STAFF PAPER

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IASB Meeting

Project	**Conceptual Framework**
Paper topic	Feedback summary: other issues

CONTACT(S)	Joan Brown	jbrown@ifrs.org	
	Jelena Voilo	jvoilo@ifrs.org	+44 (0)20 7246 6914
	Nobu Kawanishi	y.kawanishi@asb.or.jp	+81 (0) 3 5510 2727
	Rachel Knubley	rknubley@ifrs.org	+44 (0)20 7246 6904
	Peter Clark	pclark@ifrs.org	+44 (0)20 7246 6451

Purpose of paper

1. This paper summarises the feedback received on:
   (a) the unit of account, discussed in paragraphs 9.35-9.41 of the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting;*
   (b) the going concern assumption, discussed in paragraphs 9.42-9.44 of the Discussion Paper; and
   (c) the reporting entity, discussed in Appendix B of the Discussion Paper.
2. This paper provides a high level summary of the comments received. Where appropriate, we will provide more detailed breakdown of the comments for future meetings.

Structure of paper

3. This paper is structured as follows:
   (a) Unit of account (paragraphs 4 – 18);
   (b) Going concern (paragraphs 19 – 29);

(c) Reporting entity (paragraphs 30 – 38).

Unit of account

Background

4. In principle, each of an entity's rights or obligations is capable of being a separate asset or liability. However, groups of rights or obligations that arise from a single source (such as a contract) are often aggregated and accounted for as a single asset or a single liability. Moreover in some circumstances, contracts may be further aggregated and measured at a portfolio level.

5. The level of aggregation is called the unit of account. The unit of account may affect decisions on when an asset or liability is recognised and derecognised, or the amount at which a recognised asset or liability is measured.

6. The existing *Conceptual Framework* provides no guidance on the selection of a unit of account.

7. The IASB's preliminary view was that deciding which unit of account provides the most useful information to users of financial statements would normally be a decision for particular Standards, rather than a decision that could be resolved conceptually for a broad range of Standards. In making that decision, the IASB would take into consideration the qualitative characteristics of useful financial information.

8. The Discussion Paper went on to discuss how the qualitative characteristics could be applied in selecting a unit of account. However, it did not explain how much of this discussion (if any) the IASB would include in the *Conceptual Framework*.

Summary of feedback

9. Approximately half of the respondents commented on this matter.

Support for IASB's preliminary view

10. Most of those who commented agreed that the unit of account should normally be decided when the IASB develops or revises particular Standards and that, in selecting

a unit of account, the IASB should consider the qualitative characteristics of useful financial information.

11. Those who gave a reason for their support said that it could be difficult to develop comprehensive, uniform or generic rules, because the most appropriate unit of account would depend on the nature of the transactions and the business model—'unit of account' should be a flexible concept. Some respondents from the banking and insurance sectors specifically argued that the *Conceptual Framework* should not define unit of account at a contract level—in some circumstances there are good reasons for aggregating portfolios of contracts or risks.

12. Many of those who supported the proposed approach suggested that the *Conceptual Framework* should contain some reference to unit of account by:

    (a) including high level guidance on applying the qualitative characteristics (similar to that in the Discussion Paper); and/or

    (b) explicitly committing the IASB to:

        (i) consider (and preferably prescribe) the unit of account when developing or revising individual Standards; and

        (ii) explain the reason for the unit prescribed.

Opposition to IASB's preliminary view

13. Some respondents disagreed with the IASB's preliminary view. They included most of the large international accounting firms, EFRAG, national standard-setters and accountancy bodies from most regions (Europe, Asia, Oceania and Canada), banks and a banking regulator.

14. These respondents argued that the *Conceptual Framework* should do more than refer to the need to apply the qualitative characteristics in selecting a unit of account: it should set out specific principles to guide the future development of Standards and make existing Standards easier to apply.

15. In support of their views, respondents argued that:

    (a) The purpose of the *Conceptual* Framework is to give a conceptual foundation to important issues of general, pervasive, cross-cutting application. Unit of account is one of those issues.

> In our view, it is critical that the Framework should at least provide indicators about how to determine the unit of account in order to provide consistency between IFRSs. In our experience, as IFRSs become more sophisticated and require varying degrees of aggregation and disaggregation of items recognised in the financial statements, the unit of account is a recurring application challenge that preparers, users, securities market regulators and auditors face on a daily basis. In our view, it is not appropriate to leave unit of account considerations entirely as a Standards-level decision, chiefly because determining the appropriate unit of account is a cross-cutting issue that arises in many different areas, including compound instruments, puttable shares, written puts on an entity's own equity, embedded derivatives, multiple element revenue transactions, embedded leases, sale-leasebacks, lease-leasebacks, and asset groups for impairment purposes. We do not think that the two characteristics identified in DP 9.28 and the cost/ benefit constraint identified in DP 9.39 are sufficient. *Deloitte*

(b) Although it would be difficult to develop conceptual guidance that would provide ready-made answers for every future standard-setting problem, general principles on selecting a unit of account could be developed to guide the IASB in the development of future Standards. They would help the IASB to avoid inconsistencies and reconcile differences between Standards.

