

## Snapshot: *Conceptual Framework for Financial Reporting*

This Snapshot introduces the IASB's Exposure Draft *Conceptual Framework for Financial Reporting* (the 'Conceptual Framework') and provides a high level summary of the most important proposals.

**Project objectives:** To improve financial reporting by providing a more complete, clearer and updated *Conceptual Framework* that can be used by:

- (a) the IASB when it develops International Financial Reporting Standards (IFRS); and
- (b) others to help them understand and apply IFRS.

**Next steps:** The IASB will consider feedback on its proposals as it develops the revised *Conceptual Framework*. The IASB aims to publish the revised *Conceptual Framework* in 2016.

**Comment deadline:** 26 October 2015

# Background

The *Conceptual Framework* describes the objective of and concepts for financial reporting.

The purpose of the *Conceptual Framework* is to:

- (a) assist the IASB to develop Standards that are based on consistent concepts;
- (b) assist preparers to develop consistent accounting policies when no Standard applies to a particular transaction or event; and
- (c) assist all parties to understand and interpret the Standards.

The *Conceptual Framework* is important because it shapes the decisions that the IASB makes when developing future Standards. However, it is not a Standard and does not override any Standard.

The existing *Conceptual Framework* has helped the IASB to successfully pursue its stated mission to develop Standards that bring transparency, accountability and efficiency to financial markets around the world. However, some improvements are needed.

There are gaps in the existing *Conceptual Framework*. For example, it provides very little guidance on presentation and disclosure of financial information.

fill gaps

Some parts are out of date, for example the existing guidance on when assets and liabilities should be recognised.

update

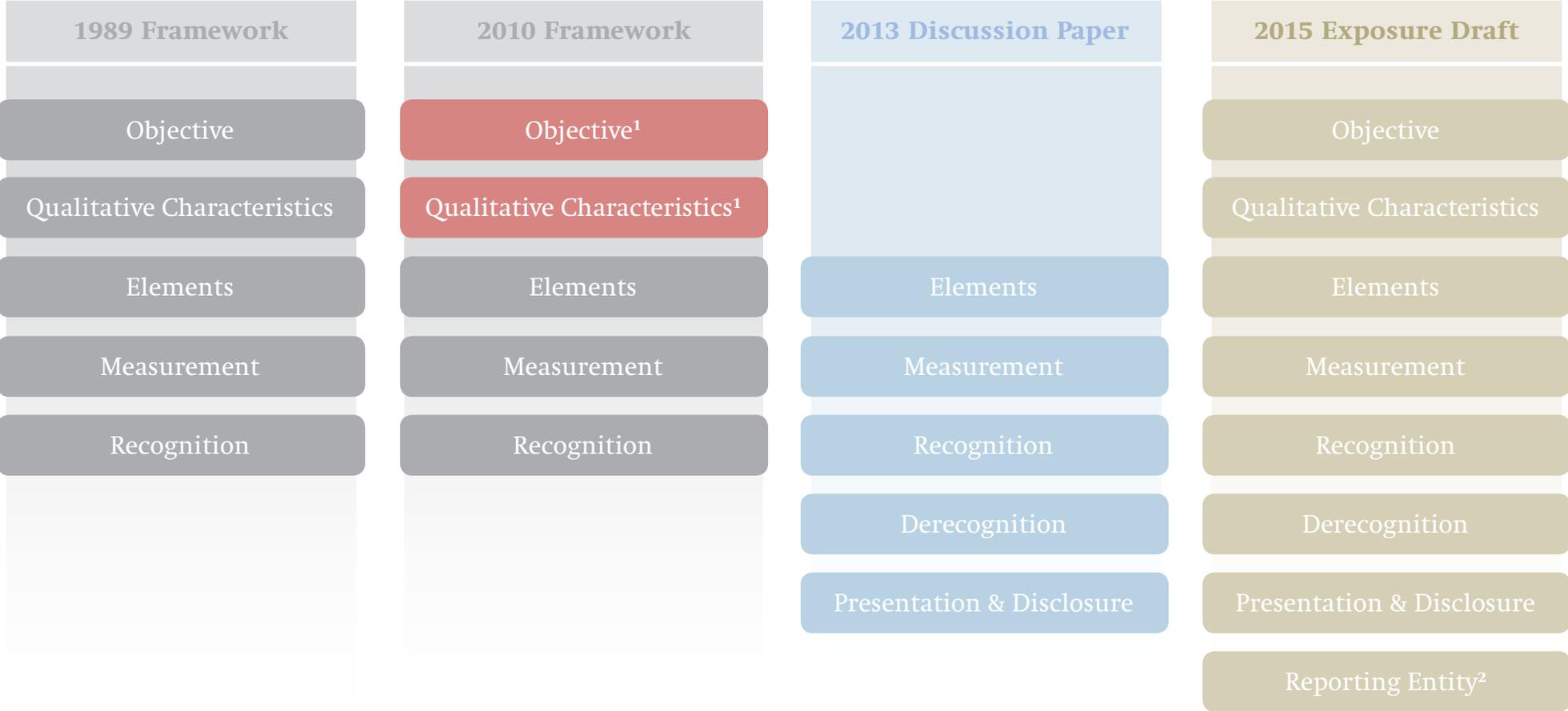
The guidance in some areas is unclear and less helpful than it could be. For example, it is unclear what role measurement uncertainty plays in deciding how to measure assets, liabilities, income or expenses.

