REVIEW OF THE CONCEPTUAL FRAMEWORK – IASB DISCUSSION PAPER

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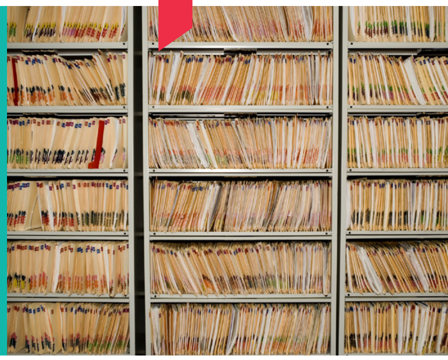

Summary

In July 2013 the International Accounting Standards Board (IASB) released a new Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*.

The Discussion Paper represents the IASB's first step towards a revision to the current *Conceptual Framework*, after the project was reinstated following constituent feedback received from the IASB's *2011 Agenda Consultation*.

This Discussion Paper is designed to obtain initial views and comments to be taken into consideration in preparing a subsequent Exposure Draft for the revision of the *Conceptual Framework*.

Key areas of focus include those that have both:

– Been known to have caused application issues in practice
– Require updates in order to be consistent with concepts developed by the IASB in other projects it has completed and/or is currently undertaking.

At a high-level these areas of focus include:

– Definitions of assets and liabilities
– Recognition and derecognition of assets and liabilities
– Measurement
– Equity
– Profit or loss and other comprehensive income (OCI)
– Presentation and disclosure
– Additional matters (including business model, unit of account, going concern, and capital maintenance).

The deadline for comments on the Discussion Paper is 14 January 2014.

STATUS
Discussion Paper

EFFECTIVE DATE
To be confirmed

ACCOUNTING IMPACT
Potential future impact to all entities you report under International Financial Reporting Standards (IFRS).

Background

The *Conceptual Framework* (the '*framework*') underpins the development of, and revisions to, all International Financial reporting Standards (IFRSs) that are issued by the IASB.

In summary, the *framework* should:

- Set out the preparation and presentation concepts to be applied to an entity's financial statements
- Form the recognition and measurement requirements to be applied
- Define the elements of an entity's financial statements (i.e. assets, liabilities, equity, income and expense)
- Enable parties to reach consistent conclusions in its application
- Assist parties when items or transactions are not specifically covered by a particular IFRS.

The IASB has previously been active in making/proposing revisions to the *framework*. In 2010, the IASB:

- Released revised the chapters regarding the:
  - *Objective of financial reporting*
  - *The characteristics of useful financial information*.
- Published an exposure draft on the *reporting entity*.

However, due to other projects becoming more of a priority in the wake of the financial crisis, the *framework* project was subsequently suspended. In responses to the IASB's *2011 Agenda Consultation*, constituents requested that the project be reinstated as a priority.

Accordingly, the IASB has restarted work on the *framework* project, with the first step being the issue of this Discussion Paper.

Summary of the Discussion Paper

The Discussion Paper is the IASB's first step to revising the *Conceptual Framework* (the '*framework*'). Feedback received from responses to the Discussion Paper will be used to assist in determining what the IASB should consider when developing its exposure draft of proposed revisions to the *framework*.

The Discussion Paper gives focus to areas that have both:

- Been known to have caused application issues in practice
- Require updates in order to be consistent with concepts developed by the IASB in other projects it has completed and/or is currently undertaking.

These areas of focus include:

a) Definitions of assets and liabilities
b) Recognition and derecognition of assets and liabilities
c) Measurement
d) Equity
e) Profit or loss and other comprehensive income (OCI)
f) Presentation and disclosure
g) Additional matters.

a) Definitions of assets and liabilities

The IASB believes that the current definitions of assets and liabilities have 'worked well', but it is considered that they could be refined and accompanied by additional guidance.

The Discussion Paper proposes revising the definitions of assets and liabilities so that they more clearly reflect that:

- An asset is a *resource*
- A liability is an *obligation*.

The table below illustrating the proposed changes in definitions has been reproduced from paragraph 2.11 of the Discussion Paper.

	Existing definitions	Proposed definition
Asset (of an entity)	A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.	A present *economic resource* controlled by the entity as a result of past events.
Liability (of an entity)	A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.	A present obligation of the entity to transfer an *economic resource* as a result of past events.
Economic resource	[no existing definition]	A right, or other source of value, that is capable of producing economic benefits.

