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February 25, 2014

Mr. Hans Hoogervorst
Chair
International Accounting Standards Board
30 Cannon Street
London
United Kingdom

Re: Comment Letter on Conceptual Framework Discussion Paper: Overview

Dear Mr. Mr. Hoogervorst,

The CFA Institute[1], in consultation with its Corporate Disclosure Policy Council ("CDPC")[2], appreciates the opportunity to comment on the International Accounting Standards Board's ("IASB" or the "Board") Discussion Paper, *A Review of the Conceptual Framework for Financial Reporting* ("Conceptual Framework DP).

CFA Institute is comprised of more than 100,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

[1] With offices in Charlottesville, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 116,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 137 countries, of whom nearly 108,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 138 member societies in 60 countries and territories.

[2] The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

SUMMARY OF APPROACH

We welcome the efforts undertaken by the IASB to improve the Conceptual Framework. The conceptual nature of the discussion paper; its foundational, yet indirect, link to existing or future standards; and the challenge in identifying how changes in the conceptual framework will result in improvements in financial reporting which are important to investors; make seeking input from the investor community on the Conceptual Framework DP particularly challenging.

Discussion papers of this nature are an example of where the IASB can work with those steeped in the language of accounting and financial analysis to assist in the translation and communication of the potential impact of such changes to investors and assist in gaining their feedback on the proposals.

We think it is important for the IASB to illustrate the impact that changes in the conceptual framework will have on existing standards and the items investors perceive as in greatest need of improvement by standard setters. To that end we have responded to those areas where we think investor input may be most needed and our response has been focused on the elements of the conceptual framework which we believe may have the most direct and immediate impact on improving financial reporting for investors. We have summarize the contents of the Conceptual Framework DP below and highlighted in bold our areas of focus. In order to make our responses accessible to our membership, we have provided separate comment letters on the four topics in bold below:

- Elements of Financial Statements
- Additional Guidance to Support the Asset and Liability Definitions
- Recognition & Derecognition
- **Definition of Equity & Distinctions Between Liability & Equity**
- **Measurement**
- **Presentation & Disclosure**
- **Other Comprehensive Income**
- Other Issues:
- Chapters 1 (The Objective of General Purpose Financial Reporting) &
  - Chapter 3 (Qualitative Characteristics of Useful Financial Information) of the Existing Conceptual Framework (Stewardship, Reliability & Prudence)
  - Business Model
  - Unit of Account
  - Going Concern
  - Capital Maintenance

In the section which follows we consider several other topics we felt it was important to provide an investor perspective to the Board.

ADDITIONAL COMMENTS

In addition to our separate comment letters on the Definition of Equity & Distinctions Between Liability & Equity; Measurement; Presentation & Disclosure; and Other Comprehensive Income we provide several additional comments related to Other Issues in Section 9 of the Conceptual Framework DP.

Stewardship, Reliability & Prudence – We have considered the Board's discussion of stewardship (Paragraphs 9.5 to 9.9), reliability (Paragraphs 9.10 to 9.13) and prudence (Paragraphs 9.15 to 9.22). We believe recent discussions amongst stakeholders have not properly characterized the removal of these concepts from the conceptual framework. Each of the concepts has, in our view, been used historically at times to justify the introduction of bias, elimination of neutrality and the reduction in use of measurements that investors find most useful in their analysis of financial statements (i.e. fair value).

We agree with the Board's analysis and discussion of these concepts in the Conceptual Framework DP and their bases for not including them in the conceptual framework. We make several additional observations on each below:

1) *Stewardship* – We agree with the explanation in Paragraph 9.9 that many stakeholders to the standard-setting process did not understand, or did not have a consistent understanding of, the concept of stewardship. Certainly investors seek to evaluate whether management has effectively and efficiently deployed the resources entrusted to it. But it has been our long-standing view that the notion of stewardship has been used by some to favor management bias or intent-based accounting in financial reporting. Rather, it is our view that financial reports should be prepared on a neutral basis with amounts reported which faithfully represent the market values of assets and liabilities and the cash flows of the entity and which depict the income and expense of the organization in a manner that allows investors to make their own unbiased assessment of management's performance. For example, the total return on an investment portfolio is the best measure of management's "stewardship" of those assets. When any portion of that portfolio is measured at historical cost, with gains and losses recognized when management chooses, then total return becomes a meaningless statistic.

   Management, in our view, can utilize disclosures or discussions of results outside of the financial statements to articulate their perspective on how the resources under their control have been effectively and efficiently deployed. They need not utilize the concept of stewardship to introduce management bias or intent-based accounting in the measurement or production of financial results as this reduces the comparability and decision-usefulness of financial information for investors.

   Overall, we do not support the inclusion of the notion of stewardship in the conceptual framework as we believe is not well understood, is subject to a substantial degree of interpretation, and has been used to justify management bias in the production of financial results – all of which are not attributes of high-quality, decision-useful information for investors.

