Conceptual Framework for Financial Reporting
Conceptual Framework at a glance

Introduction
The International Accounting Standards Board (Board) issued the revised Conceptual Framework for Financial Reporting (Conceptual Framework), a comprehensive set of concepts for financial reporting, in March 2018.

It sets out:
• the objective of financial reporting
• the qualitative characteristics of useful financial information
• a description of the reporting entity and its boundary
• definitions of an asset, a liability, equity, income and expenses
• criteria for including assets and liabilities in financial statements (recognition) and guidance on when to remove them (derecognition)
• measurement bases and guidance on when to use them
• concepts and guidance on presentation and disclosure

This Project Summary summarises:
• why the Board revised the Conceptual Framework
• the main changes from the previous Conceptual Framework
• the main concepts and guidance in each chapter of the Conceptual Framework

Purpose
• to assist the Board to develop IFRS Standards (Standards) based on consistent concepts, resulting in financial information that is useful to investors, lenders and other creditors
• to assist preparers of financial reports to develop consistent accounting policies for transactions or other events when no Standard applies or a Standard allows a choice of accounting policies
• to assist all parties to understand and interpret Standards

Status
• provides concepts and guidance that underpin the decisions the Board makes when developing Standards
• not a Standard
• does not override any Standard or any requirement in a Standard

Effective date
• immediately for the Board and the IFRS Interpretations Committee
• annual periods beginning on or after 1 January 2020 for preparers who develop an accounting policy based on the Conceptual Framework
Why have we revised the *Conceptual Framework*?

**Previous Conceptual Framework**
- issued in 1989 and partly revised in 2010
- useful, but incomplete and needed improvement

**Revised Conceptual Framework**
- a comprehensive set of concepts for financial reporting

**Priority**
identified as a priority by stakeholders in the 2011 Agenda Consultation

**Filling gaps**
for example, guidance on measurement, presentation and disclosure

**Updating**
for example, the definitions of an asset and a liability

**Clarifying**
for example, the role of measurement uncertainty

**Approach**
In revising the *Conceptual Framework*, the Board sought a balance between providing high-level concepts and providing enough detail for the *Conceptual Framework* to be useful to the Board and others.

The Board views the *Conceptual Framework* as a practical tool to help it develop Standards. Hence, the *Conceptual Framework* includes concepts that help the Board develop Standards and also discusses the factors the Board needs to consider in making judgements when application of the concepts does not lead to a single answer.
Main changes

The revised Conceptual Framework introduces the following main improvements:

<table>
<thead>
<tr>
<th>New</th>
<th>Updated</th>
<th>Clarified</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Measurement</strong></td>
<td><strong>Definitions</strong></td>
<td><strong>Prudence</strong></td>
</tr>
<tr>
<td>concepts on measurement,</td>
<td>definitions of an asset and a liability</td>
<td><strong>Stewardship</strong></td>
</tr>
<tr>
<td>including factors to be</td>
<td>criteria for including assets and liabilities in financial statements</td>
<td><strong>Measurement uncertainty</strong></td>
</tr>
<tr>
<td>considered when selecting</td>
<td></td>
<td><strong>Substance over form</strong></td>
</tr>
<tr>
<td>a measurement basis</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Presentation and disclosure</strong></td>
<td>concepts on presentation and disclosure, including when to classify income and expenses in other comprehensive income</td>
<td></td>
</tr>
<tr>
<td>guidance on when assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>and liabilities are</td>
<td></td>
<td></td>
</tr>
<tr>
<td>removed from financial</td>
<td></td>
<td></td>
</tr>
<tr>
<td>statements</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Derecognition</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>guidance on when assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>and liabilities are</td>
<td></td>
<td></td>
</tr>
<tr>
<td>removed from financial</td>
<td></td>
<td></td>
</tr>
<tr>
<td>statements</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Chapter 1—The objective of financial reporting

This chapter sets out the objective of general purpose financial reporting (financial reporting), what information is needed to achieve that objective and who the primary users (users) of financial reports are.

### Objective of financial reporting
To provide financial information that is useful to users in making decisions relating to providing resources to the entity

### Summary of changes
This chapter was issued in 2010 and went through extensive due process at that time. Therefore, in revising the Conceptual Framework, the Board did not fundamentally reconsider this chapter. However, it clarified why information used in assessing stewardship is needed to achieve the objective of financial reporting.

