meeting such threshold will be included 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?

Response to question 14:

We do not agree with the approach to recycling. We believe that all amounts that are carried to OCI should be eventually recycled to profit or loss in some future time, without exemption to this requirement.

Please note that we believe that it is possible to define rules for the timing of recycling of each element that is carried to OCI (as been done under US GAAP). However, despite the fact that we believe that such rules should be dealt in every financial reporting standard separately, the basic concepts should be set in the Conceptual Framework.

To emphasize this idea, we would like to refer to paragraph BC7.56 (at the last clause) of the ED. In that paragraph, the IASB indicates as follows:

"The absence of an appropriate basis for reclassification may be an indication that the particular item of income and expenses should not be included in OCI in the first place".

It seems that such determination, which might constitute only a thought, presumably shows that in practice, the IASB has already agreed that all items recognized to OCI should be reclassified to profit or loss and that all performances of the entity will be included eventually in the retained earnings, although in some cases there may be no trigger to such recycling. We are confident that such trigger can be identified operationally even if in some cases it will be a kind of compromised mechanism.

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?

Response to question 15:

We agree with the analysis.

Question 16 - Business activities

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

Response to question 16:

We disagree with the IASB's decision that the Conceptual Framework should not include a general discussion of the role played in financial reporting by how an entity conducts its business activities. An entity's business model has a pervasive effect on what is considered relevant and useful to users of financial statements. As such, it might affect matters like:

- Presentation – e.g., presenting profit or loss according to the nature of expenses method might be more useful to users of a holding company, while a presentation based on the function of the expenses might be more useful to users of a manufacturing company;
- Disclosure – e.g., an entity in the financial sector might require more extensive disclosure regarding its financial instruments in comparison with a retail company;
- Measurement – e.g., an entity might be required to measure some assets at fair value if they are held for trading, or at cost if they are held for the long term;

Because of its pervasive effect on financial reporting, we believe that a general discussion on the concept of how an entity's business model might affect its financial reporting should be included in the conceptual framework.

Question 17 - Long-term investment

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

Response to question 17:

We agree with the IASB's conclusion regarding long-term investments. We believe that the Conceptual Framework should not refer explicitly to the particular business activity of long-term investments. We also believe that the ED contains sufficient tools to help the IASB in making standard-setting decisions with regard to long-term investment. We do not believe that the ED should address the different information needs of long-term and short-term investors (if such differences even exist).

Question 18 - Other comments

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

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

Response to question 18:

We have no further comments.

Sincerely yours

David Goldberg, CPA (Isr.), M.B.A
Chair of the Professional Council
and former president

Arnon Ratzkovsky
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Committee