DP/2013/1
Review of the Conceptual Framework

Public Discussion

Frankfurt am Main, 25 October 2013

History of the project

IASB/FASB joint project

- *Conceptual Framework* chapters completed in 2010:
  - Objective of financial reporting
  - Qualitative characteristics
- Exposure Draft in 2010: *The reporting entity*

IASB project based on feedback from IASB Agenda Consultation 2011

- July 2012 Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*

Current project timeline

18 Jul 2013
Issue DP

6-month comment period
(14 Jan 2014)

Q4 2014
Issue
Exposure Draft

End 2015
Final issue
Revised Framework

Scope of the project

Current *Conceptual Framework* project

- Not a fundamental rethink
- Update, improve and fill in gaps
- No immediate changes to existing IFRSs (normal due process would be required)

Purpose of the Discussion Paper

- Starting point for discussion and outreach
- Seek views on key issues from interested parties

Do you think the project has an appropriate scope? What should be the implication of a revised Conceptual Framework for existing IFRSs?

Discussion Paper – July 2013

Focus

- Purpose of the Conceptual Framework
- Elements of financial statements
- Recognition and derecognition
- Distinction between liabilities and equity
- Measurement
- Presentation and disclosure, including the distinction between profit or loss and OCI
- Other issues (business model, unit of account, going concern, capital maintenance)

Role of the Conceptual Framework

IASB proposal to refocus the role

- Primary purpose is to assist IASB when developing and revising IFRSs
- Important role in helping other parties
  - To understand and interpret existing IFRS
  - To develop accounting policies when no IFRS specifically applies to a particular transaction or event
- Some “IASB only” guidance not applicable for other parties
- In rare cases the IASB may decide to issue new or revised Standards that conflict with an aspect of the *Conceptual Framework* in order to meet the overall object of financial reporting

Do you agree with the proposal?

Assets and liabilities (1/4)

Existing definitions

Asset	Liability
• a **resource** controlled by the entity • as a result of **past events** • from which **future economic benefits** are **expected** to flow to the entity	• a **present obligation** of the entity • arising from **past events** • the settlement of which is **expected** to result in an outflow from the entity of resources embodying **economic benefits**

Existing recognition criteria

- probable that future economic benefit flow to or from the entity
- cost or value can be measured with reliability

Assets and liabilities (2/4)

Need for clarifications

- Risk of confusing:
  - the resource or obligation, with
  - the inflows or outflows of economic benefits that the resource or obligation may generate
- Unclarity relating to the meaning of “expected” and the probability of recognition criteria

Assets and liabilities (3/4)

IASB proposal

Asset	Liability
• A **present economic resource** controlled by the entity as a result of **past events**	• a **present obligation** of the entity to transfer an **economic resource** as a result of **past events**

- An economic resource = a right, or other source of value, that is **capable** of producing economic benefits

Do you think the proposal improve the asset and liability definitions?

Asset and liabilities (4/4)

IASB proposal to remove recognition criteria in the *Conceptual Framework*

- There may be cases when an entity should not recognise some asset or liability:
  - If recognising would provide users with information that is not relevant, or not sufficiently relevant to justify the cost
  - If no measurement of the asset or liability would result in a faithful representation of the asset or liability, or of changes in the asset or liability.

Do you agree with the proposal to remove recognition criteria in the *Conceptual Framework*?

Distinction between equity and liabilities (1/6)

Reasons to (re)address the distinction

- Existing IFRSs do not classify instruments consistently (eg written call options on own shares classified as liability under IAS 32 vs. Employee stock options classified as equity under IFRS 2)
- Standards (IAS 32) use complex criteria that:
  - conflict with the conceptual definitions
  - are difficult to understand and apply
- Concerns of constituents with the requirements in current IFRSs, especially IAS 32

Distinction between equity and liabilities (2/6)

Discussion paper discusses two potential approaches

- Strict obligation approach
- Narrow equity approach

No analysis of other approaches in the DP due to:

- Complexity, lack of understandability and inconsistency with the conceptual definition of a liability (?)

Distinction between equity and liabilities (3/6)

Strict obligation approach (IASB proposal)

- Equity: the residual interest in the assets of the entity after deducting all its liabilities
- Reflects the current approach in the *Conceptual Framework*
- Expanded statement of changes in equity to show wealth transfers between equity holders

Narrow equity approach:

- Equity: Existing equity instruments in the **most residual class** of equity instruments issued **by the parent**
- Definition of most residual class subject to development or revision of particular Standards
- Underlie the thinking of some exceptions in IAS 32

Distinction between equity and liabilities (4/6)

Strict obligation approach	Narrow equity approach
Liabilities Trade payables Bank loans Bonds	Liabilities Trade payables Bank loans Bonds Written call options EE stock options Non-controlling interests
Equity Written call options EE stock options Non-controlling interests Common stock	Equity Common stock

Distinction between equity and liabilities (5/6)