Figure 1 – Current and proposed definitions of assets and liabilities

b) Recognition and derecognition of assets and liabilities

Recognition and derecognition deals with the principles and criteria for assets and liabilities to be included, or removed, from an entity's financial statements.

The Discussion Paper proposes:

- Improving guidance in respect of recognition
- Inserting new guidance in respect of derecognition.

The improvements in respect of recognition reflect the need to bring this into line with the principles being introduced through many of the IASB's current and recently released projects, and other developments.

Broadly speaking, the Discussion Paper proposes that assets and liabilities should be recognised by an entity, unless:

- Recognition results in irrelevant information
- The costs of recognition outweigh the benefits
- Recognition would result in a measure of information that is not a sufficiently faithful representation (including any associated income and expense that may be recognised).

Derecognition is not currently addressed in the *framework*, instead it is addressed in individual IFRSs. The Discussion Paper proposes requiring an entity derecognise an asset or liability (or part thereof) when the recognition criteria are no longer met.

c) Measurement

Measurement addresses how the amount to be included in an entity's financial statements should be determined.

Currently, the *framework* provides little guidance in this area and in which circumstances a particular measurement basis (e.g. cost, fair value) should be used.

The Discussion Paper proposes:

- Including guidance in respect of measurement
- That a single measurement basis for all elements of an entity's financial statements would not be appropriate, as it is unlikely to provide the most relevant information
- To limit the number of measurement bases
- In determining an appropriate measurement basis, the IASB needs to consider:
  - How the asset contributes to future cash flows
  - How the entity will fulfil or settle the liability
  - Ultimately, what information will be included in the statement of financial position and the statement of comprehensive income.

d) Equity

The Discussion Paper proposes that the definition of *equity* remain unchanged, being equal to an entity's assets less its liabilities (as defined).

However, the Discussion Paper does propose that:

– An entity be required to present an enhanced statement of changes in equity that provides more information regarding an entity's different classes of equity, and the transfers between these different classes
– The distinction between equity and liabilities is clarified through focus on the definition of a liability (see above).

e) Profit or loss and other comprehensive income (OCI)

Currently, the *framework* does not contain principles to determine:

– What items are recognised in *profit or loss*
– What items are recognised in *other comprehensive income*
– Whether, and when, items can be recycled *from other comprehensive income* to *profit or loss*.

In response, the Discussion Paper proposes that the *framework* should:

– Require a profit or loss total or subtotal that also results, or could result, in some items of income or expense being recycled
– Limit the use of OCI (only to income and expenses resulting from remeasurements of assets and liabilities).

In dealing with OCI more specifically, the Discussion Paper proposes two approaches in terms of what items (bridging items, mismatched remeasurements, and transitory remeasurements) would be included in OCI, being:

– *Narrow* approach (which includes bridging items and mismatched remeasurements only)
– *Broad* approach (which, in addition to the narrow approach, includes transitory remeasurements).

The table below illustrating the differences between bridging items, mismatched remeasurements, and transitory remeasurements, together with the approach to which they apply, has been reproduced from the IASBs *Snapshot* publication.

Bridging items	Mismatched remeasurements	Transitory remeasurements
Narrow and Broad approach	Narrow and Broad approach	Broad approach only
What distinguishes these items from those recognised in profit or loss?		
The item of income or expense represents the difference between: a) Measurement used in determining profit or loss b) A remeasurement used in the statement of financial position.	The item of income or expense represents the effects of part of a linked set of assets, liabilities or past or planned transactions. It represents their effect so incompletely that, in the opinion of the IASB, the item provides little relevant information about the return that the entity has made on its economic resources in the period.	The item meets all the following criteria: a) The asset or the liability has a long-term time horizon for realisation or settle-ment b) Amounts recognised in OCI are likely to fully reverse or significantly change c) Use of OCI enhances the relevance and understandability of items in profit or loss.
When should items recognised in OCI be reclassified (recycled) into profit or loss?		
Recycle as a consequence of the measurement basis presented in profit or loss.	Recycle when the item can be presented with the matched item(s).	Recycle for some types of OCI items if and when it provides relevant information in profit or loss.

