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International Accounting Standards
Board
Attn: Mr Peter Clark, Director of
Research
30 Cannon Street
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United Kingdom

Luxembourg, 14 January 2014

Re: A Review of the Conceptual Framework for Financial Reporting

(Ref.: GT4 DCL 001-13)

Dear Peter,

On behalf of the Luxembourg accounting standards setter (CNC Luxembourg), we are writing to comment on the Discussion Paper "*A Review of the Conceptual Framework for Financial Reporting*" (the 'DP').

We would like to take this opportunity to thank the IASB for its participation to the first Luxembourg outreach event held jointly with EFRAG and CNC Luxembourg on 26 November 2013.

Overall, CNC Luxembourg welcomes the fact that the IASB has initiated a project on improving its Conceptual Framework. The 2011 Agenda Consultation revealed that many constituents consider it to be a priority project. Important areas were not covered by the existing Conceptual Framework. Other areas are out-of-date or conflicting with current standards while others have resulted in inconsistent application. CNC Luxembourg also agrees with limiting the scope of the DP to financial statements, although the title may lead to confusion.

Rather than commenting separately on each of the 26 questions included in the DP, CNC Luxembourg has chosen to comment on the following selected topics:

1. Status of the Conceptual Framework
2. Definitions of assets & liabilities, recognition / derecognition & measurement
3. Distinguishing liabilities from equity
4. Other comprehensive income (OCI) vs. Net income
5. Disclosures
6. Other concepts and objectives

If you would like to discuss our comments, please do not hesitate to contact us.

Yours sincerely,


Alphonse Kugeler
Chairman – CNC Luxembourg

1. Status of the Conceptual Framework

1.1. Agreement on the general approach

CNC Luxembourg generally agrees with the purposes of the Conceptual Framework as detailed by the IASB in the DP and is of the opinion that the Conceptual Framework must be the sole conceptual basis for future standard development and that any departure there from by the IASB should be exceptional and well-explained.

1.2. Departures should be exceptional

The Conceptual Framework should set out general principles applicable across industries. Departures should only be exceptional and it is anticipated that any such departure would result in thorough analysis of whether a corresponding change is required to the Conceptual Framework or whether it is the standard that is inadequate.

1.3. A solid foundation for principles-based standards

In this regard, we consider that the Conceptual Framework should ideally be the foundation for principles-based standards. As such, it is key that the Conceptual Framework is not reversed engineered to validate the options taken in existing standards. This would indeed defeat the very purpose of the Conceptual Framework and would call into question its legitimacy. Principles are foundations and – as a general rule – foundations cannot be moved. By analogy, when a legislative act is contrary to the constitution, it is not the constitution that is amended but the law that is declared unconstitutional. Similarly, Standards should be developed in line with the principles set out in the Conceptual Framework and not the other way around.

1.4. Stability of concepts & principles over time

Besides, we would expect the Conceptual Framework to remain rather stable over time. In this respect, it is important to strike the appropriate balance between a Conceptual Framework that is high-level enough and the more specific requirements in individual standards.

1.5. Contradictions are detrimental

We are mindful that possible contradictions with the revised Conceptual Framework may call its validity and authority in the standard-setting process into question. In our view, this would be detrimental to the overall purpose of the Conceptual Framework.

2. Definitions of assets & liabilities, recognition / derecognition and measurement

2.1. New / amended definitions provide improved clarity

CNC Luxembourg generally agrees with the new or amended definitions of an asset and a liability. These definitions are easier to understand and try to address inconsistent application issues in practice (confusion between the asset/liability and the in/outflow of economic benefits).

2.2. Recognition of assets: avoiding unintended consequences

Whilst we are in favor of a conceptual rethink as to what an asset or liability could or should be and are willing to accept that this may alter or depart from what we currently see, we are concerned that the proposed changes may result in the recognition of inappropriate assets or liabilities in the balance sheet (e.g. lottery tickets, workforce, fish in the open sea, etc.).

The need for a sanity check on items being recognized is important especially in light of the removal of probability criteria (and the replacement of 'expected' by 'capable' of producing benefits) both in the definitions and recognition criteria. Before issuing an exposure draft, we would suggest that the IASB clearly identifies the impact of the revised Conceptual Framework on the nature, scope and extent of assets/liabilities currently recognized. This would help avoid unintended consequences.

We consider that the definitions of assets & liabilities, recognition / derecognition criteria and measurement principles interact and should be considered together.

We welcome the introduction of the notion of derecognition (relevance and faithful representation) as a mirror image of the notion of recognition in the Conceptual Framework.

