STAFF PAPER

June 2014

REG IASB Meeting

Project	**Conceptual Framework**		
Paper topic	Unit of Account		
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Purpose of paper

1. The purpose of this paper is to discuss issues related to the unit of account.

2. This paper does not address specific unit of account issues that might arise in the following areas:

    (a) executory contracts (see Agenda Paper 10D);

    (b) liabilities and equity (see Agenda Papers 10H and 10I); and

    (c) derecognition (to be discussed in a future meeting).

Summary of staff recommendations

3. The staff recommend that:

    (a) the IASB confirms its view in the Discussion Paper (DP/2013/1) *A Review of the Conceptual Framework for Financial Reporting* (hereinafter referred to as the 'Discussion Paper') that determining the unit of account is a Standards-level decision;

    (b) the *Conceptual Framework for Financial Reporting* (hereinafter referred to as the '*Conceptual Framework*') should describe possible units of account (see paragraph 11); and

(c) the *Conceptual Framework* should include a list of factors to consider when determining the unit of account but should not rank the priorities of the factors (see paragraph 12).

Background

4. Sections 3 and 9 of the Discussion Paper discussed issues related to unit of account (those paragraphs are reproduced in Appendix A). The IASB's preliminary view was that determining the unit of account would be a Standards-level decision, instead of a decision that can be resolved conceptually for a broad range of Standards.

5. Nearly half of the respondents commented on the unit of account. Many of those respondents stated that they agreed with the IASB's preliminary view.

6. However, some respondents stated that the IASB should provide more detailed discussion in determining the unit of account in the *Conceptual Framework*. Most of those respondents stated that the *Conceptual Framework* should discuss the factors to consider when determining the unit of account and possibly rank the priorities of these factors.

7. Specific comments on determining the unit of account included the following:

   (a) some respondents stated that the *Conceptual Framework* should describe possible units of account;

   (b) some respondents suggested that the individually identifiable economic resource or the individually identifiable obligation to transfer an economic resource should be the starting point for the unit of account;

   (c) some respondents stated that, for physical assets, the principle should always be to treat all the rights inherent in the physical asset as a single unit, unless some or all of the rights related to that asset have in fact been separated and transferred to one or more parties;

   (d) some respondents (mainly banks) disagreed with the existing requirement of measuring equity investments by measuring the value of a single share and multiplying that value by the number of shares held;

(e) some respondents suggested that rate-regulated assets and liabilities meet the definitions of an asset and a liability only if the assessment is made at the portfolio level;

(f) some respondents (mainly banks) asked for confirmation that one possible unit of account is a risk exposure within a portfolio of contracts; and

(g) Some respondents stated that the *Conceptual Framework* should commit the IASB to explaining in the Basis for Conclusions in individual Standards what unit of account it selected and why.

8. At its May 2014 meeting, the IASB tentatively decided that assets should be viewed as rights, or bundles of rights, instead of underlying physical or other objects. The IASB noted that in many cases an entity would account for an entire bundle of rights as a single asset, and describe that asset as the underlying object. An entity would account separately for rights within a bundle only when needed to provide a relevant and faithful representation, at a cost that does not exceed the benefits.

Possible changes

9. Consistently with the Discussion Paper and many of the responses, the staff recommend that the *Conceptual Framework* should state that determining the unit of account is a Standards-level decision. This is because the appropriate unit of account depends on the specific features of the item that the entity is accounting for and no single concept could describe how to determine the most useful unit of account consistently for a broad range of Standards. Accordingly, if comments such as paragraph 7(c)–(e) need to be addressed, they would be addressed at the Standards level.

10. Having reviewed the responses to the Discussion Paper, the staff believe that the material in paragraphs 9.35–9.41 and 3.102(b)–(c) (reproduced in Appendix A of this paper) is a good starting point to develop material for the *Conceptual Framework*. Nevertheless, the staff think it would be useful to add a discussion about the following:

(a) possible units of account; and

(b) factors to consider when determining the unit of account.

Possible units of account

11. Some respondents to the Discussion Paper suggested that the *Conceptual Framework* should describe possible units of account, for example:

(a) *a portion of a single item*—a single financial instrument may comprise a liability component and an equity component. In such a case, each component could be a separate unit of account;

(b) *a single item*—a physical unit (such as a machine) will in many cases provide the most useful and understandable information to users of financial statements, if the entity holds all the rights to that physical unit;

(c) *a portfolio of similar items*—information about a portfolio of insurance contracts, instead of information derived by aggregating information about individual insurance contracts, may provide more useful and understandable information to users of the financial statements of an entity that issues these contracts;

(d) *a portfolio of dissimilar items*—assets and liabilities comprising a disposal group may need to be accounted for differently from the entity's other assets and liabilities; and

(e) *a risk exposure within a portfolio of items*—if a portfolio of items is subject to similar risks, some aspects of the accounting for that portfolio may need to focus on the aggregate exposure to that risk within the portfolio.