Figure 2 – Differences between bridging items, mismatched remeasurements, and transitory remeasurements

f) Presentation and disclosure.

Respondents to the IASB's *2011 Agenda Consultation* highlighted that in revising the *framework* the IASB needed to consider introducing a specific disclosure *framework* in order to result in both:

- More relevant information being presented to users
- A reduction in the burden of preparation for preparers.

The Discussion Paper proposes revisions to the *framework* around disclosure, in areas including:

- The objective of the primary financial statements
- The objective of the notes to the financial statements
- Materiality
- Communication principles.

In addition, the IASB has identified both short-term and long-term steps to addressing disclosure requirements in existing IFRSs, including:

i) Short-term steps:

- Amendments to IAS 1 *Presentation of Financial Statements*
- Application of materiality
- Disclosure requirements currently on the IASB's project agenda.

ii) Long-term steps:

- Replacement of IAS 1, IAS 7 *Statement of Cash Flows*, and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- Revision of disclosure requirements in individual IFRSs.

The Discussion Paper proposes that the objectives of such a disclosure *framework* would include:

- Presentation of information that provide summarised information about recognised assets, liabilities, equity, income, expenses, changes in equity and cash flows, that has been classified and aggregated in a useful manner
- Disclosure of useful information in the notes to the financial statements so as to supplement the primary financial statements regarding an entity's recognised and unrecognised items.

The table below, which illustrates the types of information the IASB believes might be required to meet disclosure requirements, has been reproduced from the IASBs *Snapshot* publication.

Type of useful information	Examples of disclosures in the notes to the financial statements
Reporting entity	– The group structure, for example, subsidiaries, associates, parent etc. – The business model – Going concern.
Amounts recognised in the primary financial statements	– Disaggregation of line items in the primary financial statements. – Relationships between line items, for example, hedging, offsetting etc.
Unrecognised assets or liabilities	– Description of unrecognised assets and liabilities and why the items have not been recognised.
Risks	– The financial risks to which the entity is exposed – How the entity has managed those risks – How management of risks has impacted the entity's financial statements, including sensitivity analysis.
Methods, assumptions and judgements	– Accounting policies – Measurement methodologies, including assumptions and inputs – Quantification of the sensitivity of estimates to changes in assumptions and inputs – Alternative measurements.

Figure 3 – Potential 'useful information' to be considered by the IASB to meet disclosure requirements

g) Additional matters

The Discussion Paper also discusses other relevant areas including

i) Business Model

The Discussion Paper does not propose to define the *business model* concept.

However, the IASB has acknowledged that, when developing or revising IFRSs, it may be appropriate to give consideration to how an entity conducts its business as this can result in financial statements that are more relevant.

ii) Unit of account

The Discussion Paper states that the IASB believes the unit of account is best left to the development and revision of individual IFRSs, rather than being included as a general concept within the *framework*.

iii) Going concern

Currently, the *framework* requires an entity to prepare its financial statements on the presumption it will continue to be a going concern for the foreseeable future (i.e. that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations).

Where this is not the case, the financial statements are instead prepared on a different basis, and that fact is disclosed.

The Discussion Paper identifies sections where the going concern concept is relevant.

- *Section 3*: additional guidance to support the asset and liability definitions states that requirements to make payments that would arise only on liquidation do not meet the definition of a present obligation.
- *Section 6*: Measurement notes that a change in an entity's ability to continue as a going concern may affect how its:
  - Assets will contribute to future cash flows
  - Liabilities will be settled.

iv) Capital Maintenance

The concept of capital maintenance is important as only income earned in excess of amounts needed to maintain existing amounts of capital can be regarded as profit.

The Discussion Paper states that the IASB believes the concepts of capital maintenance are probably most relevant for entities operating in high inflation economies.

The IASB plans to undertake research to determine whether to revise IAS 29 *Financial Reporting in Hyperinflationary Economies*.

The IASB has also indicated that it may at some point consider amending the revaluation model in IAS 16 *Property, Plant and Equipment* (and IAS 38 *Intangible Assets*) to make it consistent with either the bridging concept or the capital maintenance concept.

Comment period

The deadline for comments on the Discussion Paper is 14 January 2014.

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