clarify

In 2011, the IASB carried out a public consultation on its future agenda. Many respondents to that consultation identified the *Conceptual Framework* as a priority project. Consequently, the IASB restarted its *Conceptual Framework* project, which had been suspended in 2010 to give priority to other projects on the IASB's agenda.

In July 2013, the IASB issued a Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*. The Discussion Paper set out the IASB's preliminary views on possible changes to the *Conceptual Framework*. The IASB considered the feedback received on that Discussion Paper when developing the Exposure Draft.

# History and content of the *Conceptual Framework*



1 Revised chapters on the objective of financial reporting, and on the qualitative characteristics of useful financial information, were issued in 2010.  
 2 An Exposure Draft on the Reporting Entity was issued in 2010. Feedback received on that Exposure Draft was considered when developing the 2015 Exposure Draft.

# Objective and qualitative characteristics

clarify

The **objective of general purpose financial reporting** is to provide financial information about the reporting entity that is **useful** to existing and potential investors, lenders and other creditors (users of financial statements) in **making decisions** about providing resources to the entity.

## Qualitative characteristics of useful financial information

If financial information is to be **useful**, it must be **relevant** and **faithfully represent** what it purports to represent.

When the IASB restarted work on the *Conceptual Framework* project, it planned not to reconsider fundamentally the chapters describing the objective of financial reporting and the qualitative characteristics of useful financial information. However, having listened to the comments received on the Discussion Paper, the IASB now proposes:

- (a) to place more emphasis, within the discussion of the objective of financial reporting, on the importance of providing information needed to assess management's **stewardship** of the entity's resources;
- (b) to reintroduce an explicit reference to the notion of **prudence** (described as the exercise of caution when making judgements under conditions of uncertainty) and state that prudence is important to achieve neutrality and hence, a faithful representation; and
- (c) to state explicitly that a faithful representation reports the **substance** of a transaction rather than merely its legal form.

Some respondents to the Discussion Paper raised concerns that **reliability** is no longer identified as a qualitative characteristic of useful financial information. The IASB believes that many of the concerns relate to measurement uncertainty. In response, the IASB proposes to clarify that measurement uncertainty is one factor that can make financial statements less relevant, especially if the level of uncertainty in the estimate is very high.

# Elements

update

clarify

**Elements** are the basic building blocks from which financial statements are constructed.

## Statement of financial position

Assets

Liabilities

Equity

## Statement(s) of financial performance

Income

Expenses

The IASB believes that the existing definitions of assets and liabilities have worked well, but that they could be refined. The IASB is proposing amendments to the definitions of assets and liabilities to explain more clearly:

- (a) that an asset is an economic resource, and a liability is a present obligation; and
- (b) that, for the definition of an asset or a liability to be met, inflows of economic benefits from an asset (or outflows from a liability) do not have to be certain.

