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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

SUBMISSION ON THE REVIEW OF THE *CONCEPTUAL FRAMEWORK*

Dear Ladies and Gentlemen

Thank you for the opportunity to comment on your review of the IASB *Conceptual Framework*.

The Australian Financial Reporting Council (FRC) has oversight of the accounting and auditing standards setting processes for the public and private sectors, provides strategic advice in relation to the quality of audits conducted by Australian auditors, and advises the Assistant Treasurer on these and related matters to the extent that they affect the financial reporting framework in Australia.

The FRC monitors the development of international accounting and auditing standards, works to further the development of a single set of accounting and auditing standards for world-wide use and promotes the adoption of these standards.

We note that the review has been framed in terms of a series of 26 specific questions. However as a body with a mandate to provide high level strategic oversight of accounting standards, it is more appropriate for the FRC to leave to other stakeholder bodies the task of commenting on most of the specific accounting issues.

The FRC is aware that the Australian Accounting Standards Board (AASB) will make a submission to the review addressing each of your questions, and we encourage the IASB to consider the AASB submission, which we understand reflects a detailed analysis of the discussion paper's preliminary views. We also draw your attention to the submissions of FRC members, including a joint submission by CPA Australia and Institute of Chartered Accountants Australia (ICAA); the Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC); and the External Reporting Board's New Zealand Accounting Standards Board.

As you are aware Australia was an early adopter of International Financial Reporting Standards (IFRS) from 1 January 2005, and has enthusiastically promoted a single set of high quality global accounting standards. In Australia we have adopted a transaction-neutral framework, with IFRS used as the basis of accounting standards in the for-profit, not-for-profit and public sectors. In our view it is important that the *Conceptual Framework* continues to allow for this integration of accounting standards across the economy. Therefore, the FRC encourages the IASB to use sector-neutral expression in the *Conceptual Framework* wherever possible, and to maximise its liaison with the International Public Sector Accounting Standards Board (IPSASB) regarding the Boards' respective conceptual framework projects, in the context of the Memorandum of Understanding between the IASB and the International Federation of Accountants (IFAC) dated 22 November 2011.

The FRC strongly supports the IASB in its objective of ensuring that the *Conceptual Framework* sets out the concepts that underlie the preparation and presentation of financial statements, with a focus on providing information for economic decision making purposes. An effective conceptual framework provides an important foundation for assisting in the development and revision of IFRS.

It would be useful to have the *Conceptual Framework* publicly available on the IFRS website. At present the Framework can only be accessed by paying subscribers. In our view this is not appropriate, as the *Conceptual Framework* is meant to explain the conceptual basis on which IFRS are developed and understood. We recommend the IASB make the *Conceptual Framework* freely available to better inform users of the conceptual foundation of financial reports based on IFRS.

We understand that the *Conceptual Framework* project is designed to improve financial reporting by providing a complete and updated set of concepts to use as the IASB develops and revises standards. The FRC acknowledges both the importance of the *Conceptual Framework* in the development of high quality IFRS, as well as the limitations identified by the IASB in relation to the existing Framework's scope and comprehensiveness.

In the process of evaluating the proposed amendments to the *Conceptual Framework*, the FRC has identified some concerns as to whether the options presented in the consultation paper are appropriate in the context of IASB objectives. We would like to acknowledge the valuable contribution of the paper *The conceptual framework: cornerstone of high quality financial reporting* written by Jan McCahey and Warren McGregor (September 2013). The paper highlights the importance of a conceptual framework and explains why the IASB's decision to reactivate the *Conceptual Framework* project is warranted. In particular, we would like to note the FRC's support for further work being completed to address the gaps identified in the existing Framework, especially where these relate to the scope of financial reporting and presentation and disclosure issues, in addition to the importance of the identified concepts being 'transaction neutral', that is, capable of being applied by all reporting entities.

In the context of the FRC agreement with the issues raised in the paper, this submission considers the following:

- the purpose of the *Conceptual Framework*;
- the importance of ensuring that the concepts used remain relevant;
- the extent to which concepts should have regard to their practical application when developing and revising IFRSs; and
- the overall usefulness of the proposed changes to the *Conceptual Framework*.

Purpose of the *Conceptual Framework*

A conceptual framework is essential to the production of high quality financial reports that meet the common needs of their users for economic decision making. The challenge in developing a conceptual framework is for it to be broad enough to allow individual accounting standards to be developed, but specific enough to ensure that they achieve consistent objectives.