2) *Reliability* – In our Comprehensive Business Reporting Model (CBRM) and on pages 1 to 20 of our supplement to our 2010 Comment Letter to the FASB on their Financial Instruments Project we explain our views on the primacy of relevance over reliability and our concern that some equate verifiability with reliability as pointed out by the Board in Paragraph 9.11. We have seen stakeholders set forth the arguments, improperly in our view, in favor of reliability in Paragraph 9.12. As we have said on numerous occasions in our correspondence to the Board, some highly reliable and verifiable numbers are completely irrelevant to users of financial statements. Accordingly, relevance should have primacy over reliability or verifiability. We believe investors understand the notion of faithful representation and we believe the chart in Paragraph 9.13, and the discussion in Paragraph 9.14, rightly articulates the differences and illustrates why the use of the term faithful representation is more effective for use in the conceptual framework than reliability.

3) *Prudence* – The recent dialogue on the concept of prudence is troubling to CFA Institute. The term prudence, in its original usage, is meant to be incontrovertible. To be against prudence is to be imprudent. Used in the accounting context, the notion of prudence is meant to introduce bias – generally perceived as conservative bias – to amounts recognized or measured in the financial statements.

   The problem with prudence is that it can never be neutrally (given it calls for a bias) or evenly (because it is entirely judgmental) applied. We agree with the observations made by the Board in Paragraph 9.18 on this point. The arguments in favor of prudence as set forth in Paragraph 9.19 are ones which we have heard but with which we disagree, as we do with the discussion in the last sentence of Paragraph 9.21, which suggests that financial statements should reject the notion of neutrality in favor of conservatism.

   Those who support the concept of prudence believe it is needed to counter incentives and bias that may occur from the preparer. The issue with including prudence in the conceptual framework, or in accounting standards, is that management's interpretation of prudence for one entity is likely different from prudence applied by management of another entity.

   Even more troubling to investors is that supporters of prudence believe that prudence can (and should) be used by management to override accounting standards when management believes such standards provide misleading outcomes. This idea runs counter to the perspective that management is overly optimistic. Here supporters are arguing that the same overly optimistic management has sufficient insight, discipline or rigor to know when it is appropriate to override accounting standards. Their proposed use of prudence supports management override of accounting standards in those circumstances management believes appropriate – a perspective which obviates the need for accounting standards in the first place. Sophisticated investors recognize that this use of prudence reduces the comparability and usefulness of financial statements because it introduces entity specific management bias in the preparation of results and ultimately does not provide a "true and fair view" of financial results. The ability to invoke the concept of prudence in support of the "true and fair override" would, in our view, decrease the usefulness, comparability and reliability of IFRS. If management believes an accounting standard produces an anomalous result, they should advocate to standard-setters for a change in the accounting rules rather than overriding their application.

   As touched upon in the discussion in Paragraph 9.22, as we have experienced the dialogue on prudence it seems that support for prudence is, for many, a means of reducing or rejecting fair value measurements – though many in support of prudence will argue this is not the case. Much empirical research has been done in the five years since the onset of the financial crisis which illustrates that fair value measurements did not cause the financial crisis and that fair value measurements do a better job of reflecting market realities for investors. We think it would be useful to have an open debate on fair value rather than have it indirectly through the notion of prudence.

   Further, we have observed that some who support prudence are equating financial reporting for investors with financial reporting to prudential regulators. Financial statements prepared under IFRS are to be prepared with the objective of providing investors with decision-useful information not to provide information to prudential regulators who have an entirely different mandate and the ability to request/demand information which investors – an authority that investors do not have.

We agree with the Board that a sufficient case has not been made for the explicit inclusion of prudence in the conceptual framework. In our view, any further discussion regarding the addition of prudence to the conceptual framework must be subject to an open and public debate.

Business Model – Our views on the business model approach are also articulated in our separate comment letter to the Conceptual Framework DP on measurement. That said, we think it is important to separately reiterate our views against inclusion of the business model in the conceptual framework. The Board points out in Paragraph 9.24 that the term business model was first used when developing IFRS 9, *Financial Instruments.* In preparing our 2010 Comment Letter to the FASB on their Financial Instruments Project, we comprehensively articulated on pages 6 – 10 of our supplement to that letter why we do not support the use of business model as a means of determining when or how amounts are recognized or measured in the financial statements. As we noted in that document, "management intent" has been relabeled "business model", but neither management intent nor business model alters the value of assets or liabilities. Investment decisions are made relative to market conditions, not entity-specific management based perspectives on the value of assets and liabilities. As such, we cannot support the concept of business model discussed in Paragraphs 9.23 through 9.34 being embedded within the conceptual framework.

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Thank you for the opportunity to comment on the Conceptual Framework DP. If you or your staff have questions or seek further elaboration of our views, please contact either Matthew Waldron by phone at +1.212.705.1733, or by e-mail at matthew.waldron@cfainstitute.org or Sandra J. Peters, CPA, CFA by phone at +1.212.754.8350 or by email at sandra.peters@cfainstitute.org.

Sincerely,

/s/ Sandra J. Peters

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CFA Institute

/s/ Ashwinpaul C. Sondhi

Ashwinpaul C. Sondhi
Chair Corporate Disclosure Council

cc: Corporate Disclosure Policy Council