STAFF PAPER

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REG IASB Meeting

Project	**Conceptual Framework**
Paper topic	Summary of potential inconsistencies between the existing Standards and the *Conceptual Framework* Exposure Draft

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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

24. Sitzung IFRS-FA am 09.01.2015
34_06b_IFRS-FA_CF_Inconsistencies

Purpose of paper

1. This paper summarises potential inconsistencies between the requirements of existing Standards and the concepts that the IASB has tentatively decided to include in an Exposure Draft of a revised *Conceptual Framework* (the Exposure Draft).

2. The staff do not propose any changes to the existing Standards that contain potential inconsistencies identified in this paper. Any decision to amend an existing Standard would require the IASB to go through its normal due process for adding a project to its agenda and for developing an Exposure Draft and an amendment to that Standard. However, the staff recommend that:

   (a) the IASB publishes an explanation of the implications of its proposed changes to the *Conceptual Framework*;

   (b) it includes that explanation in the Basis for Conclusions accompanying the Exposure Draft of the proposed changes; and

   (c) the explanation includes the points set out in paragraph 14.

Background and feedback

3. Paragraph 1.22 of the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the 'Discussion Paper') stated that:

> The IASB will not necessarily change existing Standards for any of the areas discussed in this *Conceptual Framework*. Any decision to amend an existing Standard would require the IASB to go through its normal due process for adding a project to its agenda and for developing an Exposure Draft and an amendment to that Standard.

4. Many respondents expressed the view that the IASB should undertake and publish a review of existing Standards and Standards under development to identify potential conflicts with the revised *Conceptual Framework*:

> …we strongly suggest that the IASB provide an appendix in the ED outlining the impact of the Proposed CF on existing standards as well as standards in development. The Conceptual Framework discussion can be highly theoretical and abstract. Such an appendix would be of great assistance to allow constituents to better understand the impact of the proposed changes to the Conceptual Framework. *Canadian Bankers Association*

5. Respondents made a number of suggestions for how the IASB should deal with any conflicts identified by this review, including:

    (a) any conflicts identified should be highlighted in the IASB's next agenda consultation;

    (b) existing Standards should not be amended just because of a conflict with the revised *Conceptual Framework* if those Standards have not caused problems in practice;

    (c) any conflicts should lead to a revision of the affected Standard or an explanation of why the IASB considers no revision is needed.

Purpose and scope of review

Purpose

6. The purpose of the review was to identify inconsistencies between the requirements of existing Standards and the concepts that the IASB has tentatively decided to include in the *Conceptual Framework* Exposure Draft. Identifying those inconsistencies will help the IASB and its constituents to understand the possible implications of the Exposure Draft proposals.

7. This Agenda Paper summarises the main potential inconsistencies that have come to our attention. Some of the inconsistencies identified in this paper have already been highlighted in papers for earlier IASB meetings.

Scope

8. The review covered the main text of existing Standards and Interpretations and of the Exposure Drafts issued for the projects currently on the IASB agenda. The review excluded Standards and Interpretations that will have been superseded by other recently issued Standards before the revised *Conceptual Framework* becomes effective (for example, the Standards and Interpretations that will be superseded by IFRS 15 *Revenue from Contracts with Customers*).

9. We did not consider as part of this review whether there are any implications for the *IFRS for Small and Medium-sized Entities* (SMEs), which has a separate section on concepts and pervasive principles underlying the financial statement of such entities. In May 2013 the IASB decided that the *Conceptual Framework* should be considered for incorporation into IFRS for SMEs only when the revised *Conceptual Framework* has been issued.

10. For some areas, for example for recognition and measurement, the Exposure Draft will propose that the IASB should specify in individual Standards requirements that, for the particular transactions, result in information that best satisfies the qualitative characteristics of useful financial information. We have not, as part of this review attempted to predict the judgements the IASB would make in those areas if it were to revisit existing Standards applying the concepts now proposed.

11. We have not identified the following requirements as being inconsistent with the *Conceptual Framework*:

    (a) requirements that, although consistent with the concepts now proposed, are currently rationalised using different concepts in the Basis for Conclusions; and

    (b) requirements that seem to have been driven by cost-benefit considerations.

Staff conclusions

12. The review shows that the proposed changes to the existing concepts would have implications for future financial reporting. The staff think that publishing an explanation of those implications would help readers of the Exposure Draft understand and comment on the proposed changes.

13. The IASB could include such an explanation in the Basis for Conclusions accompanying the Exposure Draft. This approach would be consistent with the way in which the IASB has reported its analyses of the effects of IFRSs that it has issued recently.

