

STAFF PAPER

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Project	Conceptual Framework		
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Purpose of the paper

1. This paper discusses whether any changes are needed to the proposed approach to concepts of capital and capital maintenance¹ in the light of the comments received on the Exposure Draft *Conceptual Framework for Financial Reporting* (the Exposure Draft). In particular, this paper considers whether the chapter on capital and capital maintenance should be retained or excluded from the revised *Conceptual Framework*.

Structure of the paper

2. This paper is structured as follows:
 - (a) staff recommendation (paragraph 5);
 - (b) Exposure Draft proposals (paragraphs 6–7);
 - (c) summary of feedback (paragraphs 8–15); and
 - (d) staff analysis and question for the Board (paragraphs 16–23).

¹ The concepts of capital and capital maintenance adopted in financial reporting are different from the legal concept of capital maintenance adopted in some jurisdictions, for example for dividend distribution purposes.

3. Appendix A sets out the inconsistencies suggested by respondents between the proposed chapter on capital and capital maintenance and the rest of the proposals in the Exposure Draft.
4. Appendix B sets out other comments received on the proposed chapter on capital and capital maintenance, and provides the staff's response.

Staff recommendation

5. The staff recommend that the Board:
 - (a) carries forward to the revised *Conceptual Framework* the existing chapter on capital and capital maintenance; and
 - (b) introduces that chapter with an explanatory statement that the chapter represents the remaining text of the *Framework for the Preparation and Presentation of Financial Statements (the Framework)* and has not been updated in the Conceptual Framework project (that explanatory statement will be included in the revised *Conceptual Framework* itself rather than only in the Basis for Conclusions).

Exposure Draft proposals (Chapter 8 and paragraphs BCIN.24 and BC8.1)

6. The Exposure Draft carried forward the chapter on capital and capital maintenance from the existing *Conceptual Framework* substantially unchanged. In particular, it carried forward the discussion of both financial and physical concepts of capital and capital maintenance and stated that the Board does not intend to prescribe a particular model other than in exceptional circumstances, such as for those entities reporting in the currency of a hyperinflationary economy.
7. The summary and invitation to comment on the Exposure Draft explained that the Board would consider revising the *Conceptual Framework* discussion of capital and capital maintenance if it were to carry out future work on accounting for high inflation, and that no such work is currently planned. The Basis for Conclusions on the Exposure Draft also emphasised a link between the concepts of capital and capital

maintenance and the use of current cost and noted that current cost is not discussed in detail as a possible measurement basis.

Summary of feedback

8. The invitation to comment did not request comments on capital and capital maintenance. Nonetheless, some respondents, mainly standard-setters and accountancy bodies and mainly European respondents, provided comments on the topic.
9. Almost all of those respondents raised concerns about the Board's proposed approach to concepts of capital and capital maintenance. They considered the existing chapter to be inadequate and outdated and suggested that it was inconsistent with the rest of the proposals in the Exposure Draft. Appendix A provides a list of examples of such inconsistencies suggested by respondents.
10. Some respondents suggested that the chapter implied there was a choice of capital maintenance concepts which they did not think was the case:
 - (a) two respondents stated that entities do not have a choice of capital maintenance concepts; and
 - (b) a few respondents stated that most IFRS Standards appear to be based on the financial concept of capital.
11. Some respondents suggested that concepts of capital and capital maintenance have much wider implications than just accounting for high inflation. Some argued that there are important implications for the objective of financial statements, elements, measurement and presentation, notably the use of the statement of profit or loss and other comprehensive income.
12. Most respondents who commented on the concepts of capital and capital maintenance suggested one of the following ways forward:
 - (a) about a half of the respondents suggested that the discussion of capital and capital maintenance should not be included in the revised *Conceptual Framework*, at least until and unless the Board considers the topic more comprehensively.

