International Accounting Standards Board

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Request for Information Third Agenda Consultation

FAR, the Institute for the Accountancy Profession in Sweden, is responding to your invitation to comment on the above Request for Information Third Agenda Consultation.

FAR welcomes the request from IASB regarding future work plan with the following objectives

(a) the strategic direction and balance of the Board's activities;

(b) the criteria for assessing the priority of financial reporting issues that could be added to the work plan; and

c) new financial reporting issues that could be given priority in the Board's work plan.

FAR's detailed comments are set out in appendix to this comment letter. However, FAR's main comments are summarised below:

NIFRICs

During the last few years, there has been a substantial increase in the number of NIFRICs and since 2020 the authority of NIFRICs have been clarified. This clarification is beneficial as it clarifies the status of NIFRICs. However, FAR still identifies several concerns with NIFRICs;

1) risk of an incomplete due process,
2) leading to a more rules-based over principles-based system,
3) their legal status (especially in the European Union where NIFRICs are not endorsed by the European Commission)
4) should we or can we do analogies from the NIFRICs?

Instead of issuing NIFRICs FAR believes that many of these issues should be part of IASB's standard setting such as separate projects or part of Annual improvements.

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Intangible Assets

FAR believes there is a need to review and update IAS 38. IAS 38 was adopted and issued over 20 years ago. IAS 38 needs to be aligned with the rapid technological and digital change in the world.

At the very least, FAR thinks that the recognition criteria in IAS 38 needs to be analyzed.

Yours sincerely,

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Chairman, FAR Strategy Group Accounting

Appendix

Question 1—Strategic direction and balance of the Board’s activities

The Board’s main activities include:

- developing new IFRS Standards and major amendments to IFRS Standards;
- maintaining IFRS Standards and supporting their consistent application;
- developing and maintaining the IFRS for SME's Standard;
- supporting digital financial reporting by developing and maintaining the IFRS Taxonomy;
- improving the understandability and accessibility of the Standards; and
- engaging with stakeholders.

Paragraphs 14–18 and Table 1 provide an overview of the Board’s main activities and the current level of focus for each activity. We would like your feedback on the overall balance of our main activities.

(a) Should the Board increase, leave unchanged or decrease its current level of focus for each main activity? Why or why not? You can also specify the types of work within each main activity that the Board should increase or decrease, including your reasons for such changes.

(b) Should the Board undertake any other activities within the current scope of its work

Response to (a) and (b)

The current level of focus for each of the Board’s main activities is well balanced, and the Board should in our opinion leave it unchanged.

Question 2—Criteria for assessing the priority of financial reporting issues that could be added to the Board’s work plan

Paragraph 21 discusses the criteria the Board proposes to continue using when assessing the priority of financial reporting issues that could be added to its work plan.

(a) Do you think the Board has identified the right criteria to use? Why or why not?

(b) Should the Board consider any other criteria? If so, what additional criteria should be considered and why?

Response to (a) and (b)

The seven criterias used by the Board are all relevant. Therefore, FAR neither proposes removals or additions to the criteria. However, in light of recent academic discussions on the usefulness of financial statements to investors we would like to address the first criterion: the importance of the matter to investors.

The main function of accounting is to turn cash flows into earnings through accruals. Consequently, most of IFRS—and the proposed work plan—relate to accruals. Producing accruals-based financial statements is a costly activity, which is motivated by the superior usefulness of accrual accounting over cash accounting.

Research shows that over the last 50 years, the usefulness of earnings for stock market investors has declined relative to the usefulness of cash flows (e.g., Adame et al., 2019). The decline coincides with a decrease in the ability of accruals to smooth temporary timing fluctuations in operating cash flows (Bushman et al., 2016). Recent research focuses on more detailed data to identify which types of accruals contribute to the relative decline in earnings usefulness. Lewellen and Resutek (2016) distinguish between accruals directly related to within period transactions and non-transaction accruals. The latter include, for example, changes in value of existing assets and liabilities. The findings are confirmed by Ball and Nikolaev (2021), who show earnings excluding non-transactional items outperform operating cash flows. Marton and Starica (2021) investigate the usefulness of different earnings numbers. They show that while the usefulness of bottom-line earnings relative to cash flows declines over time, EBITDA and gross profit consistently outperforms operating cash flows.