14. The staff think that the explanation of the implications should cover the following points:

    (a) The *Conceptual Framework* does not override existing Standards or Interpretations and the IASB will not necessarily change existing Standards or Interpretations as a result of the changes that it makes to the *Conceptual Framework*. Any decision to amend an existing Standard or Interpretation would require the IASB to go through its normal due process for adding a project to its agenda and for developing an Exposure Draft and an amendment to that Standard or Interpretation. As part of that due process, the IASB would assess and explain how financial statements were likely to change because of the new requirements and why it considered those changes to be justifiable.

    (b) Although any changes to the *Conceptual Framework* would not immediately change the requirements of existing Standards or

Interpretations, they would have some implications as soon as they came into effect. In the absence of an IFRS that specifically applies to a transaction, preparers must develop and apply an accounting policy for that transaction considering the *Conceptual Framework*. Similarly, if a Standards permits different accounting policies, preparers need to consider the *Conceptual Framework* when selecting or changing an accounting policy, so that the financial statements provide a fair presentation of the entity's financial position, financial performance and cash flows, as required by paragraph 15 of IAS 1 *Presentation of Financial Statements*.

(c) The IASB's intention in proposing changes to the *Conceptual Framework* does not reflect a desire to increase or decrease the number of assets and liabilities recognised in financial statements, nor does it reflect a desire to increase or decrease the use of current measurement bases. The proposed changes are intended to provide the IASB and preparers with a more disciplined set of thought processes to apply when judging which recognition, derecognition, measurement, presentation[1] and disclosure requirements would best meet the objectives of financial reporting for particular transactions. The IASB has not attempted to revisit all its previous standard-setting decisions applying those thought processes in hindsight. Furthermore, it does not expect that many preparers would need to revisit their current accounting policy choices as a result of revisions to the *Conceptual Framework*.

(d) However, the staff have identified some existing Standards that it thinks would be inconsistent with the proposed new concepts. In particular the staff have noted that:

(i) some of the classification requirements of IAS 32 *Financial Instruments—Presentation* are at present inconsistent with the existing *Conceptual Framework* definitions of a liability

1 Including requirements to present particular income or expenses in either profit or loss or other comprehensive income(OCI)

and of equity[2]. The IASB has tentatively decided not to propose, as part of this project, changes to the *Conceptual Framework* definitions that might eliminate the inconsistencies. The IASB will further explore how to distinguish liabilities from equity claims, including consideration of whether to amend the definitions of a liability or of equity, in its Research Project on *Financial Instruments with the Characteristics of Equity*.

(ii) the requirements of IFRIC 21 *Levies* (an interpretation of IAS 37 *Provisions, Continent Liabilities and Contingent Assets*) are inconsistent with the proposed new concepts for identifying liabilities. Often an entity must conduct a series of activities before it is required to pay a levy. IFRIC 21 identifies the last event in the series as the event that gives rise to a liability. The IFRS Interpretations Committee concluded that earlier events do not give rise to a liability even if the entity would have to take unrealistic action to avoid the obligation because economic compulsion does not create a present obligation. In contrast, applying the IASB's proposed definition of a present obligation, an entity would identify a liability when it has received the benefits, or conducted the activity, by reference to which the levy would be measured, and has no practical ability to avoid the remaining activities. Economic compulsion could be a factor to take into consideration when judging whether an entity has the practical ability to avoid the remaining activities. Accordingly, a liability for some levies could be identified earlier applying the *Conceptual Framework* proposals than applying IFRIC 21. The IASB is considering, as part of its research agenda, whether it should take on an active project to amend aspects of IAS 37. It will take into account as part of its research the inconsistencies between IFRIC 21 and the proposed new concepts for identifying present obligations.

(e) The proposed new definition of a 'present obligation' could also affect future IASB decisions on requirements for requirements for emissions

[2] More detail is provided in Agenda Papers 10H and 10G presented to the IASB in September 2014

trading schemes and rate-regulated activities. Entities participating in either of these activities might have obligations that are conditional on their future actions, and might have no practical ability to avoid the actions that will trigger the transfer. Rate-regulated activities are currently being considered as part of the IASB's active agenda. Emissions trading schemes are on the IASB's research agenda.

(f) The proposed changes to the *Conceptual Framework* would create some more minor inconsistencies between existing Standards and the *Conceptual Framework*:

   (i) Some existing Standards directly quote existing *Conceptual Framework* definitions: IAS 37 quotes the existing definition of a liability; IAS 38 *Intangible Assets* quotes the existing definition of an asset; and the definition of an equity instrument in Appendix A of IFRS 2 *Share Based Payment* contains a footnote quoting the existing definition of a liability. However, the staff do not think that the differences would cause any practical problems in applying the Standards: the staff believe that the IASB's aim in revising the definitions in the *Conceptual Framework* is to provide more clarity, not to fundamentally change the way in which the definitions are applied in any existing Standard.