Example: Depiction of wealth transfer

	Existing shareholders of parent		Non-controlling interests (NCI)	Obligation to issue shares	Total
	Share capital	Retained earnings			
Opening 1 January 20X2	10,000	20,000	4,000	-	34,000
Written option issued	-	-	-	5,000	5,000
Total profit/ comprehensive income for X2	-	3,500	200	-	3,700
Change in fair value of written option	-	1,000	-	-1,000	-
31 December 20X2	10,000	24,500	4,200	4,000	42,700

Distinction between equity and liabilities (6/6)

IASB proposal

- Strict obligation approach
  - Obligation to issue equity instruments are not liabilities
  - Remeasurement of each class of equity claims (subject to decisions in particular Standards); recognition of changes as wealth transfer in the statement of changes in equity
- If the entity has issued no equity instruments, it may be appropriate to treat most subordinated class of instruments as equity claim (subject to IASB decision in developing or revising particular Standards)

Do you agree with the proposal relating to the distinction between equity and liabilities?

Measurement (1/4)

IASB proposal

- Objective of measurement is to faithfully represent relevant information about:
  - the resources of the entity and claims against the entity, and changes to those resources and claims
  - how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources
- Mixed measurement model; three measurement categories
  - Cost (adjusted for depreciation, impairment etc…)
  - Current market prices (including fair value)
  - Other cash-flow based measures
- Number of different measurements used should be smallest number necessary

Measurement (2/4)

Selecting measurement

- Consider the information produced in the statement of financial position and the statement(s) of profit or loss and other comprehensive income (OCI)
- Most relevant measurement will depend on:
  - How an asset contributes to future cash flows
  - How a liability will be fulfilled or settled
- For the depiction of some transactions and events the IASB might decide that more than one measure is relevant
  - Disclose other measure in the notes
  - Using one measure in the statement of financial position and a different measure in profit or loss (reporting the difference in OCI)
- Cost/benefit considerations

Measurement (3/4)

Implications of IASB proposal

Assets	Liabilities
• **Using →** likely outcome: Cost • **Selling →** likely outcome: Current market price • **Holding for collection →** likely outcome : Cost (but no derivatives) • **Charging for right of use →**likely outcome: Cost or current market price	• **Settled according to terms →** likely outcome: Cost (but no derivatives) • **Liabilities without stated terms →** likely outcome: Cash-flow-based • **Performance →** likely outcome: Cost • **To be transferred →** likely outcome: Current market price

Measurement (4/4)

Factors for cash-flow based measurement

- Amount and timing of cash flows
- Time value of money
- Uncertainties in the amount and timing of cash flows
- The price for bearing the risk of variations in cash flows
- Own credit
- Other factors such as illiquidity

Do you agree with the measurement proposals?

Disclosure and presentation (1/7)

Main issues addressed in the DP

- Terminology *presentation* vs. *disclosure*
- Objective and scope of the primary financial statements
  - Classification and aggregation
  - Offsetting
  - Relationship between primary financial statements
- Objective and scope of the notes
- Materiality guidance
- Communication principles

Disclosure and presentation (2/7)

Presentation

- Disclosure of financial information on the face of the primary financial statements.

Scope of the primary financial statements

- the statement of financial position;
- the statement of profit or loss and OCI;
- the statement of changes in equity; and
- the statement of cash flows.

Disclosure

- The process of providing useful financial information about the reporting entity to users.

Disclosure and presentation (3/7)

Objective of the primary financial statements

- Provide summarised information about recognised assets, liabilities, equity, income, expenses, changes in equity and cash flows that has been classified and aggregated in a manner that is useful to users of financial statements in making decisions about providing resources to the entity.

Classification and aggregation

- *by function*
- *by nature*
- *by measurement*

Disclosure and presentation (4/7)

Offsetting

- Offsetting will generally not provide the most useful information
- In some cases the IASB might permit offsetting in particular Standards (considering faithful presentation and cost/benefit issues)

Relationship between primary financial statements

- No primary financial statement has primacy over the other primary statements and they should be looked at together.

Disclosure and presentation (5/7)

Objective of the notes

- Supplementary information to the primary financial statements about:
  - the assets, liabilities, equity, income, expenses, changes in equity and cash flows of the entity; and
  - how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources

Disclosure and presentation (6/7)

Scope of the notes

- Information about the reporting entity as a whole
- The amounts recognised in the entity's primary financial statements, including changes in those amounts, for example, disaggregation of line items, roll-forwards and reconciliations;
- The nature and extent of the entity's unrecognised assets and liabilities;
- The nature and extent of risks arising from the entity's assets and liabilities (whether recognised or unrecognised);
- The methods, assumptions and judgements and changes in those methods, assumptions and judgements, that affect amounts presented or otherwise disclosed.