The definitions of income and expenses would be updated so that they remain consistent with definitions of an asset and of a liability.

The Exposure Draft retains the existing definition of equity as a residual interest in the entity's assets after deducting all its liabilities.

## Proposed definitions

### Assets

Present **economic resources** controlled by the entity as a result of past events

### Liabilities

Present obligations of the entity to transfer an **economic resource** as a result of past events

### Equity

= Assets—Liabilities

An **economic resource** is a right that has the potential to produce economic benefits.

A **present obligation** is an obligation to transfer economic resources that:

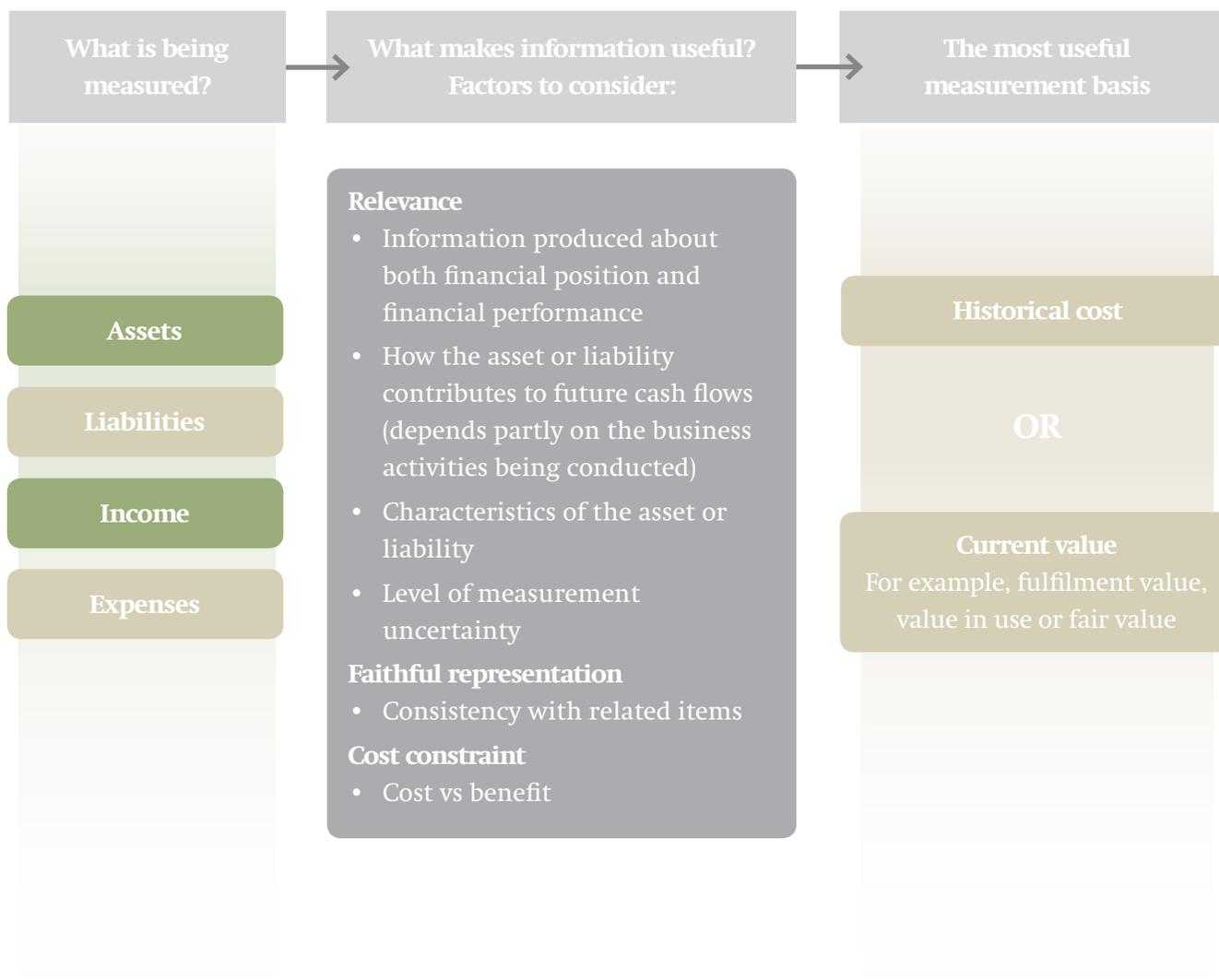
- (a) the entity has no practical ability to avoid; and
- (b) has arisen from a past event (ie economic benefits already received or activities already conducted).