   (ii) Some Standards do not provide an objective for disclosure requirements and some require forward-looking information that is not necessarily related to assets and liabilities existing at the end of, or during, the reporting period. (Further details are in Appendix A).

(g) The proposed new process for recognition decisions would replace the rigid recognition criteria in the existing *Conceptual Framework*. Most notably, the *Conceptual Framework* would no longer specify that an asset or a liability should be recognised only if it is probable that future economic benefits will flow to or from the entity. The IASB has not applied this criterion in some Standards—it has decided that recognition of some assets and liabilities (such as some derivatives) meets the objectives of financial reporting irrespective of the likelihood of future cash flows. Requirements developed in this way are inconsistent with the existing *Conceptual Framework* criteria, but would be consistent with the proposed new *Conceptual Framework* process.

15. Other potential inconsistencies considered by the staff during the review of the Standards are summarised in Appendix B. For most of these cases the staff have not attempted to predict what would be the IASB's conclusion if it were to revisit existing Standards applying the concepts now proposed, therefore, we have not listed them as inconsistencies in paragraph 14.

Staff recommendation and question for the IASB

16. The staff recommend that:
    (a) the IASB publishes an explanation of the implications of its proposed changes to the *Conceptual Framework*;
    (b) it includes that explanation in the Basis for Conclusions accompanying the Exposure Draft of the proposed changes; and
    (c) the explanation includes the points set out in paragraph 14.

Question for the IASB
Do you agree with the recommendation in paragraph 16?

Appendix A – A list of Standards that are inconsistent with the concepts on disclosure proposed for the Exposure Draft[3]

A1. The following table lists the existing Standards and Interpretations that do not state an objective for disclosure requirements.

IAS 1	*Presentation of Financial Statements*
IAS 7	*Statement of Cash Flows*
IAS 8	*Accounting Policies, Changes in Accounting Estimates and Errors*
IAS 12	*Income Taxes*
IAS 16	*Property, Plant and Equipment*
IAS 19	*Employee Benefits*
IAS 20	*Accounting for Government Grants and Disclosure of Government Assistance*
IAS 21	*The Effects of Changes in Foreign Exchange Rates*
IAS 23	*Borrowing Costs*
IAS 26	*Accounting and Reporting by Retirement Benefit Plans*
IAS 27	*Separate Financial Statements*
IAS 29	*Financial Reporting in Hyperinflationary Economies*
IAS 34	*Interim Financial Reporting*
IAS 36	*Impairment of Assets*
IAS 37	*Provisions, Contingent Liabilities and Contingent Assets*
IAS 38	*Intangible Assets*
IAS 40	*Investment Property*
IAS 41	*Agriculture*
IFRIC 5	*Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*
IFRIC 17	*Distributions of Non-cash Assets to Owners*
SIC-27	*Evaluating the Substance of Transactions Involving the Legal Form of a Lease*
SIC-29	*Service Concession Arrangements: Disclosures*

[3] A holistic review of disclosure requirements in existing Standards to identify and assess redundancies, conflicts and duplication is being carried out as part of the Disclosure Initiative.

A2. The following Standards require disclosure of forward-looking information that is not necessarily related to assets and liabilities existing at the end of, or during, the reporting period:

(a) IAS 10 *Events after the Reporting Period* requires entities to disclose material non-adjusting events after the reporting period (this potential inconsistency was highlighted in July Agenda Paper 10F). Such information is also required by IAS 34 *Interim Financial Reporting*;

(b) IAS 19 Employee *Benefits* requires entities to disclose expected contributions to the defined benefit or contribution plan for the next annual reporting period;

(c) IAS 33 *Earnings per Share* requires entities to disclose major share transactions after the reporting period; and

(d) IFRIC 17 *Distributions of Non-cash Assets to Owners* requires entities to disclose declaration of a dividend to distribute a non-cash asset after the end of a reporting period but before the financial statements are authorised for issue.

Appendix B – Other areas considered in the course of the review

B1. This Appendix summarises other potential inconsistencies considered by the staff during the review of the Standards.

Recognition requirements based on existing definitions and recognition criteria

B2. Recognition requirements in the following Standards and Interpretations repeat the definitions and/or recognition criteria in the existing *Conceptual Framework*:

(e) IAS 16 *Property, Plant and Equipment*;

(f) IAS 19 *Employee Benefits*;

(g) IAS 23 *Borrowing Costs*;

(h) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*;

(i) IAS 38 *Intangible Assets*;

(j) IAS 40 *Investment Property*;

(k) IAS 41 *Agriculture*;

(l) IFRS 3 *Business Combinations*;

(m) IFRS 6 *Exploration for and Evaluation of Mineral Resources*; and

(n) IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine*.

