STAFF PAPER

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IASB Meeting

Project	**Conceptual Framework**
Paper topic	Feedback summary—Elements of financial statements —Income, expenses and undefined elements

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Purpose of paper

1 This paper is one of three papers that summarise feedback on Chapter 4 of the Exposure Draft *Conceptual Framework for Financial Reporting* ('the Exposure Draft').

2 Chapter 4 of the Exposure Draft identified and defined five elements of financial statements. This paper summarises feedback on:

(a) the proposed definitions of income and expenses, and

(b) the proposal not to define elements for the statement of changes in equity and the statement of cash flows.

Agenda paper	Definitions discussed
10D	Asset
10E	Liability Equity
10F (this paper)	**Income and expenses** **Undefined elements**

3 The Exposure Draft asked respondents whether they agreed with the proposed definitions and if they had any comments on the guidance supporting those definitions. This paper provides a high level summary of the comments received. Where appropriate, we will provide more detail at future meetings.

Summary of key messages

4 Most respondents expressed no objections to the proposals:

(a) to retain the existing definitions of income and expenses largely unchanged,

(b) to remove from the *Conceptual Framework* some discussion of various types of income and expenses, and

(c) *not* to define elements for either the statement of changes in equity or the statement of cash flows.

Structure of paper

5 This paper addresses:

(a) the elements of the statement(s) of financial performance:

(i) definitions of income and expenses (paragraphs 6-15);

(ii) guidance accompanying those definitions (paragraphs 9 and 16-18);

(iii) other possible elements for the statement(s) of financial performance (paragraph 19).

(b) elements of other financial statements:

(i) statement of changes in equity (paragraphs 20-21);

(ii) statement of cash flows (paragraphs 22-24).

ELEMENTS OF THE STATEMENT(S) OF FINANCIAL PERFORMANCE

Definitions of income and expenses

Exposure Draft proposals (paragraphs 4.48-4.52, BC4.2-BC4.3 and BC4.104-BC4.105)

6 The existing *Conceptual Framework* identifies income and expenses as the elements of financial performance, and defines those elements by reference to changes in assets and liabilities.

7 The Exposure Draft proposed only minor changes to the definitions of income and expenses. The purpose of the changes would be to streamline the definitions and align the terminology with that proposed for the definitions of an asset and a liability.

	Existing definitions	Proposed definitions
Income	Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.	Increases in assets or decreases in liabilities that result in increases in equity, other than those relating to contributions from holders of equity claims.
Expenses	Decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.	Decreases in assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to holders of equity claims.

8 In response to concerns that the existing definitions give undue primacy to the statement of financial position, the Exposure Draft also emphasised that:

(a) information about income and expenses is just as important as information about assets and liabilities; and

(b) important decisions on, for example, recognition and measurement are driven by considering the resulting information in both the statement of financial position and the statement(s) of financial performance.[1]

[1] Exposure Draft, paragraphs 4.52, 5.9, 6.53.

9 The Exposure Draft proposed to remove from the *Conceptual Framework* some accompanying discussion of specific types of income and expenses—namely gains, losses and revenue. The Basis for Conclusions explained that:

(a) this discussion was originally included to clarify that income includes revenue and gains, and expenses include losses. Such clarification is no longer necessary;

(b) the implication that the *Conceptual Framework* defines subclasses of income and expenses is unhelpful; and

(c) the Board does not expect the removal of the discussion to cause any changes in practice.

10 Among the existing text that the Exposure Draft proposed to remove is a definition of revenue that is also used in IFRS 15 *Revenue from Contracts with Customers*.

Summary of feedback

Definitions

11 Most respondents either made no comment on the proposed definitions of income and expenses, or said that they agreed with the Exposure Draft proposals. A few of those who agreed with the proposals said that they:

(a) welcomed the simpler definitions; or

(b) agreed that income and expenses should be defined by reference to changes in assets and liabilities, rather than by attempting to 'match' income and related costs. In support of this position, a few respondents said that such matching approaches could be difficult to develop and have unwelcome consequences. Perfect matching of income and expenses is achievable only under conditions of complete certainty and matching approaches can result in deferral balances that do not meet the definitions of assets or liabilities.