(c) General principles could also guide the application of existing Standards. At present, many different units of account are applied in practice and it is not always clear what unit of account an entity should select in applying the requirements of a particular Standard. One user group commented that its members thought that this had led to inconsistencies in practice.

16. Some respondents suggested general matters that the *Conceptual Framework* should address. These included:

(a) a description of possible units of account;

(b) high level criteria or indicators of when each different unit of account might be most appropriate;

> We believe that the CF should establish broad principles on the factors to consider when determining the unit of account, which possibly include (i) the economic characteristics of the item (e.g. whether rights and obligations arising from the item are capable of being the subject of separate transactions, or whether different items share similar risk characteristics), (ii) the business model under which the item is held (e.g. reflect the manner in which an entity expects to realise future cash flows from the item), and (iii) the interaction with the notion of control and risks and rewards (e.g. what is the unit of account when an entity does not have control of an asset but retains substantial risks and rewards associated with that asset). *Singapore Accounting Standards Council*

(c) the varying roles of unit of account—namely in existence, recognition and derecognition, measurement, presentation and disclosure.

17. Some respondents highlighted more specific matters that they thought the *Conceptual Framework* should address. These matters included:

(a) clarification of the drivers for bifurcating (dividing into components) rights or obligations from a single source:

> … is the driver of 'componentisation' the simple fact that it is theoretically possible to create or carve out such a right? Alternatively, is 'componentisation' driven by the need to apply other accounting rules — eg recognition/derecognition, measurement — independently to different components (perhaps in order to avoid some mischief), overlaid by practical limits (theoretical separability, practical transferability, reliability of valuation, pricing of components, linkage)? *KPMG*

(b) the circumstances in which it would be appropriate for an asset or a liability's unit of measurement to differ from its unit of recognition (including a discussion of the circumstances in which a unit of account could be disaggregated, for example into risk components, for measurement purposes); and

(c) criteria for deciding whether the unit of measurement for a block of equity investments should be each individual share (measured at price × quantity) or the total block (which might be measured at price that includes a control premium or blockage discount).

Suggestions for further work

18. Several respondents suggested that the IASB needs to review existing Standards and conduct further research to identify the extent of the guidance needed and to develop concepts-level thinking. A few respondents acknowledged that developing conceptual guidance on unit of account might take some time. Some said they thought it should not be rushed. Some suggested that the IASB should at least announce that it will add guidance on unit of account to the *Conceptual Framework* in a reasonable time frame, if not as part of this project.

Going concern

Background

19. Discussion Paper included a discussion of the going concern assumption and noted that the IASB had identified three situations in which the going concern assumption is relevant:

(a) when measuring assets and liabilities;

(b) when identifying liabilities (for example liabilities that arise only on liquidation); and

(c) when making disclosures about the entity.

20. Respondents to the Discussion Paper were asked whether they could identify any other situations in which the going concern assumption might be relevant.

Summary of feedback

21. Less than half of the respondents commented on the going concern issue. Most of those who replied agreed with the situations identified by IASB and did not identify any other situations in which the going concern assumption might be relevant.

22. However, some respondents raised the following issues:

(a) the going concern assumption may be relevant in situations other than those identified by the IASB;

(b) more guidance is needed in the *Conceptual Framework* on the issue of going concern; and

(c) there is a need for additional disclosures related to going concern.

Relevance of going concern assumption to other situations

23. Some respondents were concerned that identifying only three specific situations in which the going concern assumption is relevant might limit its relevance and understate its importance. A few other respondents were uncertain whether the IASB intended to include the current description of the going concern assumption in the *Conceptual Framework* at all. These respondents thought that it should be treated as a fundamental underlying assumption relevant to all aspects of accounting and financial reporting. The current explanation in the existing *Conceptual Framework* was considered to be broadly appropriate by these respondents.

24. Some respondents suggested other situations in which the going concern assumption might be relevant, including when making decisions about the presentation of items as current or non-current in the statement of financial position.

Additional guidance on the going concern assumption

25. Some respondents stated that information about going concern is of significant value to users of financial statements. However, in their opinion the going concern assumption is often misunderstood. Consequently, they asked for additional guidance on the issue. They suggested that such guidance could include:

(a) a definition of going concern;

(b) a detailed conceptual discussion of the topic; and

(c) clarification of the time horizon over which an entity's ability to continue as a going concern should be assessed.

