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Dear Sir or Madam

Getting a Better Framework
Bulletins – Prudence, Reliability of Financial Information & Uncertainty

We welcome the opportunity to comment on the EFRAG's Getting a Better Framework Bulletins on Prudence, Reliability of Financial Information & Uncertainty ("the Bulletins").

In summary, our views are that;

(i) Prudence should be included in the Conceptual Framework (the "Framework") as an enhancing characteristic of faithful representation, but should be described as the general exercise of care in making judgements to ensure assets, liabilities, income and expenses are not overstated or understated (see Appendix 1); and

(ii) Reliability still exists as a characteristic in the Framework through reliable measurement in the recognition criteria and "verifiability", one of the enhancing characteristic of faithful representation (see Appendix 2); and

(iii) Uncertainty should be factored into both the definition of an element and the recognition criteria, the thresholds for the disclosure of contingent assets and liabilities should be the same and should be based on the "possible" outflow or inflow of economic benefit (see Appendix 3).

Our detailed responses to the questions raised in the Bulletins are set out in the attached appendices.

If you would like to discuss any aspect of this response please do not hesitate to contact me.

Yours faithfully

DLWilcox

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Question (i)
Is there a role for prudence in the development of accounting standards? If so, should it (i) focus on recognition and measurement criteria, and the timing of recognition of gains and losses; or (ii) be described as the general exercise of caution?

In our view, prudence historically resulted in overly cautious judgements which could be used to introduce bias into financial reporting particularly in respect of earnings. Therefore, we do not consider prudence to be an appropriate criterion for recognition (including items recognised in other comprehensive income) or measurement.

Bias can arise not only from overstatement of assets and income and understatement of liabilities and expenses but also from understatement of assets and income and overstatement of liabilities and expenses, in certain circumstances. Adopting caution can result in judgements which give more weight to negative outcomes than positive outcomes and, as such, are not balanced. Prudence can be defined as "caution" but can also be defined as "care". Hence, we would suggest prudence is described as the general exercise of care in making judgements to ensure assets, liabilities, income and expenses are not overstated or understated.

Question (ii)
Does the current Framework adequately reflect the essence of prudence, or do you share the tentative view that its role should be explicitly considered? If so how would you characterise the level of caution you believe should be observed? References to various views in the Bulletin would be helpful.

We agree that prudence should be explicitly covered in the Framework, but in our opinion it should be incorporated as an enhancing characteristic of faithful representation rather than a qualitative characteristic in its own right.

As detailed in our response to question (i) above, we consider prudence would be better expressed as "care", rather than "caution", and that it should be applied so that assets, liabilities, income and expenses are not overstated nor understated.

Question (iii)
Are there requirements in current IFRS not mentioned in this Bulletin which fail to reflect prudence? Are there requirements in current IFRS which in your view are overly prudent?

The use of "objective evidence", i.e. an incurred loss model, when considering impairment is an example of a failure in current IFRS to reflect prudence. However, we acknowledge that the Exposure Draft on credit losses looks to address this by proposing an expected loss model.

There are further examples of an imbalance in the application of prudence to assets and liabilities, such as deferred tax and defined benefit plans, where assets recognised in respect of these items are restricted but liabilities are not. However, we consider the recognition of assets only when they are recoverable, and liabilities where there is an unavoidable obligation, to be appropriate.

The failure to recognise certain internally generated intangible assets is an area where there may be over prudence. Some intangible assets that are recognised in a business combination, such as customer lists or publishing titles, are capable of being sold separately. Hence, those intangible assets would be identifiable, and could meet the recognition criteria of probable expected future economic benefits and reliable measurement when internally generated.

Question (iv)
Do you have any other comments on this Bulletin?

No, our comments are set out in our responses to questions (i) to (iii) above.

Question (i)
Are there any arguments for either of the views set out in the Bulletin that we have not discussed?

In assessing whether reliability still exists as a characteristic in the framework, neither of the arguments consider the definition of reliability and whether reliability is sufficiently addressed by verifiability (defined in the framework as meaning; *"different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation."*).

We also consider there to be quantitative and qualitative issues. There are instances where disclosures can enhance the reliability of measurement, but there are also circumstances where an item cannot be recognised as it is not capable of reliable measurement but disclosures can provide relevant and reliable information for users of the financial information.

Question (ii)
Which view do you support? Why?

We agree that there is scale between information that is easily corroborated, such as a bank balance, and information that is more subjective and could be considered to be less reliable. There are a lot of estimates and subjectivity in current IFRS but, in the most part, those estimates and subjectivities reflect commercial uncertainties.

On balance, we support View 1 that reliability still exists in the Framework. In our view, this is through the recognition criteria and verifiability, one of the enhancing characteristics of faithful representation.

The Framework notes three characteristics of faithful representation; *complete, neutral and free from error*. One of the criteria for recognising items in the financial statements is that the item can be measured with reliability, and the footnote in the Framework states; *"information is reliable when it is complete, neutral and free from error"*. If the same three characteristics are required for faithful representation and reliability, reliability must still exist as a characteristic (even if it is implicit rather than explicit).

The definition of verifiability, i.e. that different knowledgeable and independent observers could reach a consensus, reflects the estimation and subjectivity required in IFRS.

We agree with View 1 that relevance and reliability are both present in the Framework and are both necessary. However, we view relevance as the primary characteristic and agree that inclusion of reliability as an enhancing characteristic of faithful representation is appropriate.

Question (i)
Are there any arguments for either of the views set out in the Bulletin that we have not discussed?

No, we consider the views expressed address the key arguments.

Question (ii)
Which view do you support? Why?

We support View 2 as to recognise assets and liabilities that are remote can create levels of measurement uncertainty that diminish reliability to a point where the information provided is no longer relevant. In such instances, we agree that disclosures are more useful to users of the financial statements.

We also consider, for information to be fair and balanced, there should not be different thresholds for disclosure of contingent assets and liabilities, e.g. the current requirements in IAS 37 to disclose contingent liabilities unless outflows are remote but to disclose contingent assets only when inflows are probable.

Question (iii)
What are your views on the different ways in which a probability-threshold could be applied?

We agree that a recognition threshold is necessary but that there are too many different thresholds in current IFRS. For unconditional rights and obligations, we agree with the current use of "probable future economic benefits" in the recognition criteria in the Framework. However, we would like to see the definition of "probable" (i.e. more likely than not) included in the Framework. We would suggest the use of "possible" (i.e. that may occur) as a threshold for disclosure of both contingent assets and contingent liabilities, and that this term is also defined in the Framework.

We have commented in our response to various IASB exposure drafts on the use of probability-weighted averages for measurement. For some items (such as portfolios of debt), this measurement basis can be appropriate where the probability-weighted averages are verifiable. For others, such as some legal action, developing probability-weighted averages can result in amounts recognised or disclosed in the financial statements that do not equate to any of the possible amounts receivable or payable when the uncertain matters are resolved.