The existing *Conceptual Framework* sets out the concepts that underlie the preparation and presentation of financial statements. It is designed to assist the IASB when developing and revising IFRSs. The FRC's submission to the International Integrated Reporting Council (IIRC) in December 2011 (see Appendix, also available at http://www.frc.gov.au/reports/submissions/FRC_submission_IIRC_final.pdf) sets out very clearly how we think the IASB should go about developing the *Conceptual Framework*.

The *Conceptual Framework* should seek to develop principles that are relevant to IFRS

The summary of the IASB consultation paper notes that one of the underlying motivations for this project is to address "*aspects of the existing Conceptual Framework that are out of date and fail to reflect the current thinking of the IASB*." We believe that it is important that the IASB completes a regular review of the *Conceptual Framework* to ensure the ongoing relevance of the principles underpinning IFRS. Nevertheless, for this to happen the principles should be focussed at such a level as to be not unduly affected by current practices.

The *Conceptual Framework* is designed to articulate the key concepts and principles that form the foundation of IFRS as *principles-based* financial reporting standards. These should be articulated in such a way as to maintain their relevance when developing and revising IFRS, without introducing redundant or confusing detail that may detract from the underlying concepts. Such detail could appear to amount to the *de facto* enunciation of principles, but ones which are either:

- insufficiently general; or
- more appropriately developed into regulatory principles, by the relevant regulatory authorities e.g. the International Organization of Securities Commissions, rather than principles underlying the reporting of financial information to an entity's stakeholders.

The *Conceptual Framework* should not seek practical application at expense of consistency

One of the stated purposes of the *Conceptual Framework* project is to improve its practicality. However, an undue focus on the practicality of the Framework risks blurring the distinction between the framework underpinning the standards and the standards themselves. A useful *Conceptual Framework* articulates the overarching principles needed to guide the development of IFRS, whereas individual standards have their own objectives. As such, exceptions to underlying concepts should occur within the standards themselves, accompanied by the appropriate rationale. The practicality of the Framework could instead be enhanced by making an introductory part of the *Conceptual Framework*:

- simpler (perhaps in plainer language) and designed to be read by key financial report stakeholders such as directors; and
- preferably shorter.

Alternatively, an abbreviated rendition of an introductory part of the *Conceptual Framework* could be developed as an executive summary for those stakeholders and issued as a complement to the Conceptual Framework. Such a document could usefully clarify that general purpose financial reporting is not intended to include all financial information about an entity and, in that context, could delineate more clearly the boundaries of general purpose financial reporting.

The recently released IIRC Framework has achieved both the above goals.

Specifying alternatives or exceptions within the *Conceptual Framework* rather than in the standards potentially compromises its relevance as a conceptual tool. We understand that exceptions listed within the Framework reflect perceptions about the acceptability or practicality of concepts, however the Framework should reflect principles that are unaffected by such perceptions. The Framework should focus on principle-based comprehensive concepts only.

The Framework should ensure that the principles underpinning IFRS are consistent, whereas specific standards are designed with sufficient detail to be applied in practice.

The Conceptual Framework project is a useful process to re-evaluate key accounting principles

The ongoing strength of the *Conceptual Framework* is attributed, in part, to the IASB review processes. These processes ensure that the underlying concepts remain relevant and, to the extent implied by the comments immediately above, practical.

It is critical that the *Conceptual Framework* includes sufficiently comprehensive principles to support the IASB's decision making when it develops or reviews IFRS. The IASB risks considering issues in an ad hoc, repetitive manner where these issues are not properly articulated in or omitted from the underlying framework, with potentially inconsistent outcomes.

The IASB should ensure that, on an ongoing occasional basis, key issues are assessed where appropriate and that relevant changes within the financial reporting environment are accommodated within the *Conceptual Framework*. To better accommodate changes in the financial reporting environments as they occur, the proposed amendments to the Framework should clarify and broaden the concepts underpinning IFRS. The IASB should take extreme care to ensure that amendments to the *Conceptual Framework* are not extended to the codification of current practice. The FRC welcomes the inclusion of basic principles regarding presentation and disclosure in the *Conceptual Framework*, since these are key matters for financial reports, and are matters where stakeholders have existing concerns. However we believe this would be more successful in the context of exploring the implications of the economic decision making objective of general purpose financial reporting for the types of information likely to be necessary to meet the common information needs of users of financial reports.

If you would like further information on this matter from the FRC, please contact the FRC Secretary, frcsecretary@treasury.gov.au or + 61 2 6263 3144.