Factors to consider when determining the unit of account

12. The staff think that, in addition to the factors discussed in paragraphs 9.35–9.41 of the Discussion Paper, the following factors may need to be considered when determining the unit of account:

(a) *cash flow dependency*—if two items are measured on a basis that depends on implicit or explicit estimates of the future cash flows they will generate, and the cash flows from the items are interdependent, measuring those items together may produce information that is more relevant than measuring them separately, because it is likely to reflect their interdependencies. For example, an asset may be reviewed for impairment as part of a group of assets.

(b) *ability to transact separately*—separate information about individual rights or obligations may not be relevant if those rights or obligations cannot be, or are unlikely to be, the subject of separate transactions.

(c) *substance of the transaction*—although in many cases legal form is consistent with the substance of the transaction, in some cases it is not. For example, a group or series of contracts that achieves, or is designed to achieve, an overall commercial effect should be viewed as a whole. Conversely, if a single contract contains two or more sets of rights and obligations that would all have been identical if they had been created through more than one legal document, the entity may need to account for the different sets of rights as if they were separate contracts.

(d) *economic characteristics and risks*—items with different economic characteristics and risks are likely to have different implications on the prospects for future net cash inflows to an entity. For example, an embedded derivative may need to be separated from the host and accounted for as a derivative if the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host.

13. Although some respondents to the Discussion Paper asked the IASB to rank the priorities of factors to determine the unit account, the staff think it would be difficult to do so because, as noted earlier in this paper, the appropriate unit of account depends on the specific features of the item that the entity is accounting for and no single concept could describe how to determine the most useful unit of account consistently for a broad range of Standards. Accordingly, the staff do not recommend ranking the priorities of the factors.

Other matters

14. The following paragraphs address two other matters raised by respondents:

    (a) explaining what unit of account the IASB selected and why; and

    (b) editorial changes.

Explaining what unit of account the IASB selected and why

15. The IASB's preliminary view in the Discussion Paper was that in some cases the IASB may not need to specify a particular unit of account, but in other cases it may decide that it needs to specify a unit of account to ensure comparability between entities or over time.

16. Some respondents stated that the *Conceptual Framework* should commit the IASB to explaining in the basis for individual Standards what unit of account it selected and why.

17. The staff think that it would be useful for the IASB to explain what unit of account it selects and the reasons for that selection, whenever the IASB decides to specify the unit of account. However, the staff do not think the IASB should refer to this policy in the *Conceptual Framework*.

Editorial changes

18. In the Discussion Paper, unit of account was discussed in the context of recognition and measurement. Based on input from respondents to the Discussion Paper, the staff note that, in addition to recognition and measurement, the unit of account is also relevant for determining whether the item meets the definitions of the elements of financial statements, derecognition, presentation and disclosure.

19. One consequence of making editorial changes would be that paragraph 9.41 of the Discussion Paper would be amended to read as follows:

    > The unit of account will often be the same for applying the definitions of the elements of financial statements, recognition, derecognition, measurement, presentation and disclosure. However, in some situations the IASB may decide that different units of account should be used for

certain aspects of applying the definitions of the elements of financial statements, recognition, derecognition, measurement, presentation and disclosure.

Staff recommendation

20. The staff recommend that:

    (a) the IASB confirms its view in the Discussion Paper that determining the unit of account is a Standards-level decision;

    (b) the *Conceptual Framework* should describe possible units of account (see paragraph 11); and

    (c) the *Conceptual Framework* should include a list of factors to consider when determining the unit of account but should not rank the priorities of the factors (see paragraph 12).

Question for the IASB
Does the IASB agree with the staff recommendation in paragraph 20?

Appendix A: Excerpts from the Discussion Paper

A1. This Appendix reproduces the discussions related to the unit of account in the Discussion Paper.

A2. Section 9 of the Discussion Paper discussed the unit of account.

Unit of Account

9.35 In order to recognise and measure assets and liabilities in the financial statements in a way that provides useful information to existing and potential investors, lenders and other creditors, it is usually necessary to aggregate individual resources, or other rights, and obligations. The level of disaggregation required is usually referred to as the ‘unit of account’.