The implication for the Board is that, for example, accruals related to changes in value of assets and liabilities (including depreciation and amortization, which is excluded from EBITDA) do not render earnings more useful. This effect is gradually increasing in importance over time. FAR proposes that the Board initiates a research project to bring clarity into the overall usefulness of accruals resulting from IFRS, and which standards increase the usefulness of earnings. Ultimately, IFRS will only be successful if they are useful for intended users, such as equity investors. While each individual standard may be well motivated, in aggregate earnings can result in less useful earnings numbers. Recent research also points to implications for which financial reporting issues the Board should focus on, as discussed under Question 3 below.

The referred research is empirically based on US GAAP. We believe it is applicable to IFRS due to the substantial similarity between IFRS and US GAAP. However, the findings should be confirmed in an IFRS setting. In addition, the research focuses on using financial statements for valuation purposes on an equity market. In its standard setting, the Board needs to take a broader perspective, and consider, for example, lenders and the stewardship function of financial statements.

Another area where FAR has concerns is IFRS ICs agenda decisions. There has been a considerable increase in the number of issues submitted to the IFRS IC. The issues that IFRS IC deals with are widespread and cover areas that can have a material impact for many companies. When the IFRS IC considers that raised issues can be solved within an IFRS and/or the Conceptual Framework, the IFRS IC provides a material explanation how to apply an IFRS and/or the Conceptual Framework for a specific area. This is referred to as a 'NIFRIC'.

During the last few years, there has been a substantial increase in the number of NIFRICs and since 2020 the authority of NIFRICs have been clarified. This clarification is good from one perspective, i.e. making the status of NIFICs clearer. But what FAR sees as the first concern with NIFRICs are the due process. It is normally important issues that is raised with short comment period and then it results in a NIFRIC with the status as stated in Due process handbook. FAR thinks that these questions need the same due process as IFRICs or changes in IFRS.

FAR sees a risk with all these NIFRICs in relation to the principle that IFRS is principle based. All NIFRICs lead to more rule-based system where the possibility of making company specific judgements based on the underlying transactions and events, i.e. consider entity specific circumstances, will decrease. FAR's opinion is that it is important to maintain the principle-based nature of IFRS.

FAR also sees a risk regarding the status of the NICRIC. Even if it has been clarified in the Due Process Handbook it is still uncertain what their legal status is. This problem is even more serious in the European Union because the NIFRICs are not adopted/endorsed by the European Commission.

A fourth problem with the increase of NIFRICs is their applicability in other situations where similar facts and circumstances exist. Should or can they be used for similar issues, i.e. should we or can we do analogies from the NIFRICs.

Instead of issuing NIFRICs FAR believes that many of these issues should be part of IASBs standard setting such as separate projects or part of Annual improvements.

Question 3—Financial reporting issues that could be added to the Board's work plan
Paragraphs 24–28 provide an overview of financial reporting issues that could be added to the Board's work plan.

(a) What priority would you give each of the potential projects described in Appendix B—high, medium or low—considering the Board's capacity to add financial reporting issues to its work plan for 2022 to 2026 (see paragraphs 27–28)? If you have no opinion, please say so. Please provide information that explains your prioritization and whether your prioritization refers to all or only some aspects of the potential projects. The Board is particularly interested in explanations for potential projects that you rate a high or low priority.

(b) Should the Board add any financial reporting issues not described in Appendix B to its work plan for 2022 to 2026? You can suggest as many issues as you consider necessary taking into consideration the Board's capacity to add financial reporting issues to its work plan for 2022 to 2026 (see paragraphs 27–28). To help the Board analyze the feedback, when possible, please explain:

(i) the nature of the issue; and
(ii) why you think the issue is important.