### Stewardship
Users of financial reports need information to help them assess management’s stewardship. The Conceptual Framework explicitly discusses this need as well as the need for information that helps users assess the prospects for future net cash inflows to the entity.

### Users of financial reports
Users of financial reports are an entity’s existing and potential investors, lenders and other creditors. Those users must rely on financial reports for much of the financial information they need.

### Users’ decisions involve decisions about
- buying, selling or holding equity or debt instruments
- providing or settling loans and other forms of credit
- voting, or otherwise influencing management’s actions

### To make these decisions, users assess
- prospects for future net cash inflows to the entity
- management’s stewardship of the entity’s economic resources

### To make both these assessments, users need information about both
- the entity’s economic resources, claims against the entity and changes in those resources and claims
- how efficiently and effectively management has discharged its responsibilities to use the entity’s economic resources
Chapter 2—Qualitative characteristics of useful financial information

This chapter discusses what makes financial information useful.

For information to be useful it must both be relevant and provide a faithful representation of what it purports to represent. Relevance and faithful representation are the fundamental qualitative characteristics of useful financial information, and the guiding concepts that apply throughout the revised Conceptual Framework.

### Fundamental qualitative characteristics

<table>
<thead>
<tr>
<th>Relevance</th>
<th>Faithful representation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• information is relevant if it is capable of making a difference to the decisions made by users</td>
<td>• information must faithfully represent the substance of what it purports to represent</td>
</tr>
<tr>
<td>• financial information is capable of making a difference in decisions if it has predictive value or confirmatory value</td>
<td>• a faithful representation is, to the maximum extent possible, complete, neutral and free from error</td>
</tr>
<tr>
<td></td>
<td>• a faithful representation is affected by level of measurement uncertainty</td>
</tr>
</tbody>
</table>

### Enhancing qualitative characteristics

<table>
<thead>
<tr>
<th>Comparability</th>
<th>Verifiability</th>
<th>Timeliness</th>
<th>Understandability</th>
</tr>
</thead>
<tbody>
<tr>
<td>• these four qualitative characteristics enhance the usefulness of information</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• but they cannot make non-useful information useful</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Cost constraint

<table>
<thead>
<tr>
<th>Cost constraint</th>
</tr>
</thead>
<tbody>
<tr>
<td>• the benefit of providing the information needs to justify the cost of providing and using the information</td>
</tr>
</tbody>
</table>

### Summary of changes

This chapter was issued in 2010 and went through extensive due process at that time. Therefore, in revising the Conceptual Framework the Board did not fundamentally reconsider this chapter. However, the Board clarified the roles of prudence, measurement uncertainty and substance over form in assessing whether information is useful.

### Prudence

Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. Prudence does not allow for overstatement or understatement of assets, liabilities, income or expenses.

### Measurement uncertainty

Measurement uncertainty does not prevent information from being useful. However, in some cases the most relevant information may have such a high level of measurement uncertainty that the most useful information is information that is slightly less relevant but is subject to lower measurement uncertainty.
Determining the appropriate boundary of a reporting entity can be difficult if, for example, the entity is not a legal entity. In such cases, the boundary is determined by considering the information needs of the users of the entity’s financial statements. Those users need information that is relevant and that faithfully represents what it purports to represent. A reporting entity does not comprise an arbitrary or incomplete collection of assets, liabilities, equity, income and expenses.
Chapter 4—The elements of financial statements

This chapter defines the five elements of financial statements—an asset, a liability, equity, income and expenses.