# Measurement

fill gaps

**Measurement** is the process of quantifying in monetary terms information about an entity's assets, liabilities, income and expenses.

The Exposure Draft proposes the introduction of guidance on measurement. This describes various measurement bases (historical cost and current value) and the factors to consider when selecting a measurement basis.



# Recognition and derecognition

update

fill gaps

**Recognition** is the process of capturing an asset or a liability for inclusion in the statement of financial position.

**Derecognition** is the process of removing all or a part of an asset or a liability from the statement of financial position.

The Exposure Draft proposes improvements to the guidance on when assets and liabilities should be recognised in the financial statements. It also introduces guidance on when they should be derecognised.

## Recognition

The Exposure Draft proposes recognition criteria based on the qualitative characteristics of useful financial information. An entity recognises an asset or liability if such recognition provides users of the financial statements with:

- (a) relevant information about the asset or liability;
- (b) a faithful representation of the asset or liability and of any resulting income and expenses; and
- (c) information that results in benefits exceeding the cost of providing that information.

Those criteria may not always be met when one or more of the following applies:

- (a) it is uncertain whether an asset or liability exists;
- (b) there is only a low probability of future inflows (outflows) of economic benefits from the asset (liability); or
- (c) the level of measurement uncertainty is so high that the resulting information has little relevance.

## Derecognition

The existing *Conceptual Framework* does not provide guidance on derecognition. The Exposure Draft proposes guidance aimed at providing a faithful representation of:

- (a) the assets and liabilities retained after a transaction or other event that led to derecognition; and
- (b) the change in the entity's assets and liabilities as a result of that transaction or other event.

Normally decisions about derecognition are straightforward. However, some derecognition decisions are more difficult when the two aims described above conflict with each other. The discussion in the Exposure Draft concentrates on these cases.

# Presentation and disclosure

fill gaps

The Exposure Draft includes proposals on presentation and disclosure, including how to present financial performance.

In its *Disclosure Initiative*, the IASB will develop further the presentation and disclosure concepts included in the *Conceptual Framework*. This Initiative is a collection of implementation and research projects intended to improve disclosure. Information about the Disclosure Initiative can be found on:

[go.ifrs.org/Disclosure-Initiative](http://go.ifrs.org/Disclosure-Initiative)

## Conceptual Framework

### Exposure Draft

- Objective and scope of financial statements
- Achieving effective and efficient communication
- Classification and aggregation

## Disclosure Initiative

### Implementation projects

- IAS 1 *Presentation of Financial Statements* amended in 2014
- Exposure Draft *Reconciliation of liabilities from financing activities*, comment deadline ended April 2015

### Research projects

- Materiality
- Principles of Disclosure
  - Nature and role of 'primary' statements
  - Nature and role of the notes
- Standards-level review of disclosure

# Presentation and disclosure—financial performance



The IASB proposes, for the first time, to provide conceptual guidance on whether to present income and expenses in profit or loss or in other comprehensive income (OCI).

The statement of profit or loss is the primary, but not the only, source of information about an entity's financial performance.

Income and expenses are included in OCI only if that enhances the relevance of profit or loss and if they relate to assets or liabilities remeasured to current values.

**Statement of profit or loss**

	20X5	20X4
Revenue from customers	234,439	212,367
Cost of sales	(112,764)	(106,259)
...	...	...
Taxes	(21,546)	(20,587)
...	...	...
<b>Profit (loss) for the year</b>	<b>18,897</b>	<b>16,763</b>

**Statement of comprehensive income**

	20X5	20X4
Profit (loss) for the year	18,897	16,763
Currency translation	68	(51)
Fair value adjustment cash flow hedging	(2,764)	6,259
...	...	...
Taxes	(215)	87
<i>Other comprehensive income for the year</i>	<i>(2,546)</i>	<i>4,253</i>
<b>Total comprehensive income for the year</b>	<b>16,351</b>	<b>21,016</b>

Rebuttable presumption that income and expenses are included in profit or loss.

