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Note: These notes are based on the staff paper prepared for the Council. Paragraph numbers correspond to paragraph numbers used in the Council paper.

INFORMATION FOR OBSERVERS

SAC Meeting: **June 2007, London**

Project: **Conceptual Framework: Project Status**
 (Agenda Paper 1A)

INTRODUCTION

The Conceptual Framework Project

1. The Conceptual Framework project is a joint project between the International Accounting Standards Board and Financial Accounting Standards Board (the Boards) to develop an improved and common conceptual framework. Such a framework would provide a sound foundation for developing future accounting standards and is essential to fulfilling the Boards' goal of developing standards that:

- Are principles-based, internally consistent, and internationally converged
- Will lead to financial reporting that provides decision-useful information that investors and creditors (capital providers) need for making rational investment, credit, and similar decisions.

Structure of the Papers

2. This paper provides an overview of the current status of the active phases of the Conceptual Framework project.
3. Agenda Paper 1B focuses in more depth on the status of the first phase of the project that is addressing the objective of financial reporting and the qualitative characteristics of decision-useful financial information. It discusses issues raised by respondents to the Boards' July 2006 Preliminary Views on the objective and qualitative characteristics and subsequent constituent outreach and redeliberations of those issues.
4. In particular, that paper raises questions and seeks counsel about the objective of general purpose external financial reporting, which as proposed is "to provide information that is useful to present and potential investors and creditors and others in making investment, credit, and similar resource allocation decisions" (paragraph OB2). The Boards are particularly interested in learning whether that overarching objective encompasses the decision-useful financial information needs of present and potential capital providers.

OVERVIEW OF THE PROJECT PLAN AND STATUS

Project Plan

5. The objective of this joint project is to develop a common conceptual framework that is both complete and internally consistent. In developing that framework the Boards will build on, and fill significant holes in, the existing IASB and FASB frameworks and consider other conceptual frameworks and developments since they issued their original frameworks.

Conduct and status

6. The Boards are conducting the joint project in eight phases, four of which are currently active. Their status is as follows:

Project Phases, Status, and Timing			Documents/Due Process	
Phase	Topic	Current Status	To Date	2007 and beyond
A	Objectives and qualitative characteristics	Board redeliberations of issues raised by respondents to DP/PV	DP/PV issued July 2006	ED-Q4 2007 (estimated)
B	Elements and recognition	Board deliberations		DP Q4 2008 (estimated)
C	Measurement	Board deliberations	Roundtables – Q1 2007	DP Q1 2009 (estimated)
D	Reporting entity	Initial Board deliberations completed		DP/PV-Q3 2007 (estimated)
E	Presentation and disclosure, including financial reporting boundaries	Inactive		TBD
F	Framework purpose and status in GAAP hierarchy	Inactive, initial staff research, FASB to consider elevating.		TBD
G	Applicability to the not-for-profit sector	Inactive		TBD
H	Remaining issues	–		TBD

Phase A—Objectives and Qualitative Characteristics

7. This phase involves consideration of the objectives of financial reporting and the qualitative characteristics of financial reporting information. The latter include relevance, faithful representation, comparability (including consistency) and understandability, and how they relate to the pervasive constraints of materiality and cost-benefit relationships.
8. In July 2006, the Boards each issued discussion papers, *Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information*, that sought public comment on their preliminary views. In February 2007, the Boards discussed a staff summary of the comments received

and the plan for redeliberations of the issues raised. Those redeliberations, which began in April, are ongoing. The Boards plan to complete their redeliberations in the coming months leading to an Exposure Draft in the fourth quarter. Refer to Agenda Paper 1B for further discussion.

Phase B—Elements and Recognition

9. Phase B of the project, *Elements and Recognition*, consists of several milestones, which include defining assets, liabilities, and other elements of financial statements, issues related to distinguishing between liabilities and equity, determining the unit of account, and recognition and derecognition of items in financial statements. Deliberations on the definition of an asset are substantially complete. The working definition was discussed with SAC in February 2007 and with others. The Boards have also commenced deliberations of the definition of a liability and the distinction between liabilities and equity. In recent months, the IASB has focused on the distinction between liabilities and general business risks.
10. Early this year the Boards also considered whether to explore an alternative approach to reconsidering the existing definitions of liabilities and equity in the IASB Conceptual Framework and FASB Concepts Statements. That alternative would focus on developing a single element approach, such as claims, and determining the implications for presenting information about changes in claims. Given the varying views concerning the potential benefits of a single element approach, the Boards decided not to devote their limited staff resources to developing that approach, but rather leverage off the Preliminary Views that FASB expects to issue through its standards-setting project on liabilities and equity and the comments of constituents that both Boards will be seeking on that forthcoming document.
11. In the coming months, the Boards will commence discussions on two parts of this phase that have not previously been addressed: (a) unit of account and (b) recognition and derecognition.
 - a) ***Unit of Account*** — The Boards' current frameworks provide little or no guidance on how the unit of account should be determined. They intend to develop conceptual guidance to

assist in analyzing such issues that arise in various standards projects. They include, for example:

- Should similar things be accounted for together, rather than separately?
- Should an entity recognize assets and/or liabilities for contracts that are still fully executory? If so, what are the assets and liabilities and should the entity account for and report them separately or account for them as a single net item?
- Should some "related" assets and liabilities be accounted for together or netted?

b) ***Recognition and Derecognition*** — The Boards' current frameworks contain recognition criteria, some of which are similar and others that are different. Neither Board's frameworks contain criteria as to when an item should be derecognized. The Boards plan to revise their recognition criteria concepts to eliminate those differences and provide a framework for resolving derecognition issues.

12. The next major goal is the issuance of a Discussion Paper that is estimated to be in the fourth quarter of 2008.

Phase C—Measurement

13. Phase C of the project, *Measurement*, is intended to fill a significant gap in the Boards' existing frameworks on the subject of measurement in the context of financial reporting. This phase is being conducted in three major milestones with several issues in each.

14. Early this year, as part of the first milestone, the Boards held roundtable discussions in Hong Kong, London and Norwalk.

15. The Boards discussed a summary of the roundtable comments and in April they completed deliberations on Milestone I issues, which identified the following primary measurement basis candidates. These candidates will be evaluated in milestone II by reference to the qualitative characteristics of decision-useful financial reporting information, as well as concepts of measurement and capital maintenance.

- Past entry price
- Modified past amount
- Past exit price
- Current entry price
- Current exit price

- Current equilibrium price
- Value in use
- Future entry price
- Future exit price.

16. The staff is preparing a summary of milestone I decisions for posting to the Boards' websites that will provide an easily accessible source for the status of the measurement phase of the conceptual framework project as the Boards proceed to the next milestone.

17. Milestone II includes the analysis of measurement basis candidates using various criteria, including the qualitative characteristics from Phase A of the CF project. The Boards will be deliberating the Milestone II issues beginning in July and throughout the remainder of 2007. The staff plans to commence Milestone III issues in 2008 with a goal of a Discussion Paper early in 2009.

Phase D—Reporting Entity

18. Phase D of the project, *Reporting Entity*, is intended to fill a gap in the Boards' existing frameworks on the subject of the reporting entity.

19. The Boards recently completed their initial deliberations of the reporting entity issues and directed the staff to draft a discussion paper. The boards reached the same preliminary views on substantially all issues. The Boards' tentatively decided that a reporting entity can be broadly described as a circumscribed area of economic interest to external users of financial reporting and that:

- The conceptual framework should describe what constitutes an entity for the purposes of financial reporting, but should not define a reporting entity.
- What constitutes an entity for financial reporting purposes should not be limited to legal entities. Hence, legal existence is a sufficient condition for determining that an entity exists, but is not a necessary condition. Rather, an entity includes other types of arrangements or organizational structures. Thus, examples would include a corporation, trust, partnership, or association, as well as a sole proprietorship of a natural person, and, in some circumstances, a branch, segment, division, or other business unit of a legal entity.
- An entity that chooses to, or is required to, prepare general purpose external financial reports (GPEFR) is a reporting entity, and the reporting entity concept should not specify (or provide guidance on) which entities should be required to prepare GPEFR.
- The composition of a group entity should be based on the above **and** a notion of control that unifies the group.

20. The next major goal is a Discussion Paper, in the form of preliminary views, which is tentatively scheduled for issuance in the second half of 2007. There is one issue (concerning the decision-usefulness of parent-only financial statements) for which some alternative views will be presented. A full summary of the tentative decisions reached is available from the [project web site](#).

Phase F—Framework Purpose and Status in GAAP Hierarchy

21. The Boards agreed that each Board, within the context of its current GAAP hierarchy, will finalize the common framework as parts are completed and noted that later parts may include consequential amendments to earlier parts. The Boards noted that the decision of how to finalize the joint framework may need to be readdressed when the Boards discuss the placement of the framework within the IASB and FASB hierarchies.
22. The FASB also recently decided its future due process documents will include a notice that the Board will consider the authoritative status of the framework in the future, and that respondents should assume that the framework's authoritative status will be elevated in the U.S. GAAP hierarchy to be comparable to the status of the framework in International Financial Reporting Standards.