12 Some respondents disagreed with the proposed definitions of income and expenses:

(a) most of those respondents, predominantly Europeans and including some users of financial statements, expressed concerns that, in their view, the (existing and proposed) definitions:

(i) imply a primacy of the statement of financial position over the statement(s) of financial performance;

(ii) give insufficient weight to the importance of income and expenses; or

(iii) raise questions of whether changes in fair value are income.

Some of this group said they would prefer the overriding concept for recognising and measuring performance to be based on matching of income and related costs, or for income and expenses to be defined more directly by reference to transactions in the period. One respondent further observed that not all changes in assets and liabilities give rise to income or expenses—some give rise to equal but opposite changes in other assets and liabilities.

(b) a few academics and individuals suggested completely different definitions of income and expenses. Suggestions included:

(i) defining income as value-generating activities, and expenses as value-sacrificing activities;

(ii) focusing on wealth generation in the operating cycle;

(iii) defining income in terms of additional amounts available for spending, and expenses as the costs matched with that income; or

(iv) defining income and expenses by reference to realised and realisable gains and losses, or gains and losses from normal operations.

13 A few respondents recommended refinements to, or additional clarification of, the proposed definitions. Recommendations included:

(a) changing the terminology, on the grounds that the terms ‘income’ and ‘expenses’ are generally understood as referring to inflows and outflows of resources, and not encompassing re-measurements. Respondents suggested using the terms ‘gains’ and ‘losses’ instead, which might allow the terms income and expenses to be used for more specific purposes, for example to refer to those gains and losses that are reported in the statement of profit or loss.

(b) stating in the *Conceptual Framework* that sometimes it is more appropriate to measure income and expenses directly, and to measure the resulting assets and liabilities indirectly by reference to the amount of income or expense. Respondents suggested that one IFRS Standard requiring such a direct measurement of income is IFRS 15.

(c) excluding not only contributions from, and distributions to, holders of equity claims but also transactions with parties that exercise control of the entity in other ways.

(d) clarifying the effect of the change from ‘equity participants’ to ‘holders of equity claims’. The Board should explain how the change would affect entities, such as companies limited by guarantee, that have equity participants who do not hold equity claims.

(e) omitting the phrase ‘that result in increases/decreases in equity’, either because it is unnecessary or because it seems to preclude identifying income and expenses for transactions that result in no net increase or decrease in equity (such as sales of inventory at cost).

(f) clarifying that income and expenses can arise when there is no net change in equity, for example with share-based payments, and that some changes in assets or liabilities do not give rise to income or expenses but instead to equal but opposite changes in other assets and liabilities.

(g) reversing the definitions, so that income and expenses are defined as increases / decreases in equity, rather than increases/decreases in assets or liabilities.

(h) clarifying that changes in assets and liabilities are not income and expenses if they do not reflect a change in an attribute of an asset or a liability, for example, if the changes arise from a change in an accounting policy or the correction of an error.

14 Paragraph 5.8 of the Exposure Draft explained that the proposed concepts lead to the simultaneous recognition (matching) of income and related expenses when such matching arises from the recognition of changes in assets and liabilities, but that the proposed concepts do not allow the recognition of items that do not meet the definitions of assets and liabilities. On this topic:

(a) a few respondents suggested enhancing the discussion of the role of matching in the provision of useful information. They argued that the concept of matching is important in measuring income and expenses, is necessary to provide a conceptual basis for cash flow hedge accounting, and may assist in determining when unrealised gains and losses should be recognised and where they should be presented.

(b) in contrast, an accounting firm and a regulator suggested that the Exposure Draft needs to make more explicit the message that matching is not proposed as a concept, and cannot justify the recognition of items that do not meet the definition of an asset or a liability.