Yours faithfully

Lynn Wood
Chairman
Financial Reporting Council

APPENDIX – FRC SUBMISSION TO IIRC 2011

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15 December 2011

Professor Mervyn King
Chairman
International Integrated Reporting Council
Email: dpresponses@theiirc.org

Dear Professor King,

I am pleased to provide a submission from the Australian Financial Reporting Council (FRC), drafted by its Integrated Reporting Taskforce ('the Taskforce'), in response to the *Towards Integrated Reporting – Communicating Value in the 21st Century* Discussion Paper issued in September 2011.

The FRC Integrated Reporting Taskforce

The Financial Reporting Council (FRC) is the peak body responsible for overseeing the effectiveness of the financial reporting framework in Australia. Its key functions include the oversight of the accounting and auditing standards setting processes for the public and private sectors, monitoring the effectiveness of the auditor independence regime, and advising the Minister on these matters.

The Taskforce is one of the five taskforces created by the FRC early this year. The taskforces have been established to assist the FRC in areas likely to be of strategic importance to the Australian financial reporting community in coming years.

Responses from key stakeholders
The Taskforce has sought and received input from a range of stakeholders:

Association of Superannuation Funds of Australia Limited (ASFA)
Auditing and Assurance Standards Board (AUASB)
Australian Accounting Standards Board (AASB)
Australian Institute of Company Directors (AICD)
Australian Prudential Regulation Authority (APRA)
Australian Securities and Investments Commission (ASIC).
Australian Shareholders' Association (ASA)
Australian Securities Exchange (ASX)
CPA Australia
Department of Finance and Deregulation

Department of the Treasury
Financial Services Council (FSC)
Group of 100 (G100)
Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC)
Institute of Chartered Accountants in Australia (ICAA)
Institute of Public Accountants (IPA)
New Zealand External Reporting Board (XRB)

The general feedback received is that the definition of integrated reporting and what it involves is unclear. While stakeholders agreed that integrated reporting provides a more comprehensive picture of a company for users of financial reports; many concerns were raised – particularly in relation to the resulting compliance burden on companies, the impact it has on directors' liability; and also the difficulty of providing the optimum level of guidance/prescription so that businesses can adapt to their specific circumstances, while enabling ease of comparability between different companies.

Overall comments

The FRC is supportive of the development of an International Integrated Reporting framework. However, the FRC believes that for reasons of practicality, integrated reporting should take the form of (1) the existing financial statements, and (2) a separate but connected statement on non-financial matters.

We have provided our detailed comments to the questions raised in the Discussion Paper in Attachment A to this letter. The FRC is of the view that the development of an Integrated Reporting conceptual framework should be of top priority for the IIRC – as any definitions, analysis and actions are ultimately dependent on the framework. The FRC has included in Attachment B a broad view on how the conceptual framework should be structured, for your consideration. An example of where such a framework has been implemented in practice is provided by the Australian Water Accounting Standards Board, where they have used by analogy the existing financial reporting conceptual framework. Information on their framework is provided for your information in Attachment C. After the conceptual framework is developed then standards will need to be built on this foundation.

If you would like to discuss any aspect of this submission or require any further information, please contact the Taskforce Secretary Bruce Donald on +61 2 6263 3148 or at bruce.donald@treasury.gov.au.

Yours sincerely,

Lynn Wood
FRC Chairman

Attachment A

In response to the specific questions raised in the Discussion paper:

1a. Do you believe that action is needed to help improve how organisations represent their value-creation process?

The Financial Reporting Council (FRC) agrees that the development of integrated reporting could assist organisations to better explain their value creation process. That development should respect what has been achieved thus far in financial reporting, and what is being aimed for. The FRC believes that integrated reporting should aim to complement, and not substitute, financial reporting. Integrated reporting must have as a principle that it does not add to complexity and makes reporting in totality more valuable to stakeholders.

1b. Do you agree that this action should be international in scope? Why or why not?

The FRC agrees that integrated reporting should be developed at an international level. The development of a broadly consistent international framework is much preferred over ad hoc integrated reporting requirements at the local jurisdictional level, especially as global entities will have to comply with regulations across several jurisdictions. Care should therefore be exercised to avoid the imposition of domestic integrated reporting requirements prematurely.