26. There was also a request to explain the link between the going concern assumption and concepts such as 'practically unconditional' and 'no realistic alternative', which are included in Section 3 *Additional guidance to support the asset and liability definitions* of the Discussion Paper.

27. Some respondents asked the IASB to provide guidance on the preparation of financial statements when an entity is not a going concern and asked for clarification about whether financial statements prepared on a non-going-concern basis could be described as complying with the Standards.

Additional disclosure requirements

28. Several accountancy bodies recommended that the IASB should work with the International Auditing and Assurance Standards Board (IAASB) on the subject of going concern. They noted that the IAASB had recently published an exposure draft that proposes that auditors should include more specific statements about going concern in their reports. This group of respondents suggested additional disclosures on going concern may be necessary because the auditor's report cannot have more information than that disclosed by the management in the financial statements.

29. A few respondents suggested that the IASB should require disclosure of potential threats to an entity's going concern such as reliance on one customer.

Reporting entity

Approach to reporting entity

Background

30. Paragraph B3 of the Discussion Paper explained the IASB's approach to the discussion of reporting entity:

> Because a Discussion Paper[1] and an Exposure Draft[2] have already been issued on the reporting entity, the IASB believes that it is unnecessary to include a discussion of the issues associated with the reporting entity in this Discussion Paper. Instead, the IASB intends to review the reporting entity proposals, including comments received on the Reporting Entity ED, as it develops an Exposure Draft on a revised *Conceptual Framework*. As noted in Section 1, the *Conceptual Framework* project (including work on the reporting entity) is no longer being conducted jointly with the FASB.

Summary of feedback

31. A few respondents provided comments:

    (a) Excluding a discussion of reporting entity from the Discussion Paper made it difficult to understand the consequences of all of the parts of the Conceptual Framework on each other.

    (b) There is no pressing need for a separate reporting entity chapter in the Conceptual Framework. A broad description of a reporting entity may be part of the Conceptual Framework but control issues should be addressed at the Standards-level.

Entity vs proprietary perspective

Background

32. Paragraph B12 of the Discussion Paper explained the IASB's view regarding the entity perspective and the proprietary perspective:

> The Reporting Entity DP included a discussion of the entity perspective and the proprietary perspective and proposed that the entity perspective should be adopted. However, the discussion was not carried forward to the Reporting Entity ED.

[1] *Preliminary Views on an Improved Conceptual Framework for Financial Reporting – The Reporting Entity* ("the Reporting Entity DP"), May 2008.

[2] Exposure Draft *Conceptual Framework for Financial Reporting – The Reporting Entity* ("the Reporting Entity ED"), March 2010.

Many respondents requested that the reporting entity chapter should include a discussion of the perspective from which financial statements are presented. Some respondents expressed support for the entity perspective while others expressed support for the proprietary perspective.

Summary of feedback

Need for discussion

33. Some respondents stated that the perspective from which financial statements are presented (ie the entity vs proprietary perspective) may be controversial, but it is critical and should be discussed in the *Conceptual Framework*. A few of these respondents stated that it is necessary to carry out an in-depth analysis of the implications of adopting either perspective and to ensure they are properly debated. Those who responded did not indicate whether the discussion on the perspective should be a separate Chapter of the *Conceptual Framework* or instead be included in the Liabilities and Equity section of the *Conceptual Framework*.

34. A few respondents indicated their preference for the entity perspective over the proprietary perspective.

Implications on the distinction between liabilities and equity

35. A few respondents suggested that, before attempting to differentiate between equity and liabilities, it is essential to first clarify if this is being done from an entity or a proprietary perspective.

36. A few respondents provided more specific comments:

    (a) The strict obligation approach is consistent with the entity perspective and the narrow equity approach is consistent with the proprietary perspective.

    (b) The IASB should complete the work on the reporting entity in order to establish definitively whether non-controlling interest is liability or equity.

    (c) Remeasuring classes of equity via the statement of changes in equity would be inconsistent with the entity perspective.

37. Agenda Paper 10F for this meeting provides a summary of comments received on the distinction between liabilities and equity.

Other comments

38. A few respondents provided other comments:

    (a) The description of a reporting entity in the 2010 Exposure Draft was so broad that it could cover any set of business activities that can be separately identified and for which it would be useful for providers of capital to have information.

    (b) The IASB should examine more comprehensively whether a joint control approach for determining the boundaries of the group reporting entity provides decision-useful information.

    (c) Each corporate legal entity should prepare and disclose a full set of independent financial statements, and a combination of corporate legal entities under single control should present a full set of consolidated financial statements.

    (d) The existence of an organisation is not dependent on whether anyone has a legitimate claim to receive financial reports.

    (e) While any organisation may consist of a number of sub-organisations, a general purpose financial report should report the whole of the organisation and that other reports would be special-purpose or limited-purpose reports.