15 A few respondents commented on particular aspects of the definitions of income and expenses without suggesting specific changes:

(a) one individual noted that the proposed definitions (like the existing definitions) do not explain how to distinguish between those changes in assets and liabilities that are accounted for on a gross basis (such as sales of inventory at their carrying amount, which are accounted for as giving rise to income and expenses of equal amount), and changes in assets and liabilities that are accounted for on a net basis (such as repayments of debt).

(b) a few respondents thought that the expenses arising from equity-settled share-based payments do not meet the proposed definition of an expense because there is no change in a liability or in equity[2].

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[2] *Staff note* The Basis for Conclusions accompanying IFRS 2 *Share-based Payment* explains why the Board concluded that share-based payment transactions give rise to an expense. The proposed changes to the definitions of income and expenses would not affect the substance of that explanation.

When an entity issues shares in exchange for a contribution of an asset (whether cash or another economic resource), it recognises both the asset received and an *increase* in equity. If and when the

Guidance accompanying the definitions

16 A few European respondents explicitly welcomed the statement in the Exposure Draft that information about income and expenses is just as important as information about assets and liabilities (some adding that many preparers and users of financial statements regard information about income, expenses and cash flows as *more* important). A European standard-setting body suggested that, in cases where application of the definitions would not lead to matching of income and expenses, the Board should carefully consider whether the resulting information is relevant. An organisation representing users of financial statements suggested that:

(a) it was important to note that different types of income have different levels of usefulness to users; and

(b) it would be useful to clarify that income and expenses include both inflows/outflows and enhancements/depletions of assets and liabilities.

17 Some respondents, including several users of financial statements, disagreed with the proposal to remove from the *Conceptual Framework* the existing discussion of types of income and expenses (revenue, gains and losses) or, more specifically, the definition of revenue. They argued that:

(a) revenue is a key performance indicator and not adequately described by the definition of income.

(b) the existing discussion is helpful and should be kept for completeness because it assists with establishing concepts of financial performance and profit or loss and makes the *Conceptual Framework* more robust.

(c) the distinction between revenue and gains is important in jurisdictions where revenue (or income) can be used as a determinant for regulatory reporting thresholds.

entity consumes the asset it has received, it recognises an expense and a *decrease* in equity. If the entity consumes the asset immediately (as is the case with employee services), the increase and decrease in equity may be recognised at the same time, with no net change. However, there are still two economic phenomena being accounted for, one of which decreases assets and equity and meets the definition of an expense.

(d) removing the description of revenue could indicate that the statement(s) of financial performance are less important than indicated by the existing *Conceptual Framework*.

(e) the *Conceptual Framework* should continue to discuss the notion of ‘ordinary activities’, which has broad application, particularly in relation to alternative performance measures and to distinguish revenue from other income.

(f) the discussion should be retained but would be more logically placed in the chapter on presentation.

18 A standard-setting body noted that IFRS 15 defines both ‘revenue’ and ‘customer’ by reference to an entity’s ordinary activities. However, the Board had rejected requests for IFRS 15 to clarify the meaning of ‘ordinary activities’ because the notion of ordinary activities was derived from the definition of revenue in the *Conceptual Framework*. The standard-setting body suggested that, on removing the term ‘ordinary activities’ from the *Conceptual Framework*, the Board should consider explaining the term better at a Standards level.

Other possible elements for the statement(s) of financial performance

19 A few respondents suggested that there should be other elements defined for the statement(s) of financial performance:

(a) a standard-setter suggested that the elements defined for the statement(s) of financial performance should be ‘profit or loss’, ‘other comprehensive income’ and ‘comprehensive income’, not income and expenses. In support of this suggestion, the standard-setter argued that the elements should be the group of essential items that are presented as a minimum on the face of each financial statement. ‘Profit or loss’ and ‘comprehensive income’ must be presented to meet the objectives of financial reporting; and to portray the relationship between those two amounts, it is also essential to present ‘other comprehensive income’.