2. Do you agree with the definition of Integrated Reporting on page 6? Why/why not?

Page 6 of the Discussion Paper defines integrated reporting with the statement "*Integrated Reporting brings together the material information about an organisation's strategy, governance, performance and prospects in a way that reflects the commercial, social and environmental context within which it operates. It provides a clear and concise representation of how an organisation creates value, now and in the future.*" Such a description provides what integrated reporting seeks to achieve, but does not define what integrated reporting really is. This existing description also tends to imply that integrated reporting is a collection of reports, rather than truly integrated into one report.

The FRC recommends that the IIRC first develop the conceptual framework which would set out the overarching principles, then derive a definition of integrated reporting from the framework. The basic building blocks for such a framework can be derived from the financial reporting Framework (Appendix B). This framework was applied for water accounting in Australia (Appendix C).

The FRC is of the view that there should be recognition that, as for financial reporting, annual reports are aimed not only at shareholders, but also for employees, creditors, and suppliers, amongst other stakeholders. The common user needs between all stakeholders should be explained, otherwise there is a risk of disparate interests amongst users breaking down the integration.

Some less obvious issues that may form part of the integrated report are diversity and disability issues. The challenge for developing guidelines for integrated reporting is to include such matters which may not be material to individual entities, but are important on a social level and are of importance globally.

3. Do you support the development of an International Integrated Reporting Framework?

Yes. The development of a framework should continue, but carefully. An international Integrated Reporting framework should aim to complement and not replace financial reporting.

There is an existing conceptual framework for financial reporting – would that become a subset of the integrated reporting conceptual framework when developed? If the boundaries of financial reporting are to be opened (and we do not agree with this), there will need to be considerably more analysis of where this new framework sits. It has been and will be developed with the support of many parties, and is likely to be ranked highly among the future projects supported by the International Accounting Standards Board as a result of its current review of its agenda. Integrated reporting cannot swim against this tide simply by appealing to generalisations.

4a. Do you agree that the initial focus of Integrated Reporting should be on reporting by larger companies and on the needs of their investors? Why/why not?

The FRC agrees that large companies and perhaps large public sector entities should be the initial focus of experimentation. Application beyond large entities should not be rushed.

4b. Do you agree that the concepts underlying Integrated Reporting will be equally applicable to small and medium enterprises, the public sector and NFP organisations?

They should be, and the implications for each should be carefully evaluated. It would be undesirable for it to become a barrier to entry for smaller entities when they seek to grow. It would also be undesirable to divide capital markets arbitrarily as is currently done by the IFRS Trustees. The public sector is increasingly intertwined with the private sector and of such size and scope of operations in many countries that it must also be addressed.

5. Are (a) the organisation's business model; and (b) its ability to create and sustain value in the short, medium, and long term, appropriate as central themes for the future direction of reporting? Why/why not?

Themes for the future direction of reporting should flow from a properly constructed conceptual framework that clearly articulates user needs. The future direction of reporting should provide flexibility for companies to report information relevant to their own circumstances, otherwise it would be adding to the compliance burden. The principle of being valuable to users must apply.

Taking "the organisation's business model" to mean an organisation's model for implementation of its strategic direction i.e. the factors management considers when making decisions etc, the FRC sees it as appropriate for this to be communicated in the annual report. Entities can show what factors are important and relevant to them. Such an approach may mitigate costs and reduce complexity.

6. Do you find the concept of multiple capitals helpful in explaining how an organisation creates and sustains values? Why/why not?

The concept of stocks and flows is an old and tested economic concept, and one which is also employed in accounting conceptual frameworks. This should be useful for users of annual reports to understand the process in which an organisation creates and sustain values.

7. Do the Guiding Principles identified in the Discussion Paper provide a sound foundation for preparing an integrated reporting? – are they collectively appropriate; is each individually appropriate; and are there other Guiding Principles that would be added? Why/why not?

In the absence of a developed conceptual framework for integrated reporting, it is difficult for the FRC to comment.

The Guiding Principles appear relevant, but needs to be developed further. The FRC does not believe that the underpinning elements of an integrated report have been identified, and consider the ones listed to be closer to user needs than elements, but provide a good start.

The FRC believes in Guiding Principles, but we are of the view that they should be established in light of a conceptual framework which addresses the issues illustrated in Appendix B.

8. Do the content elements identified in the Discussion Paper provide a sound foundation for preparing an Integrated Report – are they collectively appropriate; is each individually appropriate; and are there other Content Elements that should be added?

See above.

9a. Do you agree with the main benefits as presented in the Discussion Paper?

