

## STAFF PAPER

July 2014

## REG IASB Meeting

Project	Conceptual Framework		
Paper topic	Cover paper		
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**Purpose of this meeting**

1. At this meeting we are planning to discuss:
  - (a) profit or loss and other comprehensive income;
  - (b) measurement;
  - (c) additional guidance on definition of a liability;
  - (d) control;
  - (e) derecognition;
  - (f) elements for the statement of cash flows and statement of changes in equity;
  - (g) business model;
  - (h) presentation and disclosure; and
  - (i) transition and effective date.
2. This paper describes:
  - (a) the papers for this meeting, including an overview of recommendations in each paper; and
  - (b) next steps.

### Papers for this meeting

3. Agenda Paper 10A provides a summary of tentative decisions made so far in the course of deliberations on the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the ‘Discussion Paper’). It is provided for information purposes only and we do not plan to discuss it at the meeting.
4. The papers that we would like to discuss at this meeting are summarised in the table below. Each paper includes a discussion of the issues, staff analysis and recommendations, and questions for the IASB.

AP	Title	Content
10B	Profit or loss and other comprehensive income – clarifying the proposed approach	<p>This paper explores how to provide clarifications that the IASB has asked for at the June 2014 meeting:</p> <ul style="list-style-type: none"> <li>(a) why profit or loss is the primary source of information about an entity’s performance for the period; and</li> <li>(b) whether it is possible to find principles that identify some items of income and expense that can only be included in profit or loss rather than OCI, without providing a detailed list of such items.</li> </ul> <p>The paper discusses the role of the total or subtotal for profit or loss in reporting performance and the basis for describing profit or loss as a pool of items of income and expense as the primary source of information about an entity’s performance for the period suggested in the Discussion Paper and the feedback received on those suggestions. The staff conclude that the basis provided in the Discussion Paper is appropriate and recommend that it is included in the <i>Conceptual Framework</i> Exposure Draft.</p> <p>In addition, the staff recommend that the <i>Conceptual Framework</i> Exposure Draft should emphasise that no single number is sufficient for understanding an entity’s performance. Rather, understanding performance involves analysis of items of income and expense included in profit or loss, as well as consideration of other relevant information in the financial statements, notably the items of income and expense included in OCI.</p> <p>The staff also recommend that the <i>Conceptual Framework</i> Exposure Draft:</p> <ul style="list-style-type: none"> <li>(a) proposes that the presumption for including items of income and expense in profit or loss cannot be rebutted for items of income and expense that arise on assets and liabilities carried at cost-based measures,</li> </ul>

AP	Title	Content
		<p>(b) proposes that the presumption for including items of income and expense in profit or loss can only be rebutted for changes in current measures of assets and liabilities, and only if including those changes—or components of those changes—in OCI enhances the relevance of profit or loss as the primary source of information about an entity’s performance for the period, and</p> <p>(c) emphasises that including items of income and expense resulting from changes in current measures of assets and liabilities—or components of those changes—in OCI is an application of the classification and aggregation principle for presentation and disclosure, designed to provide effective communication of financial information and to make that information more understandable.</p>
10C	Liability definition – present obligation	<p>The IASB has tentatively decided to define a liability as ‘a present obligation of the entity to transfer an economic resource as a result of past events’.</p> <p>This paper seeks to develop concepts to explain the term ‘present obligation’, in particular to address situations in which the entity has some, but less than complete, discretion to avoid a future transfer. This paper uses the term ‘constrained discretion’ to describe these situations.</p> <p>The staff recommend that an entity has a present obligation to transfer an economic resource as a result of past events if both:</p> <p>(a) the entity has no practical ability to avoid the transfer; and</p> <p>(b) the amount of the transfer is determined by reference to benefits that the entity has received, or activities that it has conducted, in the past.</p> <p>The staff propose what guidance should be included in the <i>Conceptual Framework</i> to explain when an entity has no practical ability to avoid a transfer. Finally, the staff recommend that no guidance is needed in the <i>Conceptual Framework</i> on the role of constrained discretion in the identification of <i>assets</i>.</p>
10D	Asset definition: control	<p>This paper considers feedback on the definition of control suggested in the Discussion Paper and on the guidance accompanying that definition.</p> <p>The main recommendations are that:</p> <p>(a) a requirement for control should remain in the definition of an asset;</p>