B3. However, not all existing Standards apply these criteria. In particular, some Standards—such as IFRS 9 *Financial Instruments*—require assets and liabilities to be recognised irrespective of the likelihood that future economic benefits will flow to or from the entity.

B4. The staff have not tried to assess whether the IASB would have specified the same recognition criteria for those particular assets or liabilities if it had applied the concepts now proposed.

Leases

B5. IAS 17 *Leases* requires recognition of assets on the lessee's balance sheet only for finance leases. Operating leases do not lead to the recognition of assets. The distinction between finance and operating leases is based on whether the lease transfers substantially all the risks and rewards incidental to ownership of the underlying asset.

B6. In May 2014 the IASB tentatively decided that assets should be viewed as rights or bundles of rights rather than the underlying physical or other object. Under this approach, a right of use that arises from an operating lease is in concept no different from a right of use arising from a finance lease. Hence, non-recognition of operating leases is inconsistent with the proposed concepts.

B7. The IASB is currently undertaking a project to address lease accounting with the objective that a lessee should recognise assets and liabilities arising from all leases (with some exemptions for short-term or small asset leases). The approach adopted in that project is based on the existing *Conceptual Framework.* Nonetheless, the staff think that it is consistent with the revised concepts.

Other aspects of the asset and liability definitions

B8. Doubts are sometimes raised as to whether some assets and liabilities currently recognised applying the existing Standards satisfy the definitions for those elements in the *Conceptual Framework*. These include:

(a) deferred tax assets and deferred tax liabilities identified applying IAS 12 *Income Taxes*;

(b) government grant liabilities recognised applying IAS 20 *Accounting for Governments Grants and Disclosure of Government Assistance*; and

(c) goodwill recognised applying IFRS 3 *Business Combinations*[4].

B9. Neither the existing *Conceptual Framework*, nor the concepts proposed for the revised *Conceptual Framework* provide a definitive answer to these questions.

[4] In developing IFRS 3 the IASB considered whether goodwill meets the definition of an asset and explained its decision in paragraphs BC313-B323 of the Basis for Conclusions.

The staff have not attempted to predict what would be the IASB's judgement in those areas if it were to revisit existing Standards applying the concepts now proposed.

Distinction between profit or loss and OCI

B10. In June 2014 the IASB has tentatively decided that profit or loss is the primary source of information about an entity's performance for the period. Accordingly, the revised *Conceptual Framework* should include a rebuttable presumption that all items of income and expense must be included in profit or loss. The IASB can only decide to include an item of income and expense in OCI if:

(a) it arises from a change in a current measure of an asset or a liability; and

(b) including that item in OCI enhances the relevance of profit or loss as the primary source of information about an entity's performance for the period.

B11. The staff have considered the current use of OCI in the Standards against these tentative decisions. Appendix B to June Agenda Paper 10B provides a summary of the current use of OCI and the rationale for that use. The staff note that that all the existing uses of OCI – including those proposed in ongoing projects – arise on current measures of assets and liabilities.

B12. The second condition for the use of OCI, ie that an item of income and expense could only be included in OCI if that enhances the relevance of profit or loss as the primary source of information about an entity's performance for the period, is a matter of judgement. In the course of the review, we have not attempted to predict whether the IASB would arrive at the same conclusions for including the items of income and expense in OCI if it were relying on the newly proposed concept now proposed.

B13. The IASB also tentatively decided that there should be a rebuttable presumption that all items of income and expense included in OCI should be reclassified to profit or loss when doing so enhances the relevance of profit or loss as the primary source of information about an entity's performance for the period. The IASB could only consider prohibiting recycling if recycling would undermine the relevance of profit or loss as the primary source of information about an entity's performance. That could be the case, for example, when there is no appropriate basis for recycling.

B14. Some existing Standards do not require reclassification to profit or loss for these items of income and expense:

(a) IFRS 9 *Financial Instruments* for:

(i) gains and losses on equity instruments designated as at fair value through OCI;

(ii) effects of changes in the liability's credit risk for financial liabilities designated as at fair value through profit or loss;

(b) IAS 16, IAS 38 and IAS 40 for revaluation gains reported in OCI;

(c) IAS 19 for remeasurements of the net defined benefit liability (asset) recognised in OCI.

B15. The staff have not tried to predict whether the IASB would reach the same conclusions in these cases if it were to revisit them using the concepts now proposed.