It is difficult to argue that an annual report should not provide a rounded view of the entity. The FRC remains concerned that in achieving this, insufficient attention has been paid to financial reporting which has been often dismissed as complex and irrelevant. Integrated reporting needs to complement financial reporting

The FRC is of the view that enforcing businesses to issue integrated reports is unlikely to prove a good strategy in the short to medium term. It will bring integrated reporting into conflict with existing institutional and legal arrangements and we should learn from the long road that accounting standards have followed towards a global approach. International accounting standards are one of the few examples of global requirements, and the process of their development should be studied.

Once companies become aware of the possibility of integrated reporting requirements, there needs to be clear guidance on what it involves, what it seeks to achieve, and how it would be implemented, amongst other issues. However, such guidance needs to be balanced as the benefits sought may be diminished if the approach adopted is too prescriptive, and will likely lead to 'boilerplate' responses. Again the objective is value to the user.

9b. Do you agree with the main challenges as presented in the Discussion Paper?

Yes, but the challenges listed are not comprehensive. Some additional challenges are:

- Complexity – introducing a new reporting regime which aims to tie together multiple components will no doubt add complexity for the preparer. Although it is difficult to avoid complexity in the complex matter of corporate reporting, it is unsure whether integrated reporting will achieve any reductions in complexity. Nevertheless this must be the objective.

- Pace of change / Perceived rate of change: The community now has a view about the pace of change, and may not react well to additional requirements for integrated reporting, especially as it is still very uncertain what integrated reporting may involve.

- Assurance: Assurance will be required on integrated reports, and auditors will require an auditing framework. Institutionally, it is not clear how multiple auditors could be engaged to cover the breadth of integrated reporting. Currently, we do not require audits of annual reports beyond consideration of consistency with information in the financial reports.

- Selective reporting: There is a risk that companies would report only information that would reflect positively on the company, as it would not be possible to prescribe what should be reported.

- There is some risk of companies providing boilerplate disclosures in the absence of a comprehensive framework and standards.

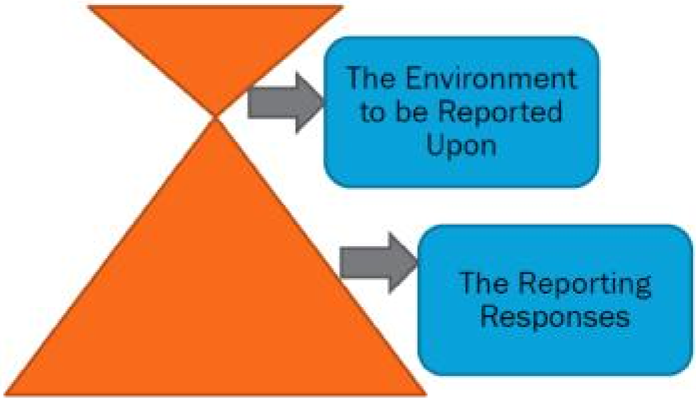
The place of integrated reporting alongside the plethora of other narrower (sector specific in many cases) existing sustainability reporting models could be clarified e.g. would it replace them or subsume them. Particular gains in reducing complexity would be achieved if these were no longer necessary under integrated reporting.

10a. Do you agree that the actions listed in the Discussion paper should be the next steps undertaken by the IIRC? Why/why not?

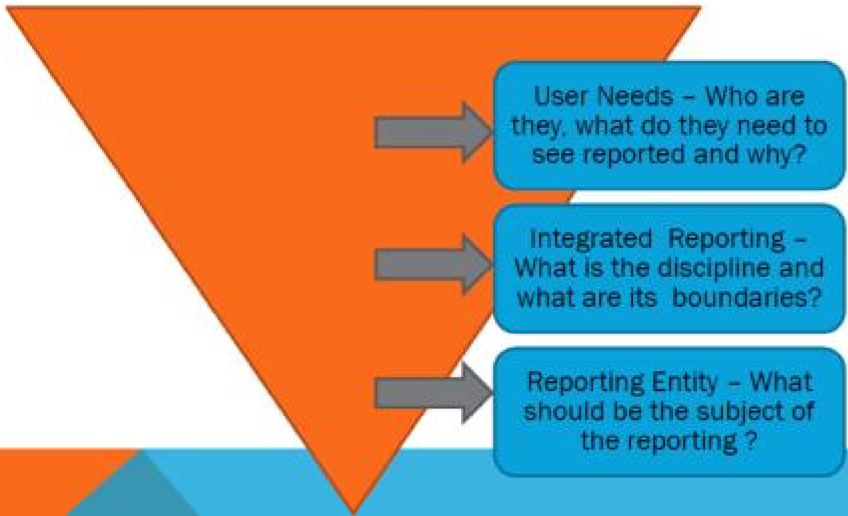
As stated above, the FRC believes that the first step should be to develop a conceptual framework and from that, a definition of integrated reporting. This must be carefully considered and developed, and should include technical considerations as well as broader objectives.