<table>
<thead>
<tr>
<th>Previous definition of an asset</th>
<th>Revised definition of an asset</th>
</tr>
</thead>
<tbody>
<tr>
<td>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</td>
<td>A present economic resource controlled by the entity as a result of past events An economic resource is a right that has the potential to produce economic benefits</td>
</tr>
</tbody>
</table>

Main changes in the definition of an asset

- separate definition of an economic resource—to clarify that an asset is the economic resource, not the ultimate inflow of economic benefits
- deletion of ‘expected flow’—it does not need to be certain, or even likely, that economic benefits will arise
- a low probability of economic benefits might affect recognition decisions and the measurement of the asset

<table>
<thead>
<tr>
<th>Previous definition of a liability</th>
<th>Revised definition of a liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>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</td>
<td>A present obligation of the entity to transfer an economic resource as a result of past events An obligation is a duty or responsibility that the entity has no practical ability to avoid</td>
</tr>
</tbody>
</table>

Main changes in the definition of a liability

- separate definition of an economic resource—to clarify that a liability is the obligation to transfer the economic resource, not the ultimate outflow of economic benefits
- deletion of ‘expected flow’—with the same implications as set out above for an asset
- introduction of the ‘no practical ability to avoid’ criterion to the definition of obligation

Summary of changes

The definitions of an asset and a liability have been refined and the definitions of income and expenses have been updated only to reflect that refinement. The definition of equity as the residual interest in the assets of the entity after deducting all its liabilities is unchanged. The Board’s research project on Financial Instruments with Characteristics of Equity is exploring the distinction between liabilities and equity.

No practical ability to avoid

The revised Conceptual Framework discusses how the ‘no practical ability to avoid’ criterion is applied in the following circumstances:

(a) if a duty or responsibility arises from the entity’s customary practices, published policies or specific statements—the entity has an obligation if it has no practical ability to act in a manner inconsistent with those practices, policies or statements.

(b) if a duty or responsibility is conditional on a particular future action that the entity itself may take—the entity has an obligation if it has no practical ability to avoid taking that action.

continued ...
Executory contract
An executory contract is a contract that is equally unperformed. It establishes a single asset or liability for the inseparable combined right and obligation to exchange economic resources.

Substance of contracts
To represent contractual rights and obligations faithfully, financial statements must report their substance. In some cases, the substance of such rights and obligations is clear from a contract’s legal form. But, in other cases, the terms of the contract, or of a group or series of contracts, may require analysis to identify the substance of the rights and obligations.

Unit of account
The right(s) or obligation(s), or group of rights and obligations, to which recognition criteria and measurement concepts are applied.

Selecting the unit of account

<table>
<thead>
<tr>
<th>Relevance</th>
<th>Faithful representation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• a unit of account is selected to provide relevant information about the asset or liability and any related income and expenses</td>
<td>• a unit of account is selected to provide a faithful representation of the substance of the transaction or other event from which the asset, liability and any related income or expenses have arisen</td>
</tr>
</tbody>
</table>

Revised definition of income
Increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims

Revised definition of expenses
Decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims

Although income and expenses are defined in terms of changes in assets and liabilities, information about income and expenses is just as important as information about assets and liabilities.
Chapter 5—Recognition and derecognition

This chapter discusses criteria for including assets and liabilities in financial statements (recognition) and guidance on when to remove them (derecognition).

### Recognition

The process of capturing for inclusion in the statement of financial position or the statement(s) of financial performance an item that meets the definition of an asset, a liability, equity, income or expenses.

Recognition is appropriate if it results in both relevant information about assets, liabilities, equity, income and expenses and a faithful representation of those items, because the aim is to provide information that is useful to investors, lenders and other creditors.

### Summary of changes

The previous recognition criteria were that an entity should recognise an item that met the definition of an element if it was probable that economic benefits would flow to the entity and if the item had a cost or value that could be determined reliably.

The revised recognition criteria refer explicitly to the qualitative characteristics of useful information.

The Board’s aim was to develop a more coherent set of concepts, not to increase or decrease the range of assets and liabilities recognised.

### Why recognition is important

Recognising assets, liabilities, equity, income and expenses depicts an entity’s financial position and financial performance in structured summaries (the statements of financial position and financial performance). The amounts recognised in a statement are included in the totals and, if applicable, subtotals, in the statement. The statements are linked because income and expenses are linked to changes in assets and liabilities.

---

**Recognition criteria**

**Relevance**

- whether recognition of an item results in relevant information may be affected by, for example:
  - low probability of a flow of economic benefits
  - existence uncertainty

**Faithful representation**

- whether recognition of an item results in a faithful representation may be affected by, for example:
  - measurement uncertainty
  - recognition inconsistency (accounting mismatch)
  - presentation and disclosure

---

**Cost constraint**

Cost constrains recognition decisions, just as it constrains other financial reporting decisions.