(b) a few respondents suggested that income and expenses should be subdivided into two or more separate elements. Suggestions included:

(i) dividing income into revenue and gains/other income, and dividing expenses into expenses and losses.

(ii) using the terms income and expenses for items presented as part of profit or loss, and different terms for items that are presented as part of other comprehensive income.

(c) a few respondents noted that the Exposure Draft proposes that only items meeting the definition of income and expenses are recognised in the statement(s) of financial performance. Those respondents suggested that, if recycling is to be required or permitted, the *Conceptual Framework* will have to allow for the recognition of reclassification adjustments, defining them as separate elements.

ELEMENTS OF OTHER FINANCIAL STATEMENTS

Statement of changes in equity

Exposure Draft proposals (paragraphs BC4.106-BC4.110)

20 The existing *Conceptual Framework* does not identify elements for the statement of changes in equity. During the development of the Exposure Draft, the Board considered identifying elements—possibly contributions of equity, distributions of equity and transfers between classes of equity—and adding definitions of those elements to the revised *Conceptual Framework*. However, it decided against doing so, noting that the absence of definitions had not caused major problems, and that it could be difficult to create clear definitions without making significant amendments to the definitions of income and expenses.

Summary of feedback

21 Most respondents did not comment on this decision. A few respondents expressed a view that that the *Conceptual Framework* should define elements for the statement of changes in equity:

(a) some argued that it was important to identify and define all the elements of the three inter-related statements in which transactions could be recognised, ie statements of financial position, of financial performance and of changes in equity:

 (i) an academic organisation and a standard-setter thought that an important restriction arising from the reasoning in the *Conceptual Framework* is that only items that meet the definitions of elements are recognised in the financial statements. They noted that, without defining the elements of the statement of changes in equity, the *Conceptual Framework* can apply this restriction to only two of the three inter-related statements. Paragraph 5.7 of the Exposure Draft refers only to the statements of financial position and financial performance.

 (ii) an accountancy body and a standard setter argued that identifying and defining all of the elements of the three inter-related statements would help explain the relationships between the elements of those statements.

 (iii) a standard-setter suggested that the elements defined for the financial statements should include the items that need to be presented to portray the inter-relationships between other elements. Elements would have to be defined for the statement of changes in equity to portray the interrelationship between the elements of the statement(s) of financial performance and the statement of financial position.

(b) a few respondents suggested that clarification of the meaning of contributions and distributions of equity could help stakeholders distinguish such contributions and distributions from income and expenses. An accounting firm identified examples of 'problematic' transactions for which definitions might help: for example, off-market intra-group loans and some non-reciprocal benefits given to shareholders.

Statement of cash flows

Exposure Draft proposals *(paragraphs BC4.106-BC4.110)*

22 The existing *Conceptual Framework* does not identify elements for the statement of cash flows. During the development of the Exposure Draft, the Board considered identifying elements—possibly cash inflows (cash receipts) and cash outflows (cash payments)—and adding definitions of those elements to the revised *Conceptual Framework*. However it thought that defining elements of cash flows would not solve any known practical problem and could pre-empt the outcome of Board research on cash flows statements by implying:

(a) that all entities should produce a statement of cash flows; and

(b) a preference for the 'direct method' of presenting cash flows in a cash flow statement.

23 On the basis that these disadvantages would outweigh the main advantage (emphasising the importance of cash flow information), the Board decided not to define any elements for the statement of cash flows.

Summary of feedback

24 Most respondents did not comment on the Board's decision. Only a few respondents said that they thought that the *Conceptual Framework* should identify and define the elements of the cash flow statement:

(a) those giving a reason argued that definitions of the elements of the cash flow statement are needed to acknowledge the importance (some thought primacy) of that statement, and the importance of information about cash flows in meeting the objectives of financial statements; and

(b) an accountancy body also disagreed with the reasons the Board gave for not defining the elements of the cash flow statement. It argued that the *Conceptual Framework* should provide the concepts from which to develop more specific future requirements.