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November 25, 2015

Via E-Mail: commentletters@ifrs.org

Hans Hoogervorst, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

**Re: Exposure Draft ED/2015/3 Conceptual Framework for Financial Reporting**

Dear Chair Hoogervorst:

On behalf of the California Public Employees' Retirement System (CalPERS), thank you for the opportunity to provide our comments on the International Accounting Standards Board's (IASB) Exposure Draft (ED) regarding Conceptual Framework for Financial Reporting (CF).

CalPERS is the largest public defined benefit pension fund in the United States (U.S.) with approximately $300 billion in global assets, voting in over 10,000 annual public meetings. CalPERS invests these assets on behalf of more than 1.72 million members, retirees and beneficiaries.[1] CalPERS strives to achieve long-term, sustainable, risk-adjusted returns consistent with our fiduciary duty. To do so, we are guided by the CalPERS Investment Beliefs in our approach to strategic decision making. In particular, Investment belief #4 states that "long-term value creating requires the effective management of three forms of capital: financial, physical and human." Accordingly, we are strong advocates of reform that ensures the improvement, integrity and effective management of corporate financial reporting.

Corporate financial reporting plays an integral role in the capital markets by providing transparent and relevant information about the economic performance and condition of businesses. As a core issue, CalPERS expects fair, accurate and timely reporting on how financial, human and physical capital are employed to generate sustainable economic returns. Although the U.S. has not adopted International Financial Reporting Standards (IFRS), CalPERS is a global investor in companies reporting in IFRS and supports high quality global standards.

CalPERS is a founding member in the International Corporate Governance Network (ICGN) and contributed to the ICGN letter (dated 13 November, 2015). We agree with ICGN on the need to emphasize the importance of IASB's review and work on the CF.

[1] CalPERS at a Glance, November 2015. https://www.calpers.ca.gov/docs/forms-publications/calpers-at-a-glance.pdf

The CF shapes decisions on current and future accounting standards. The CF is important to users of financial reporting as it provides a structure outlining a high level of principles and variables, along with the reasoning used in defining accounting standards. CalPERS believes responsible long-term stewardship and capital maintenance are important concepts that should drive the principles in the CF. The CF should focus on the needs of current investors in their capital allocation decisions. We agree with and support the ICGN's response letter on Conceptual Framework dated 13 November 2015.

CalPERS believes management's stewardship and providing the information necessary for investor stewardship should be prominent in the CF. Stewardship aims to promote the long term success of companies. Stewardship refers to the responsibility of management on the oversight and use of an entity's resources. Management has a responsibility to manage risks to ensure proper oversight and accurate recording of an entity's resources and liabilities. It is important that investors are provided the opportunity to assess the stewardship of management ensuring adequate information to make capital allocation and voting decisions.

The CF includes eight main topics covering a wide breadth and depth of important characteristics underlying financial reporting. Some of these topics were covered in the 2013-Discussion Paper. Below, we provide our high level responses to some of the proposed changes outlined in the ED as well as some more detailed responses to certain questions.

**Chapter 1 - Objective of General Purpose Financial Reporting**

**Question 1—Proposed changes to Chapters 1 and 2**
**Do you support the proposals:**

**(a) to give more prominence, within the objective of financial reporting, to the importance of providing information needed to assess management's stewardship of the entity's resources;**

Yes, CalPERS supports an increased focus on financial reporting objectives to ensure shareowners have the necessary reporting information to not only assess management's stewardship but also assess how effectively the board of directors provides overall oversight of management and the company.

Without a stewardship objective in financial reporting, such reporting may become excessively focused on forward-looking predictions and estimates of future cash flows. Shareowners and future investors need financial information based on stewardship to gain a comprehensive understanding of how an entity generates returns and increases value to shareowners as well as the importance and understanding of the board's oversight role on risk.

CalPERS also believes that stewardship information should include environmental and social performance data. We strongly support the Memorandum of Understanding between the IASB and the Integrated Reporting Council (IIRC) that will deepen their cooperation in developing an integrated corporate reporting framework. CalPERS agrees an integrated reporting framework will improve the quality and consistency of global corporate reporting to deliver value to investor and the wider economy.[2]

## Chapter 2 - Qualitative Characteristics of Useful Information

**Question 1—Proposed changes to Chapters 2**

**(b) to reintroduce an explicit reference to the notion of prudence (described as caution when making judgments under conditions of uncertainty) and to state that prudence is important in achieving neutrality;**

Prudence is a necessary characteristic in financial reporting. We agree with the sentiment that prudence is needed to counteract management's desire to project optimism. We support the need for honest and accurate reporting. We agree with the Basis for Conclusions on the Conceptual Framework that prudence should not allow for hidden reserves, excessive provisions or deliberate understatement of assets and overstatement of liabilities. Investors do not believe financial reporting should accept unconditional conservatism but would prefer solid evidence in support of recognition and would prefer a process to reduce the probability of overvaluing assets. The 2008 financial crisis had examples of companies leaning towards higher valuation of assets and the desire to project optimism because it results in short-term financial rewards.

**Question 1—Proposed changes to Chapters 2**

**(e) to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information?**

Financial reporting should be relevant and enable investors to evaluate risks and rewards. Information should be complete and reliable (faithful representation) ensuring any off-balance sheet items are appropriately disclosed. We agree that a more objective basis to achieve a faithful representation of assets and liability, in which neither management's intentions nor the reporting model affects the measurement of assets or liabilities. Also, financial information must be verifiable, with consistent application of standards to ensure comparability. We agree with the CF's current concept on materiality:

> Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity.[3]

We look forward to responding to the IASB's exposure draft on the concept of materiality due 26 February 2016.