2.3. Risk and rewards as an indicator to assess control

With regards to the concept of control, we would suggest that risks and rewards related to an asset or liability are potentially an element, among others, to be considered in determining whether an entity maintains a degree of control over the item following a partial disposal. We would not necessarily view control and risks and rewards as two individual approaches that cannot be used simultaneously.

2.4. Liabilities to include constructive obligations

More specifically, regarding liabilities we support the preliminary view of the IASB as detailed in 3.62 ("*constructive obligations*") that the definition of a liability should not be limited to obligations that are legally enforceable but should also include constructive obligations.

There is however one conflict that remains to be resolved, namely the exclusion of restructuring plans according to IAS 37 due to the fact that there is no obligation to others.

2.5. Present obligation: past events & practically unconditional (view 2)

With regards to the present obligation, CNC Luxembourg would tend to agree with view 2 that a present obligation must have arisen from past events and be practically unconditional as there appears a more solid conceptual basis for this view than for view 3.

Having said so, CNC Luxembourg could equally live with view 3 ("*past events but may be conditional on the entity's future actions*"). It is interesting to note that the DP through the inclusion of 7 examples of possible liabilities (better balance in terms of common sense with view 2 vs. more liabilities recognised with view 3), fails to completely distinguish between the outcome of judgments under both views and indeed tables 3.2 and 3.3 result in the same liabilities being recognized under both views. Further application guidance would probably be needed to better distinguish between the two views.

2.6. Definitions of elements of the financial statements

CNC Luxembourg can agree with the Conceptual Framework providing for definitions of the elements of the financial statements, namely income, expenses, changes in equity (contributions/distributions, transfers between classes) and cash receipts/payments.

It is considered that the usefulness of the various financial statements for particular industries should be covered with IAS 1 "Presentation of financial statements".

2.7. "Mixed measurement model" provides more useful information

CNC Luxembourg also agrees with the discussions and proposals put forward regarding the mixed measurement approach.

As suggested by the DP, CNC Luxembourg indeed agrees that there is no single measurement basis that always provides the most useful information. In this context, it is generally accepted that some assets (and liabilities) are to be measured using a historical basis while others may or should be measured on a current basis.

A single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements. CNC Luxembourg therefore supports the mixed measurement model as we believe that – on balance – such model is more likely to provide the most useful information.

3. Distinguishing liabilities from equity

CNC Luxembourg generally agrees that there should be a clear distinction between equity and liabilities. Investors, banks and other lenders want to have information about the entity's leverage and its return on equity.

3.1. Issue to be tackled through amendment of the definition of liability

CNC Luxembourg can share the preliminary view of the IASB that the definition of equity should not be amended from being the residual interest in the net assets of an entity. Instead, we agree that the best way to tackle the current uncertainty relating to the distinction between liability and equity is through amending the definition of a liability.

3.2. Preference for the strict obligation approach

CNC Luxembourg would support the strict obligation approach as opposed to the narrow equity approach thus favoring the entity perspective as opposed to the proprietary perspective.

We indeed consider that the strict obligation approach is based on the objective characteristics of the instrument (across a large range of instruments and of legal & regulatory environments). The strict obligation approach also appears to be simpler to apply in a consistent manner.

In our view the criteria of 'obligation to deliver economic resources' is the right one. It is by the way the basis for what we already know under IAS 32 "*Financial instruments: Presentation*".

If particular exceptions do lead to counter-intuitive results, this could also be tackled by individual standards.

3.3. Primary and secondary equity claims

Primary equity claims and secondary equity claims are economically different. This is reflected by the IASB's different approach to measurement.

We do however wonder whether:

- for primary equity claims, instead of changing the statement of changes in equity, the same result could not be reached through disclosures (as total equity does not change but merely transfers are depicted);
- for secondary equity claims (the aim being to give information on potential dilution), how the remeasurement as a liability interacts with the basic principle of equity being the residual. The notion of wealth transfers should be further explored.

3.4. Situations where an entity has issued no equity instruments

CNC Luxembourg does not support the approach consisting of automatically treating the most subordinated class of instrument as if it were an equity claim.

We consider that there is a need for robust principles that would apply in these situations in order to provide users with relevant financial information.

4. Other comprehensive income (OCI) vs. Net income

4.1. Conceptual definition of OCI is essential

CNC Luxembourg considers that the development of a robust and complete set of principles to govern the items classified in other comprehensive income (OCI) as opposed to items classified in profit and loss (P&L) is vital in addressing the current confusion and debate. Failing to do so will result in preparers and investors favoring non-GAAP / non-IFRS measures such as EBITDA. Failing to do so will also adversely contribute to mistrust in financial statements and in particular to earnings management.