Profit or loss is a required total or subtotal.

Presumption that income and expenses included in OCI in one period are subsequently included in profit or loss (recycling).

# Reporting entity

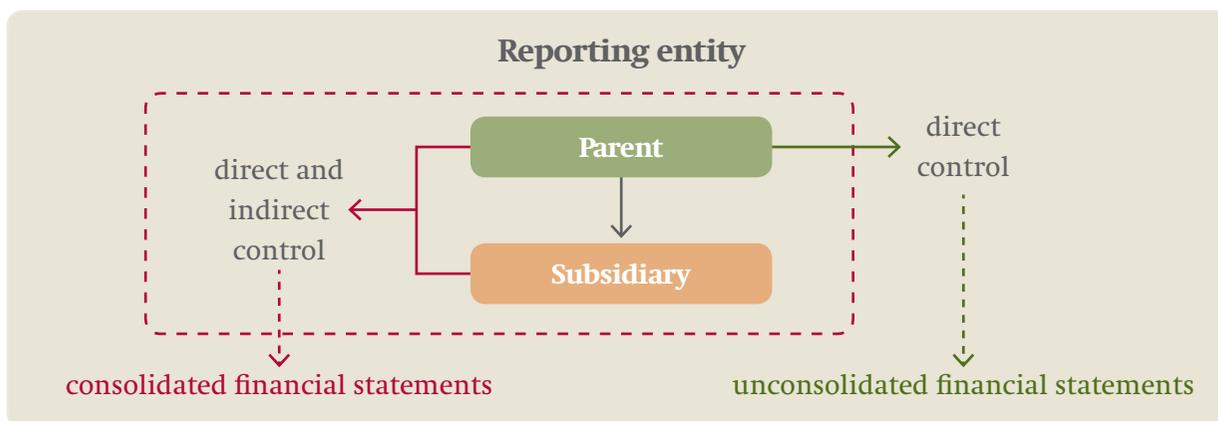
fill gaps

The IASB proposes guidance on the reporting entity, based on comments and feedback received on the 2010 Exposure Draft on the reporting entity.

A **reporting entity** is an entity that chooses, or is required, to present general purpose financial statements.

It does not have to be a legal entity and can comprise only a portion of an entity or two or more entities.

The Exposure Draft proposes to determine the boundary of a reporting entity that has one or more subsidiaries on the basis of control.



Consolidated financial statements are generally more likely to provide useful information to users than unconsolidated financial statements. In consolidated financial statements, an entity reports on both:

- its own (directly controlled) assets and liabilities; and
- its indirect assets and liabilities (those of its subsidiaries: the entities that it controls).

In unconsolidated financial statements, an entity reports only on its own (directly controlled) assets and liabilities.

If an entity prepares both consolidated and unconsolidated financial statements, the unconsolidated financial statements need to disclose how users may obtain the consolidated financial statements.

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# Questions & Answers

**Q:** What is the effective date and what will be the transition period?

**A:** As soon as the IASB completes its revision of the *Conceptual Framework*, it will start using the revised version to help it develop new or revised IFRS. However, for entities that use the *Conceptual Framework* to develop accounting policies, the transition period will be approximately 18 months.

**Q:** Who will be affected by a revised *Conceptual Framework*?

**A:** Because the *Conceptual Framework* will guide the IASB when it develops Standards, it will affect financial statements indirectly when entities implement new or revised Standards based on the revised *Conceptual Framework*. It will affect directly those entities that use the *Conceptual Framework* to help them decide how to account for a transaction not covered by a specific Standard.

**Q:** What effect will the *Conceptual Framework* have on existing Standards?

**A:** The *Conceptual Framework* is not a Standard and does not override existing Standards. Any decisions to amend an existing Standard would require the IASB to go through its normal extensive due process.