## Chapter 3 – Financial Statements and the Reporting Entity

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[2] IASB and International Integrated Reporting Council Memorandum of Understanding, December 2014. http://www.ifrs.org/Use-around-the-world/Pages/IASB-and-IIRC-MoU.aspx

[3] International Financial Reporting Standards, Section 2.11 Materiality, May 2015. http://www.ifrs.org/Current-Projects/IASB-Projects/Conceptual-Framework/Documents/May%202015/ED_CF_MAY%202015.pdf

**Question 2—Description and boundary of a reporting entity**
**Do you agree with:**

**(a) the proposed description of a reporting entity in paragraphs 3.11–3.12**

Yes, we agree with the proposed description of a reporting entity. We also agree with the concept that the CF is based on the assumption that the reporting entity is a going concern and will continue in operation for the foreseeable future. It is assumed that the entity has neither the intention nor the need to liquidate or cease trading.

However, CalPERS also believes the importance of the CF as a guide to the auditing profession, and the criteria for going concern should be more explicit and provide a longer period of lead time in the evaluation of going concern. Our recommendation is based on CalPERS' contribution to the presentation to the Public Company Accounting Oversight Board's Investor Advisory Group (IAG), Working Group on Going Concern.[4]

The IAG's working group found a weakness in the definition of going concern. The definition used by auditors set a very a high hurdle. As a result, the IAG stated, "the auditor is unlikely to give advance notice in a going concern report, and management is unlikely to provide investors early warning disclosures, until it is too late."[5] There is a need to establish more appropriate guidance.

As part of the IAG working group, CalPERS noted the top ten U.S. bankruptcies between 2001-2011 where only two of the ten received a going concern opinion. Additionally the top ten U.S. issuers receiving assistance through the trouble asset relief program (TARP), nine of the ten received a clean opinion prior to the financial crisis providing investors no warning of their eventual failure or need for bail-out.

**Question 2—Description and boundary of a reporting entity**
**Do you agree with:**

**(b) the discussion of the boundary of a reporting entity in paragraphs 3.13–3.25?**

The CF outlines what defines a reporting entity and the importance of providing financial information. It is very important to investors that an entity controlling one or more other entities should prepare consolidated financial statements, but noting that unconsolidated financial information is also necessary and should be presented together with the consolidated financial statements.

## Chapter 7 – Presentation and Disclosure

[4] Public Company Accounting Oversight Board , Investor Advisory Group Meeting, Working Group -Going Concern & Related Global Initiatives, March 28, 2012. http://pcaobus.org/News/Events/Pages/03282012_IAGMeeting.aspx

[5] Ibid, Going Concern Considerations and Recommendations, March 28, 2012. http://pcaobus.org/News/Events/Documents/03282012_IAGMeeting/Going_Concern_Considerations_and_Recommendations.pdf

**Question 11—Objective and scope of financial statements and communication**
**Do you have any comments on the discussion of the objective and scope of financial statements and on the use of presentation and disclosure as communication tools?**

The CF highlights aggregation as information that is more useful by summarizing a large volume of detail. It also points out that a balance needs to be found so that relevant information is not obscured either by providing too much detail or by not providing enough detail if information is aggregated at a high level. At one point in time, the Financial Accounting Standards Board (FASB) and the IASB identified a joint Financial Statement Presentation Project.[6] Many investors, including CalPERS, supported moving the project forward to an exposure draft to support the boards' actions to ensure substantive presentation of the financial position of companies. CalPERS believes that improving the format of financial statements will benefit markets not only by improving the quality and organization of financial information but by facilitating a process for better investment decision making. We would support the CF providing additional information in the financial statements to:

1. Portray a cohesive financial picture of an entity's activities
2. Disaggregate information so that it is useful in predicting an entity's future cash flows
3. Help users assess an entity's liquidity and financial flexibility.

The CF should consider providing additional information through disaggregation, roll-forwards and reconciliation schedules which benefit all users of financial statements.

CalPERS supports the IASB's exploration on how to distinguish between liabilities and equity in its Financial Instruments with Characteristics of Equity research project. We agree that as the IASB goes through its normal due process, the CF will require changes based on any active project on financial instruments.

CalPERS looks forward to providing comments on the IASB's deliberations on financial instruments. In 2010, CalPERS provided comments to the FASB regarding accounting for financial instruments.[7] We continue to strongly believe the need for an improved and consistent financial reporting model for the recognition, measurement and presentation of financial instruments.

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[6] Financial Statement Presentation Project, FASB & IFRS, May 3, 2011.
http://www.fasb.org/project/financial_statement_presentation.shtml

[7] CalPERS letter to the FASB regarding File Reference No. 1810-100 Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities, September 30, 2010.
http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175821408803&blobheader=application%2Fpdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=237206&blobheadervalue1=filename%3D1418-_1810-100_CALPERS_ANNE_SIMPSON.pdf&blobcol=urldata&blobtable=MungoBlobs

CalPERS continues to support the need for one set of high quality accounting standards. We recommend better coordination and collaboration between the IASB and the FASB, as each continue work on its own Conceptual Framework for Financial Reporting.[8]

Thank you for the opportunity to provide our comments. If you have any questions, please do not hesitate to contact me at (916) 795-9058 or James.Andrus@calpers.ca.gov.

Sincerely,

JAMES ANDRUS
Investment Manager,
Global Governance

cc: Anne Simpson, Investment Director, Director of Corporate Governance

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[8] FASB Exposure Draft on Conceptual Framework for Financial Reporting, Issued 24 September 2015. http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176166402450&acceptedDisclaimer=true