- (i) Most of those respondents argued that the chapter is not useful in its present form and is inconsistent with the rest of the proposals in the Exposure Draft.
 - (ii) Two respondents suggested that a discussion of capital and capital maintenance was unnecessary in the revised *Conceptual Framework*. They didn't think it would provide any additional relevant content.
- (b) other respondents did not think that the discussion of capital and capital maintenance should be excluded from the revised *Conceptual Framework*. These respondents suggested that the Board should update that discussion and either include it as a separate chapter or incorporate it in other chapters, for example the chapters on measurement and presentation and disclosure. Some of these respondents stated that concepts of capital and capital maintenance are fundamental to financial reporting. In particular, a few respondents suggested that it would be difficult for the Board to consider issues related to performance reporting in the absence of a clear concept of capital and capital maintenance.
13. The Australian Accounting Standards Board (AASB) and the New Zealand Accounting Standards Board stated that they could accept the Board's proposed approach at this time provided that the Board explains in the Basis for Conclusions on the revised *Conceptual Framework* why it has not developed the concepts of capital and capital maintenance. They did not agree with the explanations included in the Basis for Conclusions on the Exposure Draft that focussed on the interaction between the concepts of capital and capital maintenance, current cost measurement basis and accounting for high inflation. In particular, the AASB stated that the identification of an ideal concept of capital and capital maintenance is independent of a discussion of current cost.
14. Respondents who commented on how the discussion of capital and capital maintenance could be updated expressed diverse views:
- (a) a few respondents argued that both financial and physical concepts of capital have a role to play in financial reporting and should be

acknowledged in the revised *Conceptual Framework*. These respondents made the following suggestions:

- (i) the revised *Conceptual Framework* should discuss the advantages and disadvantages of various concepts of capital and capital maintenance and the interaction of those concepts with other areas of financial reporting such as its objective, the elements of financial statements, measurement and presentation and disclosure; and
 - (ii) changes in carrying values of assets and liabilities arising from adoption of the physical concept of capital represent a distinct category of items that should be included in other comprehensive income and that should be reflected in the presentation and disclosure chapter of the revised *Conceptual Framework*.
- (b) some respondents suggested that only the financial concept of capital should be discussed in the revised *Conceptual Framework*. They argued that there is no choice of capital maintenance concept for entities and that IFRS Standards are de facto based on the financial concept of capital. Two respondents suggested that only the financial concept of capital defined in terms of nominal monetary units should be discussed in the revised *Conceptual Framework*. They argued that neither the financial concept of capital defined in terms of constant purchasing power units nor the physical concept of capital feature prominently in IFRS Standards. Some of these respondents acknowledged that there are or can be departures from a single concept of capital in IFRS Standards but those departures should be viewed as exceptions. (Respondents cited the requirements of IAS 29 *Financial Reporting in Hyperinflationary Economies* and revaluation of property, plant and equipment and intangible assets permitted by IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* respectively as examples of such departures).
15. Some respondents also provided comments on other specific aspects of the chapter on capital and capital maintenance and related discussion in the Basis for Conclusions. Those comments and the staff's response are set out in Appendix B.

Staff analysis

16. The staff acknowledge the concerns raised by respondents about the proposal to carry forward to the revised *Conceptual Framework* the existing chapter on concepts of capital and capital maintenance substantially unchanged. The staff considered the merits and the feasibility of:
- (a) excluding the discussion of capital and capital maintenance from the revised *Conceptual Framework*; and
 - (b) updating the discussion of capital and capital maintenance.
17. The staff do not think it would be appropriate for the revised *Conceptual Framework* to exclude the discussion of capital and capital maintenance altogether. This is because those concepts are important to financial reporting and have interactions with the objective of financial reporting, the definitions of income and expenses, the selection of measurement bases and presentation and disclosure decisions. The staff note that many respondents who commented on the concepts of capital and capital maintenance, including those who suggested that the existing chapter should not be carried forward to the revised *Conceptual Framework*, agreed with this view. The staff are concerned that if the chapter on capital and capital maintenance were not included in revised *Conceptual Framework*, that could imply that the Board does not consider those concepts to be important.
18. Likewise, the staff do not think that updating the discussion of capital and capital maintenance is a feasible alternative at this stage. The staff note that respondents expressed diverse views on *how* that discussion should be updated (see paragraph 14). In particular, some respondents suggested that both the financial and physical concepts have a role to play in financial reporting and should be acknowledged in the revised *Conceptual Framework*, whereas other respondents argued that only the financial concept of capital should be included in the revised *Conceptual Framework*.
19. In addition, if the Board decided to update the concepts of capital and capital maintenance at this stage, it would need to consider whether those updated concepts need to be re-exposed. Developing and exposing the updated concepts could significantly delay the completion of the Conceptual Framework project. Delaying the completion of the project would be contrary to the advice received from most

members of the IFRS Advisory Council² and the Accounting Standards Advisory Forum (ASAF)³.