**Q:** Will the IASB issue Standards that conflict with the new *Conceptual Framework*?

**A:** The *Conceptual Framework* cannot consider all circumstances that could arise. To meet the objective of financial reporting, the IASB may sometimes need to set a requirement that departs from an aspect of the *Conceptual Framework*. In that case, the IASB will explain the departure in the Basis for Conclusions on the Standard in question.

**Q:** Why has the IASB also issued an Exposure Draft of proposed amendments to Standards with the *Conceptual Framework* Exposure Draft?

Some existing Standards refer directly to the existing *Conceptual Framework*. The purpose of the proposed amendments is to update those references so that they will refer to the revised *Conceptual Framework*.

The IASB proposes a transition period of approximately 18 months for these amendments. Application will be retrospective in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except that proposed amendments to IFRS 3 *Business Combinations* will be prospective.

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## Questions & Answers continued...

**Q:** Will there be more guidance on how to distinguish liabilities from equity?

**A:** The distinction between liabilities and equity has caused significant problems in practice. The IASB is exploring further how to distinguish between liabilities and equity in its research project on *Financial Instruments with Characteristics of Equity*. Conducting that research in a separate project avoids delaying other much-needed improvements to the *Conceptual Framework*.

One possible outcome of that research could be a recommendation to propose an amendment to the *Conceptual Framework* in relation to distinguishing between liabilities and equity.

**Q:** Does the Exposure Draft acknowledge that an entity's business model is important for financial reporting?

**A:** The Exposure Draft discusses how the way in which an entity conducts its business activities affects:

- the unit of account;
- measurement; and
- presentation and disclosure (including the use of OCI).

The Exposure Draft does not include an overarching discussion of the accounting implications of how an entity conducts its business activities. The implications vary according to the particular decisions to be made in different chapters of the *Conceptual Framework*.

The Exposure Draft does not use the term 'business model', to avoid possible confusion.

**Q:** Income and expenses are defined as changes in assets and liabilities—does this mean that the IASB cares only about the statement of financial position?

**A:** No. Information about both financial position and financial performance is important to users of financial statements. Hence, when making decisions about recognition, measurement, presentation and disclosure the IASB considers whether the resulting information provides useful information about both financial position and financial performance. The Exposure Draft emphasises this point more clearly than the existing *Conceptual Framework* does.

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**Q:** Does the Exposure Draft address long-term investment?

**A:** The IASB believes that the proposals in the Exposure Draft provide sufficient tools to enable the IASB:

- to make appropriate standard-setting decisions if future projects consider how an entity should account for long-term investments; and
- to address appropriately the needs of long-term investors.

**Q:** Does the *Conceptual Framework* apply to small and medium-sized entities (SMEs)?

**A:** The *International Financial Reporting Standard for Small and Medium-sized Entities* (the ‘*IFRS for SMEs*’) includes a section on the concepts and basic principles underlying the financial statements of small and medium-sized entities. That section is based on the existing *Conceptual Framework*. The IASB will consider whether it should amend that section in a future review of the *IFRS for SMEs*, after it has finalised the revised *Conceptual Framework*.

**Q:** Is the project a joint project with the FASB?

**A:** This was a joint project with the US Financial Accounting Standards Board (FASB) until 2010. At this time the IASB and the FASB jointly published two chapters of the *Conceptual Framework* describing the objective of financial reporting and the qualitative characteristics of useful financial information.

The IASB restarted the project in 2012. Since then, the IASB has no longer been working jointly with the FASB on this project. Instead, the IASB has been receiving input from a broad range of accounting standard-setters, including the FASB, through the Accounting Standards Advisory Forum (ASAF).

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# Further information

The Exposure Draft includes questions on the topics presented. Respondents are invited to respond to any or all of those questions and to comment on other matters that the IASB should consider when finalising its revised *Conceptual Framework*. The IASB's discussions will take place in public meetings. To access information about those public meetings, please visit [www.ifrs.org](http://www.ifrs.org).

To view the Exposure Draft, submit your comments, stay up to date with the latest developments and to sign up for email alerts about the project, please visit the project homepage on [go.ifrs.org/Conceptual-Framework](http://go.ifrs.org/Conceptual-Framework).

The deadline for comments on the Exposure Draft is 26 October 2015.





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