The FRC is of the view that the present pilot program is too pre-emptive. Without a conceptual framework and a clear definition, the benefits of the pilot program are minimal. The pilot should be implemented only after the framework and requirements are drafted, and should be used to test the feasibility and adequateness of the guidelines.

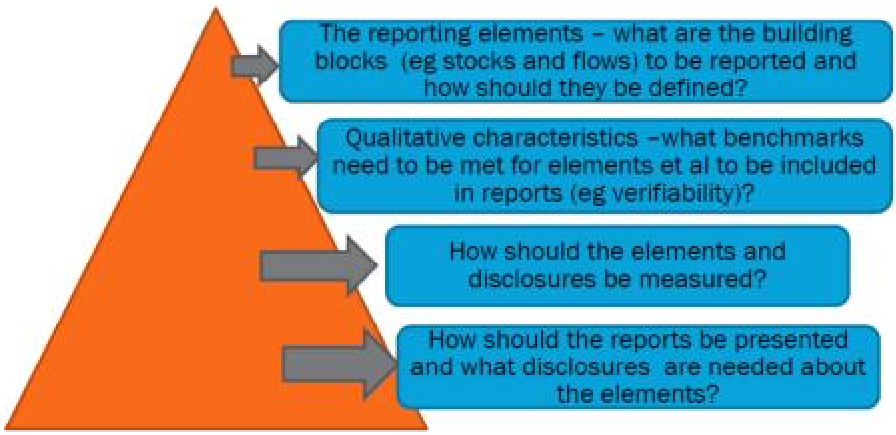
CONCEPTUAL FRAMEWORK DESIGN



THE ENVIRONMENT



THE REPORTING RESPONSES



Attachment C (available at
http://www.bom.gov.au/water/about/consultation/document/WACF_August09.pdf)

Water Accounting Conceptual Framework (WACF)

The goals of water accounting are to assist in meeting the information needs of users in making water related decisions, and to instil public and investor confidence in the amount of water being traded, extracted for consumptive use and recovered and managed for environmental and other public benefit outcomes. The theoretical foundation of water accounting is contained in the Water Accounting Conceptual Framework for the preparation and presentation of General Purpose Water Accounting Reports (WACF). The primary purpose of the WACF is to guide the development of Australian Water Accounting Standards (AWAS) to ensure they remain cohesive and integrated. However, preparers can draw on the WACF for principle based guidance in assisting the preparation and presentation of general purpose water accounting reports where the AWAS are not sufficient for their requirements. The WACF has been used to develop the Preliminary Australian Water Accounting Standard (PAWAS) which will undergo a practical test through the Methods for the Pilot National Water Account.

The WACF comprises a Preface and eight Statements of Water Accounting Concepts (SWACs). It has been written in consultation with water industry experts, financial accountants, and financial accounting standard setters.

The WACF has been published for public comment. The Water Accounting Standards Board (WASB) invites feedback on the practical application of the existing WACF document. This feedback will be taken into account when the WACF is formally reviewed following the publication of the first National Water Account at the end of 2010.

Comments in relation to the WACF will be made available to the public at the end of 2010 for the purpose of reviewing the WACF unless the respondents request confidentiality. Requests for confidentiality will not be granted unless supported by good reason, such as commercial confidence. Names and addresses will not be made available.

Email feedback to: wasbofeedback@bom.gov.au . If you have any questions relating to water accounting and WASB, please see Frequently Asked Questions or email your additional question to wasbo@bom.gov.au .

To read the WACF as a single document, download it here.

Or read the individual sections:

- WACF Introduction
- SWAC 1 - Definition of the Water Reporting Entity
- SWAC 2 - Objective of General Purpose Water Accounting Reports

- SWAC 3 - Qualitative Characteristics of General Purpose Water Accounting Reports
- SWAC 4 - Definition of Elements of General Purpose Water Accounting Reports
- SWAC 5 - Recognition of the Elements of General Purpose Water Accounting Reports
- SWAC 6 - Quantification of Attributes of Elements of General Purpose Water Accounting Reports
- SWAC 7 - Compliance Disclosures in General Purpose Water Accounting Reports
- SWAC 8 - Assurance of General Purpose Water Accounting Reports