20. However, the staff agree that including the existing chapter on capital and capital maintenance in the revised *Conceptual Framework* alongside other chapters that contain revised concepts for financial reporting, without an explanation, could create confusion and would not result in a coherent document. Accordingly, the staff think that the Board should clearly signpost the chapter on capital and capital maintenance as a chapter that has not been updated in the Conceptual Framework project.
21. There has already been a precedent of taking a similar approach. When the Board issued revised Chapters 1 and 3 of the *Conceptual Framework* in 2010, it carried forward the existing Introduction and the remaining chapters of the *Framework*. That content was preceded by clear statements that it had been carried forward unchanged and that the Board would update it in the future. Importantly, those explanatory statements were included in the *Conceptual Framework* itself rather than in the Basis for Conclusions.
22. Accordingly, the staff recommend that the Board:
 - (a) carries forward to the revised *Conceptual Framework* the existing chapter on capital and capital maintenance; and
 - (b) introduces that chapter with an explanatory statement that the chapter represents the remaining text of the *Framework* and has not been updated in the Conceptual Framework project (that explanatory statement will be included in the revised *Conceptual Framework* itself rather than only in the Basis for Conclusions).
23. If the Board agrees with the staff recommendation, the discussion in the Basis for Conclusions would need to be updated accordingly. In particular, that updated discussion could explain that the Board may decide to revisit the concepts of capital and capital maintenance in the future when such a revision is considered necessary, for example if the Board decides to carry out work on accounting for high inflation. However, the staff think that the Basis for Conclusions should also clarify that the

² [Paragraph 10 of the meeting report of IFRS Advisory Council of February 2016](#)

³ [Paragraph 14 of the ASAF's meeting summary of April 2016](#)

Board does not think that the concepts of capital and capital maintenance are only relevant for accounting for high inflation. Such an explanation would help to address the concerns of respondents about the Basis for Conclusions discussed in paragraph 13.

Question for the Board

Does the Board agree with the staff recommendation in paragraph 22?

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

- A.2 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 chapter⁴. 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.

⁴ 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	<p>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.</p>	<p>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 <i>Conceptual Framework</i>.</p>
B2	<p>A few respondents commented on accounting for high inflation.</p> <p>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.</p> <p>Two respondents noted that whereas IAS 29 <i>Financial Reporting in Hyperinflationary Economies</i> 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.</p>	<p>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.</p> <p>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.</p>

Respondents' comments	The staff's response
<p>B3 SwissHoldings expressed a view that applying IAS 21 <i>The Effects of Changes in Foreign Exchange Rates</i> 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 <i>Conceptual Framework</i> project whether different capital maintenance concepts may be appropriate for:</p> <ul style="list-style-type: none"> - financial statements produced in jurisdictions affected by such government restrictions; and - financial statements of other entities in the group. 	<p>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.</p>
<p>B4 Some members of the Asian-Oceanian Standard-Setters Group suggested that the Board should explain the seemingly inconsistent requirements of IAS 16 <i>Property, Plant and Equipment</i> and IAS 40 <i>Investment Property</i> (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.</p>	<p>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 <i>Conceptual Framework</i> project.</p>
<p>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.</p>	<p>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.</p>
<p>B6 The Financial Reporting Council (UK) suggested that it is necessary to conduct</p>	<p>The staff note that the Primary Financial Statements research project is likely to</p>

Respondents' comments	The staff's response
<p>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.</p>	<p>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.</p>
<p>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.</p>	<p>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.</p>