Response to (a) and (b)

In this section, FAR highlights issues that could be added to the Board's work plan and motivate our choice of issues. FAR is fully aware that all these issues cannot be added over the next few years but hope the Board will find the input useful in choosing between issues.

Primary Financial Statements

To the extent that findings in the research discussed for Question 2 above is confirmed, a few issues should have increased importance. First, the currently ongoing standard setting project on Primary financial statements is important, in particular relating to the presentation of subtotals in the statement of profit and loss. As research indicates, some of these subtotals are potentially substantially more useful than bottom-line earnings. The issue of Other Comprehensive Income, listed among potential projects in Appendix B, could be important as it constitute a vehicle for presenting accruals that are not useful outside the statement of profit and loss.

Statement of Cash Flows

Secondly, the Statement of cash flows, mentioned in Appendix B, is important to the extent that investors rely on cash flow information for equity investment decisions. Currently, it is often not possible to use the statement of cash flows to identify two measures deemed important to investors: cash from operations and free cash flows.

Intangible assets

Over the last few decades, the importance of intangible assets has increased in the economy. Kahle and Stulz (2017) show that investments in intangible assets have increased over time in relation to investments in tangible assets, and recently the former surpassed the latter in absolute numbers. Research indicates that this has both led to a decrease in earnings quality (Srivastava, 2014) and a decline in the number of listed firms (Stulz, 2020).

If the board decides to add intangible assets to its work plan, it is important to be aware of some economic characteristics of such assets that cannot be easily remedied through financial reporting. First, compared to tangible assets, some intangible assets are easily replicated as their use by one firm does not preclude the simultaneous use by another firms (Kahle & Stulz, 2017). Second, intangible assets are often complementary, in that their value is highly dependent on their joint use with other resources.

FAR believes there is a need to review and update IAS 38. IAS 38 was adopted and issued over 20 years ago. IAS 38 needs to be aligned with the rapid technological and digital change in the world. At the very least, FAR thinks that the recognition criteria in IAS 38 need to be analyzed. Some examples of areas to focus on are:

- Current project management approaches, such as agile software development, for internal development of intangible assets is not compatible with the waterfall model used in IAS 38.
- The agenda decision 'Configuration or Customization Costs in a Cloud Computing Arrangement ', published in April 2021 illustrates that the current guidance is not adequate to allow for

capitalization of new ways to make use of intangibles, which does not have the same characteristics as the intangible assets that IAS 38 was once designed to capture.

- Another area which is not dealt with in IAS 38 is variable or contingent consideration which currently leads to a mixed practice.
- The development of cryptographic assets of various kinds is not properly dealt with under current IFRSs. The IFRS IC issued an agenda decision on this topic which showed that there is a lack of guidance in current standards. In a project where the recognition and measurement scope under IAS 38 is addressed, the issue of cryptographic assets could also be included.

Discount rate

Several IFRS permit or require entities to measure assets or liabilities by discounting estimates of future cash flows to their present values. Different standards require different inputs to be reflected in such present values and uses different discount rates.

Example of IFRS that use present value measurement techniques (sometimes with references to other standards):

- IAS 19 Employee Benefits
- IAS 36 Impairment of Assets
- IAS 37 Provisions, Contingent Liabilities and Contingent Assets
- IAS 40 Investment property
- IAS 41 Agriculture
- IFRS 5 Non-current Assets Held for sale and Discounted Operations
- IFRS 9 Financial instruments
- IFRS 10 Consolidated Financial Statements
- IFRS 13 Fair Value Measurement
- IFRS 15 Revenue from contract with customers
- IFRS 16 leases

Differences in concepts and definitions create both confusion and inconsistencies and there is a need for additional guidance in relation to:

- Clarification of the difference between different concepts and definitions (put in context) and the connection between measurement basis and measurements inputs.
- Based on different use of different discount rates develop guidance/discussion on when to use real vs nominal interest rates
- Discussion and concepts behind the use of a pre-tax interest rate vs post-tax

Question 4 - Other comments

Do you have any other comments on the Board's activities and work plan? Appendix A provides a summary of the Board's current work plan.

Response

We do not have any other comments.

References

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