9.36 For example, as discussed in Section 3, ownership of a physical asset such as a machine comprises several rights (the right to use the asset, the right to sell the asset, the right to pledge the asset and any other rights conferred by legal title to the asset). Although, in principle, each of these rights is capable of being a separate asset, combining them into a single unit of account and recognising a single asset (the machine) will in many cases provide the most relevant and understandable information to users of the financial statements. In other cases (for example, when the machine has been leased), recognising (or derecognising) some of the rights separately may provide a more faithful representation of the financial position of the entity.

9.37 The unit of account used can also affect the measurement of recognised assets and liabilities, for example:

(a) a different measure of an equity investment may be obtained if:

(i) the value of a single share in that equity investment is measured and multiplied by the number of shares held; or

(ii) the value of the total equity investment is measured.

(b) in determining whether an asset is impaired, a different conclusion may be reached if the asset is reviewed for impairment in isolation or as part of a group of assets. This is because, within a group, gains on some assets may be offset against losses on other assets, whereas if they were reviewed in isolation the gains would be ignored.

(c) if assets or liabilities are measured by reference to the most likely outcome of uncertain future cash flows, that outcome may differ depending on whether it is determined for each asset or liability individually, or for a group of assets or liabilities.

9.38 The IASB's preliminary view is that deciding which unit of account will provide the most useful information to existing and potential investors, lenders and other creditors will normally be a decision for projects to develop or revise particular Standards, rather than a decision that can be resolved conceptually for a broad range of Standards. In making that decision, the IASB will consider the qualitative characteristics of useful financial information. The selected unit of account must:

(a) provide relevant information. Information about individual rights or obligations may not be relevant if those rights or obligations cannot be, or are unlikely to be, the subject of separate transactions or if they would expire in different patterns.

(b) faithfully represent what it purports to represent. Grouping unrelated assets or liabilities together, in order to measure them, may not faithfully represent an entity's financial position or performance.

9.39 In addition, the costs associated with the selected unit of account must not exceed the benefits. In general, the costs associated with recognising and measuring items will be greater for a smaller unit of account.

9.40 In some cases, the IASB may not need to specify a particular unit of account (for example, if the unit of account is unlikely to affect the recognition or measurement of assets or liabilities). However, in other cases, the IASB may decide that it needs to specify a unit of account to ensure comparability between entities or over time. The selected unit of account must also provide information that is understandable.

9.41 The unit of account for recognition and measurement will normally be the same. However, in some situations the IASB may decide that different units of account should be used for recognition and/or measurement.

A3. Section 3 of the Discussion Paper also discussed issues related to the unit of account.

Economic resource

3.12 Sometimes, a single resource contains obligations as well as rights. For example, contracts create a series of rights and obligations for each party. The unit of account (see Section 9) will determine whether the entity accounts for that package as a single asset or a single liability or as one or more separate assets and one or more separate liabilities. Generally, when a package of rights and obligations arise from the same source, an entity will account for them at the highest level of aggregation that enables it to depict the rights and obligations, and the changes in those rights and obligations, in the most relevant, faithful and understandable manner.

3.13 The unit of account will determine whether a contract is viewed as giving rise to a single net right or net obligation, or to one or more separate rights and obligations. Offsetting is not the same as having a single (net) right or a single (net) obligation. When a single (net) right or a single (net) obligation exists in a particular case, the entity has only a single asset or a single liability. For example, suppose that an entity holds an option to buy an asset if it pays CU100 and that asset has an expected value of CU140. The entity does not have an asset of CU140 and a liability to pay the strike price of CU100. Instead, the entity has an asset of CU40. In contrast, offsetting arises when an entity has both an asset and a liability and recognises and measures them separately, but presents them as a single (net) amount (possibly with disclosure of the separate asset and liability). [Footnote reference omitted.]

Reporting the substance of contractual rights and obligations

Proposed guidance

3.102 ... The *Conceptual Framework* could state that:

(a) ...

(b) a group or series of contracts that achieves, or is designed to achieve, an overall commercial effect should be viewed as a whole. One situation which this treatment may be particularly important is if rights and obligations in one contract entirely negate obligations or rights in another contract.

(c) conversely, if a single contract contains two or more sets of rights and obligations that would all have been identical if they had been created through more than one legal document, the entity may need to account for the different sets of rights as if they were separate contracts.

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