STAFF PAPER

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REG IASB Meeting

Project	**Conceptual Framework**		
Paper topic	Draft discussion paper: Capital maintenance		
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This paper is a very early draft of part of the Conceptual Framework discussion paper. It has been prepared by the staff for discussion by the IASB. Issues discussed and conclusions reached will be subject to change.

Capital maintenance

1. Concepts of capital maintenance are important as only income earned in excess of amounts needed to maintain capital may be regarded as profit. The existing Conceptual Framework describes the following concepts of capital maintenance:

   (a) *Financial capital maintenance*. Under this concept a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.

   (b) *Physical capital maintenance*. Under this concept a profit is earned only if the physical productive capacity (or operating capacity) of the entity (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from owners during the period.[1]

2. Most entities adopt a financial concept of capital maintenance. However, the existing Conceptual Framework does not prescribe a particular model of capital maintenance. The existing Conceptual Framework notes that management of an entity should exercise judgement and select the concept of financial maintenance that provides the most useful information to the users of financial statements.

3. The concepts of capital maintenance are used in IAS 29 *Financial Reporting in Hyperinflationary Economies*.

Proposed approach to capital maintenance

4. The IASB note that the concepts of capital maintenance are most relevant for entities operating in high inflation economies. The IASB plans to undertake research to determine whether to revise IAS 29. Consequently, the IASB believes that the issues associated with capital maintenance are best dealt with at the same time as a possible standards level project on accounting for high inflation rather than as part of the Conceptual Framework project.

5. Hence, the IASB plans to include the existing descriptions and discussion of capital maintenance concepts in the revised Conceptual Framework largely unchanged until such time as any standards level project on accounting for high inflation indicates a need for change.

Revaluations of property plant and equipment

6. IAS 16 *Property, Plant and Equipment* permits entities to revalue property, plant and equipment[2]. If an entity elects the revaluation model, it accounts for its revalued items as follows:

    (a) The item of property, plant and equipment is carried at its revalued amount less any subsequent accumulated depreciation and subsequent accumulated impairment losses;

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[1] 4.59

[2] IAS 38 *Intangible Assets* includes a similar revaluation model.

(b) Depreciation is based on the revalued carrying amount of the asset;

(c) Revaluation gains are recognised in other comprehensive income (OCI) and are accumulated in equity as a revaluation surplus (unless they reverse a revaluation decrease that was previously recognised in profit or loss);

(d) Revaluation losses are recognised in profit or loss (unless a credit balance exists on the revaluation surplus for that asset, in which case the loss is recognised in OCI).

(e) Revaluation surpluses are not recycled on derecognition of the associated asset. However, an entity may transfer the revaluation surplus directly to another component of equity.

7. As noted in AP 10H(a) *Draft discussion paper: Presentation in the statement of comprehensive income*, presenting revaluations of property plant and equipment in OCI is inconsistent with the bridging concept described in that paper. This is because the amounts reported in profit or loss are not the same as would be presented if the item were measured on a cost basis (depreciation reported in profit or loss is based on the revalued amount and revaluation surpluses are not recycled). AP 10H(a) describes changes to the revaluation model that would make it consistent with the concept of a bridging item.

8. However, it could be argued that the revaluation model in IAS 16 is in fact a form of capital maintenance adjustment. This would explain the fact that depreciation reported in profit or loss is based on the revalued amount rather than cost and that revaluation surpluses are not recycled. However, reporting revaluation gains and losses in OCI is inconsistent with this view, because capital maintenance adjustments are normally reported directly in equity. It should be noted, however, that prior to the introduction of OCI, revaluation gains and losses were reported directly in equity.

9. Given these factors, the IASB may at some point wish to consider whether to amend the revaluation model in IAS 16 and IAS 38 to make it consistent with either the bridging concept or the capital maintenance concept. In developing this [draft] discussion paper, the IASB has not considered whether such changes would be appropriate.

Question for respondents

10. Do you support the proposed approach to capital maintenance outlined in paragraphs 1- 5?