---

continued...
Derecognition
The removal of all or part of a recognised asset or liability from an entity’s statement of financial position

Derecognition normally occurs

<table>
<thead>
<tr>
<th>For an asset</th>
<th>For a liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>when the entity loses control of all or part of the recognised asset</td>
<td>when the entity no longer has a present obligation for all or part of the recognised liability</td>
</tr>
</tbody>
</table>

Derecognition aims to faithfully represent both
- any assets and liabilities retained after the transaction that led to the derecognition
- the change in the entity’s assets and liabilities as a result of that transaction

Summary of changes
The guidance on derecognition is new.

Derecognition resulting from a transfer

Normally, a faithful representation of a transfer of an asset or liability is achieved by derecognition of the asset or liability with appropriate presentation and disclosure.

However, in limited cases, it may be necessary to continue to recognise a transferred component of an asset or liability together with a liability or asset for the proceeds received or paid, with appropriate presentation and disclosure.
Chapter 6—Measurement

This chapter describes various measurement bases and discusses factors to be considered when selecting a measurement basis.

<table>
<thead>
<tr>
<th>Historical cost measurement bases</th>
</tr>
</thead>
<tbody>
<tr>
<td>• historical cost provides information derived, at least in part, from the price of the transaction or other event that gave rise to the item being measured</td>
</tr>
<tr>
<td>• historical cost of assets is reduced if they become impaired and historical cost of liabilities is increased if they become onerous</td>
</tr>
<tr>
<td>• one way to apply a historical cost measurement basis to financial assets and financial liabilities is to measure them at amortised cost</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Current value measurement bases</th>
</tr>
</thead>
<tbody>
<tr>
<td>• current value provides information updated to reflect conditions at the measurement date</td>
</tr>
<tr>
<td>• current value measurement bases include:</td>
</tr>
<tr>
<td>fair value</td>
</tr>
<tr>
<td>• the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date</td>
</tr>
<tr>
<td>• reflects market participants’ current expectations about the amount, timing and uncertainty of future cash flows</td>
</tr>
<tr>
<td>value in use (for assets) fulfiment value (for liabilities)</td>
</tr>
<tr>
<td>• reflects entity-specific current expectations about the amount, timing and uncertainty of future cash flows</td>
</tr>
<tr>
<td>current cost</td>
</tr>
<tr>
<td>• reflects the current amount that would be:</td>
</tr>
<tr>
<td>• paid to acquire an equivalent asset</td>
</tr>
<tr>
<td>• received to take on an equivalent liability</td>
</tr>
</tbody>
</table>

Summary of changes

The previous version of the Conceptual Framework included little guidance on measurement. The revised Conceptual Framework describes what information measurement bases provide and explains the factors to consider when selecting a measurement basis.
The factors to be considered when selecting a measurement basis are **relevance** and **faithful representation**, because the aim is to provide information that is useful to investors, lenders and other creditors.

### Factors to consider in selecting a measurement basis

#### Relevance

**Relevance** of information provided by a measurement basis is affected by:

- characteristics of the asset or liability
  - the variability of cash flows
  - sensitivity of the value to market factors or other risks
  - for example, amortised cost cannot provide relevant information about a derivative
- contribution to future cash flows
  - whether cash flows are produced directly or indirectly in combination with other economic resources
  - the nature of the entity’s business activities
  - for example, if assets are used in combination to produce goods or services, historical cost can provide relevant information about margins achieved in a period

#### Faithful representation

Whether a measurement basis can provide a **faithful representation** is affected by:

- measurement inconsistency
  - if financial statements contain measurement inconsistencies (accounting mismatch), those financial statements may not faithfully represent some aspects of the entity’s financial position and financial performance
- measurement uncertainty
  - does not necessarily prevent the use of a measurement basis that provides relevant information
  - but if too high might make it necessary to consider selecting a different measurement basis

#### Cost constraint

Cost constrains the selection of a measurement basis, just as it constrains other financial reporting decisions.

### Selecting a measurement basis

In selecting a measurement basis, it is necessary to consider the nature of the information in both the statement of financial position and the statement(s) of financial performance.

