STAFF PAPER

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IASB Meeting

Project	**Conceptual Framework**
Paper topic	Equity - Classes and accounting requirements within equity

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Introduction

1. This paper discusses whether the *Conceptual Framework* should require or preclude any accounting requirements to be discussed in a future project to develop or amend a Standard on the classification of claims on an entity as equity. Such accounting requirements may include:

   (a) Classes within equity; and

   (b) Recognition, measurement, presentation and disclosure of information that might be relevant for users regarding different classes of equity.

2. We recommend that the *Conceptual Framework* should neither require nor preclude any accounting requirements for classes of claims within equity.

The Discussion Paper

3. The Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* included a number of suggestions that might be discussed in a future project to develop or amend a Standard on the classification of claims as liability or as equity.

4. In considering the objectives of the distinction between liabilities and equity, the Discussion Paper noted that existing and potential investors need information to

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help them assess the prospects for future net cash inflows to an entity.[1] In addition, information about priorities and payment requirements of existing claims helps users to predict how future cash flows will be distributed among those with a claim against it.[2] In other words, (existing and potential) investors need information about both:

(a) the future net cash inflows to the entity (cash inflows less cash outflows); and

(b) the claims that determine how those net cash inflows will be distributed among holders of different claims.

5. The Discussion Paper also stated that IFRSs do not in general prescribe which categories of equity an entity should present separately (apart from non-controlling interests), because determining which categories are most relevant to users may depend on local legislation and on the reporting entity's governing constitution.

6. The Discussion Paper went on to suggest that some of the information about equity claims required by users of financial statements could be provided if the measure of some categories of equity claim were updated through an expanded statement of changes in equity. The Discussion Paper noted that introducing a requirement to update measures of equity claims through the statement of changes in equity would bring a new feature into IFRSs. Such a requirement would have to be introduced by developing a new Standard or amending an existing standard, and would be subject to the IASB's normal due process. The Discussion Paper noted that such a requirement might help financial statements achieve two objectives:

(a) It would give equity holders a clearer and more systematic view of how other equity claims affect them.

(b) It would provide another way to resolve some liability/equity classification issues that have proved problematic over the years.

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[1] OB3

[2] OB13

Feedback from respondents and staff analysis

7. Many respondents commented on the matters in paragraph 6 above that were included in the Discussion Paper. Those suggestions were simply standards-level details to illustrate other possible ways of providing useful information and the IASB never intended to include such requirements in the *Conceptual Framework*. We ask the IASB to confirm this below. As noted in Agenda Paper 10B in April 2014, those matters and comments will be considered by the IASB in the Financial Instruments with Characteristics of Equity research project.

8. Many of those respondents did not support the **specific** proposals for the recognition and measurement of classes of equity claims within the statement of changes in equity. However, in our view, that should not result in the IASB precluding **any** such requirements in the *Conceptual Framework*. Furthermore, many respondents to the Discussion Paper, including many investors and other users, supported providing additional information on the effects of different classes of equity claim.

9. In our view, the *Conceptual Framework* should not prevent the IASB from requiring entities to provide information regarding equity claims that would be useful to users of financial statements. Doing so would contradict the stated objective of financial reporting. Like for assets and liabilities, the IASB should be able to apply the guidance in the *Conceptual Framework* to develop in IFRSs recognition, measurement, presentation and disclosure requirements for items that meet the definition of equity if applying those requirements will enhance the usefulness of the financial statements. The only restrictions will be that, by definition:

   (a) items classified as liabilities and equity will be presented separately in the statement of financial position; and

   (b) changes in liabilities will be recognised in the statement of profit or loss and other comprehensive income, and changes in equity will be recognised in the statement of changes in equity.

10. Many respondents disagreed with the suggestion in the Discussion Paper to update the measure of some classes of equity claims. These respondents noted

that financial statements are not designed to show the value the entity.[3] However, we note that similar items would need to be subsequently measured if classified as a liability. In our view, the classification of a claim as a liability, or as equity, should not limit the accounting requirements beyond the effect of that classification.

11. Many commentators stated that IFRSs do not currently update measures of equity instruments. However, that is only partly true:

    (a) IFRSs do not permit entities to update measures of equity instruments *through profit or loss*. There is no existing obstacle to updating those measures through equity (and reporting the resulting changes as transfers within the statement of changes in equity).

    (b) IFRSs require entities to update measures of non-controlling interests (NCI) to reflect NCI's share in profit or loss, in other comprehensive income and in other equity movements.

12. The approach described in paragraph 6 is largely consistent with, and an extension of, the way that IFRSs treat non-controlling interest (NCI) in a subsidiary. NCI does not meet the existing or proposed definition of a liability, because the entity has no obligation to transfer economic resources. Therefore, IFRSs treat NCI as part of equity, not as a liability. IAS 1 already requires entities to display prominently the NCI's share in equity, in profit or loss and in comprehensive income. An entity would display NCI as a separate column in the statement of changes in equity. In our view, precluding such requirements would imply that the treatment of NCI does not comply with the *Conceptual Framework*.

Question for the IASB
Does the IASB agree that the *Conceptual Framework* should neither require nor preclude any accounting requirements for classes within equity that will result in useful information to users of financial statements?

[3] OB7