AP	Title	Content
		<p>(b) the <i>Conceptual Framework</i> should define control as ‘the present ability to direct the use of the economic resource and obtain the economic benefits that flow from it’; and</p> <p>(c) supporting guidance should identify exposure to the significant risks and rewards of ownership as an indicator of control. However, the terminology should be consistent with that in IFRS 10. Thus, instead of using the term ‘risks and rewards of ownership’, the <i>Conceptual Framework</i> should use wording that explains the meaning of that term, ie ‘exposure, or rights, to variations in benefits’.</p>
10E	Derecognition	<p>The purpose of this paper is to discuss issues related to derecognition.</p> <p>The staff recommend that the <i>Conceptual Framework</i> should describe the approaches available, and discuss what factors to consider, in deciding at the Standards-level:</p> <p>(a) how best to portray the changes that result from a transaction in which an entity retains only a component of an asset or a liability, by either:</p> <ul style="list-style-type: none"> <li>(i) full derecognition (ie derecognise the original asset (or liability) entirely and recognise any retained right (or obligation) as a new asset (or liability));</li> <li>(ii) partial derecognition (ie continue to recognise the component of the original asset (or liability) that is retained and derecognise the component that is not retained); or</li> <li>(iii) continued recognition (ie continue to recognise the original asset (or liability) and treat the proceeds received or paid for the transfer as a loan received (or granted)); and</li> </ul> <p>(b) how to account for modifications of contracts.</p>
10F	Presentation and disclosure—scope and content	<p>This paper discusses the scope and content of presentation and disclosure guidance to be included in the <i>Conceptual Framework</i>.</p> <p>In this paper, the staff recommend that the <i>Conceptual Framework</i> Exposure Draft:</p> <p>(a) does not introduce a notion of ‘primary financial statements’, as had been proposed in the Discussion Paper;</p> <p>(b) states the following objective of financial statements:</p>

AP	Title	Content
		<p>The objective of financial statements is to provide information about an entity’s assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management’s stewardship of the entity’s resources. As a result, financial statements provide information about the financial position, financial performance and cash flows of an entity.</p> <p>(c) discusses disclosures that the IASB would normally consider requiring in setting Standards (but does not provide examples of different types of disclosures);</p> <p>(d) confirms the discussion of disclosure of risks and forward-looking information proposed in the Discussion Paper:</p> <ul style="list-style-type: none"> <li>(i) the notes to the financial statements would normally include information about the nature and extent of risks arising from the entity’s assets and liabilities; and</li> <li>(ii) forward-looking information should be required only if it provides relevant information about the assets and liabilities that existed and end of, or during, the reporting period; and</li> </ul> <p>(e) confirms the guidance on classification and aggregation, offsetting and comparative information proposed in the Discussion Paper:</p> <ul style="list-style-type: none"> <li>(i) an entity should classify and aggregate information about recognised elements based on similar properties in order to present information that is understandable;</li> <li>(ii) offsetting items of dissimilar nature does not therefore generally provide the most useful information; and</li> <li>(iii) comparative information is an integral part of an entity’s financial statements for the current period because it provides relevant trend information.</li> </ul>
10G	Other elements	<p>This paper discusses whether to define elements for the statement of changes in equity and the statement of cash flows.</p> <p>The staff recommend that the <i>Conceptual Framework</i> should not define elements for the statement of changes in equity and for the statement of cash flows.</p> <p>Thus, the only elements would continue to be assets, liability and equity, and income and expense.</p>

AP	Title	Content
10H	Business model	<p>The purpose of this paper is to consider whether business model has a role to play in standard-setting.</p> <p>The staff recommend that the Exposure Draft of the revised <i>Conceptual Framework</i> should state that consideration of the nature of an entity’s business activities is likely to improve the relevance of financial information. It should describe for each area of standard-setting how the nature of an entity’s business activities would affect that area of standard-setting. The IASB should tailor that description to each area affected, rather than provide a single over-arching description.</p> <p>The staff believe that the nature of an entity’s business activities is likely to affect measurement, unit of account, the distinction between profit or loss and OCI, and presentation and disclosure more than it is likely to affect other areas covered by the <i>Conceptual Framework</i>.</p>
10I	Transition and effective date	<p>This paper discusses whether it is necessary to include guidance on transition and effective date in the revised <i>Conceptual Framework</i> and, if so, what form such guidance should take.</p> <p>The staff recommend that:</p> <ul style="list-style-type: none"> <li>(a) the IASB and the IFRS Interpretations Committee should start applying the revised <i>Conceptual Framework</i> immediately after its publication;</li> <li>(b) a transition period of no less than approximately 18 months should be allowed for entities that use the <i>Conceptual Framework</i> to develop and apply accounting policies if no IFRS specifically applies to a transaction, other event or condition. Early application should be permitted; and</li> <li>(c) no additional guidance on transition should be provided in the revised <i>Conceptual Framework</i>. Consequently, entities would be required to apply the provisions of IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> to any changes in accounting policy arising from an application of the revised <i>Conceptual Framework</i>.</li> </ul>
10J	Measurement – Objective and the effect of the qualitative characteristics	<p>The purpose of this paper is to discuss the objective of measurement and the implications of the qualitative characteristics of useful financial information for measurement.</p> <p>The staff recommend that the Exposure Draft should:</p> <ul style="list-style-type: none"> <li>(a) <b>not</b> define a separate measurement objective.</li> <li>(b) describe as follows how measurement contributes to the overall objective of financial reporting:</li> </ul>