The relative importance of each factor to be considered (see boxes) depends upon the facts and circumstances of individual cases.

Consideration of the factors and the cost constraint is likely to result in the selection of different measurement bases for different assets, liabilities, income and expenses.
Chapter 7—Presentation and disclosure

This chapter includes concepts on presentation and disclosure and guidance on including income and expenses in the statement of profit or loss and other comprehensive income.

### The statement of profit or loss

- The statement of profit or loss is the primary source of information about an entity’s financial performance for the reporting period.
- Profit or loss could be a section of a single statement of financial performance or a separate statement.
- The statement(s) of financial performance include(s) a total (subtotal) for profit or loss.
- In principle, all income and expenses are classified and included in the statement of profit or loss.

### Other comprehensive income

- In exceptional circumstances, the Board may decide to exclude from the statement of profit or loss income or expenses arising from a change in current value of an asset or liability and include those income and expenses in other comprehensive income.
- The Board may make such a decision when doing so would result in the statement of profit or loss providing more relevant information or a more faithful representation.

### Recycling

- In principle, income and expenses included in other comprehensive income in one period are recycled to the statement of profit or loss in a future period when doing so results in the statement of profit or loss providing more relevant information or a more faithful representation.
- When recycling does not result in the statement of profit or loss providing more relevant information or a more faithful representation, the Board may decide income and expenses included in other comprehensive income are not to be subsequently recycled.

### Summary of changes

This chapter is new.

### Better Communication

Information about assets, liabilities, equity, income and expenses is communicated through presentation and disclosure in the financial statements.

Effective communication of information in financial statements makes that information more relevant and contributes to a faithful representation of an entity’s assets, liabilities, equity, income and expenses.

The revised Conceptual Framework includes concepts that describe how information should be presented and disclosed in the financial statements.

The Board is also working on several projects on the theme of Better Communication to make financial information more useful to investors, lenders and other creditors and to improve the communication of that information.
Amendments to References to the Conceptual Framework in IFRS Standards—a separate accompanying document

That document sets out amendments to Standards to update references to the Conceptual Framework.

<table>
<thead>
<tr>
<th>Objective of the amendments</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Some Standards include explicit references to previous versions of the Conceptual Framework</td>
</tr>
<tr>
<td>• These amendments update those references so they refer to the revised Conceptual Framework</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Effects</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The Board expects the amendments to references to the Conceptual Framework in Standards will not have a significant effect on users and preparers of financial statements</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Effective date and transition</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The amendments are effective for annual periods beginning on or after 1 January 2020, with earlier application permitted</td>
</tr>
<tr>
<td>• The amendments should be applied retrospectively unless retrospective application would be impracticable or involve undue cost or effort</td>
</tr>
</tbody>
</table>

Exemptions

• IFRS 3 Business Combinations

To avoid unintended consequences, acquirers are required to apply the definitions of an asset and a liability and supporting concepts in the previous, rather than the revised, Conceptual Framework. The Board plans to assess how IFRS 3 can be updated without unintended consequences.

• Regulatory account balances

When developing accounting policies for regulatory account balances applying IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, entities are required to refer to the previous, rather than the revised, Conceptual Framework. This avoids entities revising those accounting policies twice within a short period: once for the revised Conceptual Framework and again when a revised Standard on rate-regulated activities is issued.
Important information

This Project Summary has been compiled by the staff of the IFRS Foundation for the convenience of interested parties. The views within this document are those of the staff who prepared this document and do not necessarily reflect the views or the opinions of the Board. The content of this Project Summary does not constitute any advice and is not to be considered as an authoritative document issued by the Board.

Official pronouncements of the Board are available in electronic format to eIFRS subscribers. Publications are available for ordering from the IFRS Foundation website at www.ifrs.org.

Other relevant documents

*Conceptual Framework for Financial Reporting*—describes the objective of, and the concepts for, general purpose financial reporting.

*Basis for Conclusions on the Conceptual Framework for Financial Reporting*—summarises the Board’s considerations in developing the Conceptual Framework.

*Amendments to References to the Conceptual Framework in IFRS Standards*—sets out amendments to Standards, their accompanying documents and IFRS practice statements.

*Feedback Statement*—summarises the feedback on the proposals that led to the revised *Conceptual Framework*. 