Disclosure and presentation (7/7)

Materiality guidance

- No change to existing guidance in the *Conceptual Framework*
- IASB considers developing additional guidance or education material outside of the *Conceptual Framework* project

Communication principles

- A set of principles as guidance for the IASB when it develops or amends disclosure guidance in IFRSs

Do you agree with the proposed additions to the *Conceptual Framework* relating to disclosure and presentation?

Distinction between profit or loss and OCI (1/5)

Reasons to address the distinction in the *Conceptual Framework*

- Lack of clarity on role of profit or loss and OCI
- Perceived inconsistency for IASB’s use of OCI in particular Standards
- Lack of conceptual basis for income recycling

Distinction between profit or loss and OCI (2/5)

Potential criteria for the distinction listed in the DP

Profit or loss	OCI
• Realised	• Unrealised
• Recurring (persistent)	• Non-recurring
• Operating	• Non-operating
• Measurement certainty	• Measurement uncertainty
• Short-term	• Long-term
• Under management control	• Outside management control

IASB's view

None of them can be used in isolation to define what should be included in profit or loss, ie not operational and meaningful

Distinction between profit or loss and OCI (3/5)

DP explores potential items for OCI

- Mismatched remeasurements
  - Current remeasurement information incomplete (eg effective portion of changes in fair value in cash flow hedge)
- Bridging items
  - Two different measures (eg IFRS 9 Classification and Measurement ED [changes in FV], Insurance contracts ED [changes in discount rate])
- Transitory remeasurements
  - Long-term; remeasurement expected to reverse or change significantly
  - remeasurement enhances profit or loss as the primary indicator of the return the entity has made on its economic resources (eg pensions remeasurement)

Distinction between profit or loss and OCI (4/5)

	Narrow Approach	Broad Approach
Items eligible for OCI?	• Mismatched remeasurements • Bridging items	• Mismatched remeasurements • Bridging items • Transitory remeasurements
Recycling	• Always • Driven by the category and the reason why the item went into OCI	• Sometimes • Bridging and mismatched always Transitory remeasurements – only if it provides relevant information
Result	• Less discretion for the IASB	• More discretion for the IASB

Distinction between profit or loss and OCI (5/5)

IASB proposal

- Retain the split between profit or loss and OCI
- OCI should be limited to items of income and expense resulting from changes in current measures of assets and liabilities
- To permit or require at least some items of income and expense previously recognised in OCI to be recognised subsequently in profit or loss (ie recycling)

Do you think the proposals address the concerns and questions from constituents relating to the distinction between profit or loss and OCI?

Conceptual Framework chapters revised in 2010 (1/4)

Issues raised by constituents

- Emphasis of stewardship
- Removal of prudence
- Reliability vs. faithful representation

Conceptual Framework chapters revised in 2010 (2/4)

Stewardship

- Pre-2010 Conceptual Framework made explicit reference to Stewardship, the revised objective of financial reporting in Chapter 1 does not use the word ‘stewardship’.

Concerns raised

- Stewardship/accountability should be a primary objective
- Some believe stewardship should be the overarching objective of IFRSs

Do you think the IASB should revise Chapter 1 relating to the prominence of accountability/stewardship?

Conceptual Framework chapters revised in 2010 (3/4)

Prudence

- Pre-2010 Conceptual Framework listed prudence as a degree of caution in the exercise of the judgements made under conditions of uncertainty such that assets or income are not overstated and liabilities or expenses are not understated.
- IASB removed prudence because of inconsistency with neutrality (understating assets and overstating liabilities in one period leads to overstatement of financial performance in later periods).

Do you think the IASB should reintroduce prudence?
If so, what should be the meaning of prudence?

Conceptual Framework chapters revised in 2010 (4/4)

Reliability

- Pre-2010 Conceptual Framework stated that ‘reliability’ was a qualitative characteristic of useful financial information, Chapter 3 revised in 2010 replaced ‘reliability’ with ‘faithful representation’

Concerns raised

- The concept of reliability is better understood, and easier to explain, than faithful representation
- Information is not useful if users cannot rely on it
- Reintroducing reliability would be more likely to result in the use of measurements that are more verifiable and less subject to error

Do you think the IASB should reintroduce reliability?

Other issues (1/2)

IASB proposal - Business model

- For developing or revising particular Standards the IASBs considers how an entity conducts its business activities
- No definition of the term 'business model' in the *Conceptual Framework*

IASB proposal - Unit of account

- Decisions about the unit of account when developing or revising particular Standards

Do you think the CF should refer to the business model?
Do you agree with IASB's unit of account proposal?

Other issues (2/2)

IASB proposal - Going concern

- Three situations where going concern assumptions are relevant:
  - Measurement of assets and liabilities
  - Identification of liabilities
  - Disclosures about the entity

IASB proposal - Capital maintenance

- No change to the existing description of capital maintenance in the *Conceptual Framework*; A new or revised Standard on accounting for high inflation would indicate a need for change in the *Conceptual Framework*.

Do you support the proposals?

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