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STAFF PAPER

IASB Meeting

Project	**Conceptual Framework**
Paper topic	Concepts of capital and capital maintenance

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Accounting Standards Advisory Forum, December 2016, Appendix A and Appendix B to Agenda paper 1G

This paper will be discussed at the Board meeting in December 2016.

Appendix A—Inconsistencies between Chapter 8—*Concepts of capital and capital maintenance* and the rest of the Exposure Draft

A1. This appendix sets out inconsistencies suggested by respondents between the proposed chapter on capital and capital maintenance and the rest of the proposals in the Exposure Draft. As discussed in paragraphs 18–19, the staff do not recommend updating the discussion of capital and capital maintenance at this stage. Accordingly, the staff do not propose addressing these perceived inconsistencies.

Respondents' comments	
A1	A few respondents suggested that there is a disconnect between the proposed chapter on capital and capital maintenance and the proposals in the measurement chapter. In particular, they suggested that only one capital maintenance concept sits well with the discussion in the measurement chapter[1]. They suggested that such an inconsistency raises questions about the usefulness of the capital maintenance chapter in standard-setting. The 100 Group also suggested that there is an inconsistency between the proposed chapter on capital and capital maintenance and paragraph BC6.23. This is because paragraph BC6.23 states that it would be unlikely for the Board to consider selecting current cost as a measurement basis when developing future standards whilst the chapter on capital and capital maintenance gives the impression that application of the physical capital concept is contemplated by the Board.
A2	A few respondents noted that Chapter 8 introduces the concept of capital maintenance adjustments, however these are not listed among the elements of financial statements in Chapter 4 *The elements of financial statements* and do not appear on the diagram in Chapter 5 *Recognition and derecognition*. They further suggested that in paragraph 8.4 capital maintenance adjustments are regarded as expenses whereas in paragraphs 8.8, 8.9 and 8.10 capital maintenance adjustments seem to be specifically excluded from being expenses. Those respondents were concerned that those inconsistencies undermine the coherence of the overall conceptual model set out in the Exposure Draft. They further suggested that the non-application in IFRS Standards of the concepts of capital maintenance needs to be stated more clearly than it is in paragraph 8.9, which currently states that the *Conceptual Framework* is applicable to a range of accounting models and it is not the intention of the Board to prescribe a particular model other than in exceptional circumstances, such as for financial reporting in hyperinflationary economies.

[1] The staff understand that these respondents referred to the financial capital maintenance concept.

	Respondents' comments
A3	A few respondents suggested that there are inconsistencies between the proposed chapter on capital and capital maintenance and the proposed guidance on presenting information about financial performance. Basel Committee on Banking Supervision suggested that the proposed chapter on capital and capital maintenance is inconsistent with the proposed guidance on the use of other comprehensive income and recycling. Shell International suggested that the references to profit in the proposed chapter on capital and capital maintenance appear inconsistent with the language used elsewhere in the Exposure Draft. They further noted that paragraph 8.4 describes profit as 'the residual amount that remains after expenses (including capital maintenance adjustments, where appropriate) have been deducted from income' whereas the summary and invitation to comment states that the Exposure Draft does not define profit or loss.

Appendix B—Other comments on Chapter 8—*Concepts of capital and capital maintenance*

B.1 This appendix sets out other comments received on Chapter 8—*Concepts of capital and capital maintenance*, and provides the staff's response.

	Respondents' comments	The staff's response
B1	The Financial Reporting Council (UK) noted that the term 'capital maintenance' is sometimes used in a different sense compared to how this term is used in the Exposure Draft and refers to the legal concept that restricts companies from paying dividends or otherwise reducing legal capital.	The staff agree that the legal meaning of 'capital maintenance' in some jurisdictions is different from the meaning of that term in the context of financial reporting. The staff think that an observation to that effect could be included in the Basis for Conclusions on the revised *Conceptual Framework*.
B2	A few respondents commented on accounting for high inflation. Australia and New Zealand Banking Group Limited stated that it is unclear what is considered 'high' as opposed to 'normal' inflation and why the concepts of capital maintenance are only considered relevant for high inflation. They asked the Board to clarify that in the Basis for Conclusions. Two respondents noted that whereas IAS 29 *Financial Reporting in Hyperinflationary Economies* addresses hyperinflation there is no guidance in IFRS Standards on accounting in conditions of high inflation. They expressed a view that such guidance was needed. The American Accounting Association stated that they identified inflation as a source of difficulty for investors. The 100 Group suggested that conditions of high inflation such as those experienced in the 1970's may return in the foreseeable future and asked the Board to initiate a research project on inflation accounting.	As discussed in paragraph 23, the staff think that the Board should clarify in the Basis for Conclusions that the Board does not think that the concepts of capital and capital maintenance are only relevant for accounting for high inflation. The Board does not have any current plans to carry out work on accounting for high inflation. The Board is required to follow its due process for adding a project to its agenda.

	Respondents' comments	The staff's response
B3	SwissHoldings expressed a view that applying IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 can produce anomalies in consolidated financial statements when there are government restrictions that create 'false' foreign exchange markets. They suggested that the Board should explore in the *Conceptual Framework* project whether different capital maintenance concepts may be appropriate for: - financial statements produced in jurisdictions affected by such government restrictions; and - financial statements of other entities in the group.	As discussed in paragraphs 18–19, the staff do not recommend updating the discussion of capital and capital maintenance at this stage. However, the Board may decide to revisit those concepts in the future when such revision is considered necessary. As part of any such future work the Board could consider which concept of capital is most appropriate for financial statements produced in jurisdictions affected by government restrictions of foreign exchange rates.
B4	Some members of the Asian-Oceanian Standard-Setters Group suggested that the Board should explain the seemingly inconsistent requirements of IAS 16 *Property, Plant and Equipment* and IAS 40 *Investment Property* (ie recognising revaluations in other comprehensive income under IAS 16 and in profit or loss under IAS 40) by the application of different concepts of capital.	As discussed in paragraphs 18–19, the staff do not recommend updating the discussion of capital and capital maintenance at this stage. In addition, the staff note that explaining differences in requirements of particular IFRS Standards is outside the scope of the *Conceptual Framework* project.
B5	The UK Shareholders' Association stated it is unclear whether 'nominal monetary units' correspond to historical cost and 'units of constant purchasing power' correspond to current values. They further argued that Chapter 8 in its present form leaves open the question of whether profits include revaluations as well as realised profits.	As discussed in paragraphs 18–19, the staff do not recommend updating the discussion of capital and capital maintenance at this stage. However, the Board has tentatively confirmed the proposals in the Exposure Draft that increases and decreases in assets represent income and expenses respectively and that income and expenses are included in the statement of profit or loss unless specified conditions are met.
B6	The Financial Reporting Council (UK) suggested that it is necessary to conduct	The staff note that the Primary Financial Statements research project is likely to

	Respondents' comments	The staff's response
	further research and analysis on the concept of performance. They suggested that such further research may identify a role for one or more concept(s) of capital and capital maintenance.	examine how to better communicate information about financial performance. However, it is unlikely that that project will seek to identify a role for the concepts of capital and capital maintenance.
B7	The Institute of Public Accountants (Australia) suggested that the Board should expand Chapter 8 to address capital management concepts including determination of appropriate capital levels, economic return on capital and dilutionary impacts of capital activities.	As discussed in paragraphs 18–19, the staff do not recommend updating the discussion of capital and capital maintenance at this stage. However, even if the Board decides to carry out further work on capital and capital maintenance in the future, the staff think that capital management concepts such as determination of appropriate capital levels are outside the remit of financial reporting standards.