AP	Title	Content
		<p>Measurement provides information in monetary terms about the resources of an entity, claims against the entity and changes in those resources and claims. Such information helps users to assess the entity’s prospects for future cash flows and assess management’s stewardship of the entity’s resources.</p> <p>(c) state that when the IASB selects a measurement, it should consider the nature and relevance of the resulting information produced in both the statement of financial position and the statement(s) of profit or loss and other comprehensive income (OCI).</p> <p>(d) state that:</p> <ul style="list-style-type: none"> <li>(i) the level of uncertainty associated with the measurement of an item (the reliability of that measurement) is one of the factors that should be considered when selecting a measurement basis; and</li> <li>(ii) a high degree of measurement uncertainty should not prevent the use of a measurement basis that provides relevant information.</li> </ul> <p>(e) refer explicitly to reliability when describing the level of measurement uncertainty associated with the measurement of an item.</p> <p>(f) retain the discussion of faithful representation included in the Discussion Paper.</p> <p>(g) discuss in the measurement section the idea that a faithful representation by itself does not necessarily result in useful information. The information provided by the representation must also be relevant.</p> <p>(h) explain the need to weigh the benefits of a new or different measurement basis against any increased costs or complexity. This would replace the statement in the Discussion Paper that the number of measurement bases should be the smallest necessary to provide relevant information.</p> <p>(i) retain a discussion of necessary and unnecessary changes in measurement bases.</p> <p>(j) include the discussion of the other enhancing qualitative characteristics suggested in the Discussion Paper, largely unchanged.</p> <p>(k) retain a separate reference to the cost-benefit constraint as one of the factors the IASB should consider when selecting a measurement.</p>

AP	Title	Content
10K	Measurement – categories	<p>This paper discusses the staff’s recommended approach to describing the different measurement bases, the information that they provide and the factors that might make a particular measurement basis more useful to the users of financial statements.</p> <p>The staff recommend that the Exposure Draft should:</p> <p>(a) discuss the different ways in which measurements can be categorised, namely:</p> <ul style="list-style-type: none"> <li>(i) historical or current measurements;</li> <li>(ii) entry value or exit values; and</li> <li>(iii) entity perspective or market perspective; and</li> </ul> <p>(b) describe the following measurement bases:</p> <ul style="list-style-type: none"> <li>(i) historical cost (for an asset) and historical proceeds (for a liability);</li> <li>(ii) fair value (for an asset or a liability);</li> <li>(iii) net realisable value (for an asset) and cost of release (for a liability);</li> <li>(iv) replacement cost (for an asset) and assumption proceeds (for a liability); and</li> <li>(v) value in use (for as asset) and fulfilment value (for a liability).</li> </ul> <p>The appendix to this paper includes a working draft for this discussion.</p>
10L	Measurement – Cash-flow-based measurements	<p>This paper discusses:</p> <p>(a) the purpose of cash-flow-based measurements – are cash-flow-based measurements simply a technique to estimate the measurement bases or can such a measurement be described as a measurement basis in its own right?</p> <p>(b) possible changes to the description in the Discussion Paper of the factors to be considered when developing a cash-flow-based measurement.</p> <p>The staff recommend that the IASB should not restrict its use of cash-flow-based measurements to situations when they are being used as a technique to estimate the result of applying other measurement bases.</p> <p>The staff also recommend including in the Exposure Draft:</p> <p>(a) an expanded discussion of the different approaches to dealing</p>



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		<p style="text-align: center;">with uncertain cash flows;</p> <p>(b) additional guidance on the use of discount rates. This guidance would state, amongst other things, that if an entity measures an item using a cash-flow-based measurement and the effect of the time value of money is significant for the cash flows associated with that item, then the entity should discount those cash flows to reflect the time value of money; and</p> <p>(c) additional guidance on when the effect of changes in an entity's own credit standing should be included in the measurement of a liability.</p>

### Next steps

5. At the September meeting we plan to discuss:
  - (a) the distinction between liabilities and equity;
  - (b) remaining aspects of measurement;
  - (c) implications of long-term investment;
  - (d) possible amendments to Chapters 1 and 3; and
  - (e) consequential amendments.