In our view, this section of Conceptual Framework covered in the DP is therefore essential.

4.2. P&L as a primary source for performance reporting

CNC Luxembourg considers that there are specific items for which OCI makes perfect sense such as own-credit risk, hedging transactions and exchange differences.

Still, we strongly support the principle of the P&L providing the primary source of information about the return an entity has made on its economic resources in a period.

4.3. Obligation to recycle of OCI items to P&L

CNC Luxembourg is in favor of an obligation to recycle all items of OCI to the P&L at some defined future date.

4.4. Preference for a narrow approach to OCI

CNC Luxembourg tends to favor the narrow approach to OCI.

In our view the broader approach lacks a conceptual basis and appears to be more of an attempt to fit the definition of OCI to its current use in existing standards rather than addressing the key question of what should be presented in OCI as opposed to P&L. Under

this approach we particularly question the rationale behind enabling such broad discretion to the IASB and/or management in deciding whether and when to recycle OCI amounts. Consequently, we tend to favor the narrow approach which appears to be conceptually more sound and less discretionary. In the same vein, we also question the conceptual basis underpinning the inclusion of transitory remeasurements.

5. Disclosures

5.1. Inclusion of a section on note disclosure is positive

CNC Luxembourg welcomes the inclusion of a section dealing with note disclosures in the Conceptual Framework. This clearly goes in the right direction.

However, we note that the current proposal is somewhat high level and too general in its description. We understand that the IASB is currently working on disclosure overload (more meaningful) and educational guidance on materiality. It is considered that the Conceptual Framework provides for a good opportunity to include those aspects.

5.2. Communication principles: a good starting point

CNC Luxembourg considers that the communication principles stated in paragraph 7.50 provide for a good starting point in order to ensure the usefulness and relevance of note disclosures.

6. Other concepts and objectives

6.1. Chapters 1 and 3 should not substantially amended

CNC Luxembourg generally considers that Chapter 1 "*The objective of general purpose financial statements*" and Chapter 3 "*Qualitative characteristics of useful financial information*" should a priori not be reconsidered.

That being said and depending on the outcome of the current discussions, the potential inclusion of concepts such as stewardship, reliability and prudence as well as of the concept of business model could lead to specific amendments in those chapters.

6.2. The objective of stewardship / accountability: yes but how?

CNC Luxembourg considers that there should be a balance between the financial statements objectives of stewardship (accountability) and the assessment of future cash flow prospects for existing and potential investors.

Yes, it is very important for investors to understand how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.

However, in practice, it is not an easy task to define how this stewardship objective would be reflected or served by the financial statements (e.g. appropriate disclosures).

6.3. Faithful representation encompasses the characteristics of reliability

CNC Luxembourg does not see in substance any value added in replacing faithful representation with reliability, as that was the case before in the old version of the Conceptual Framework.

The new qualitative characteristic might even be viewed as being broader and implicitly including the other one.

6.4. Reinserting prudence to confirm the need to use caution

CNC Luxembourg views prudence more as a state of mind rather than as a characteristic of financial information as such.

We do not believe that prudence is in contradiction with neutrality.

We consider that preparers should apply a certain degree of '*caution*' as part of the recognition and measurement of assets and liabilities (e.g. when making estimates and judgments).

CNC Luxembourg therefore considers that reinserting the term "prudence" to represent this caution is appropriate especially given the explicit reference to prudence in many existing IFRS.

In addition, we believe that the concept of prudence as embedded in the current balance of IFRS standards goes in the right direction (i.e. provisions for probable liabilities are recognized according to IAS 37 whereas contingent assets are not recognized due to the fact that the realization of income is not virtually certain).

The balance is right in current standards and we do not support a further bias towards liabilities or the creation of hidden reserves (by overstating liabilities and understating assets).

6.5. The use of the business model concept should be limited

CNC Luxembourg understands and agrees that different entities may have varying business models.

However, we do not support basing future standards on specific business models of entities as this would be detrimental to the comparability of the IFRS as a whole both within and across industries.

Besides, we believe that it would be extremely difficult to define in a general yet relevant fashion the concept of business model for inclusion in the Conceptual Framework.

Whilst we disagree with standards offering different accounting choices based on individual business models, we would favor the inclusion of appropriate relevant information in the notes to the financial statements so that users can best understand the activities and operations of a given entity.

Finally, CNC Luxembourg considers that the concept of business models could be used in individual standards on a case-by-case basis (e.g. IFRS 9: assets held to collect contractual cash-flows).

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