STAFF PAPER

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Project	Conceptual Framework		
Paper topic	Misunderstandings about the IASB's conceptual framework project		
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Misunderstandings about the IASB's conceptual framework project

The IASB decided in September 2012 how to restart its project on the conceptual framework. People sometimes say things that suggest they have misunderstood what the IASB is likely to do in the project. The following table presents some of those misunderstandings, and provides some insights into how the IASB has approached those topics recently.

Misunderstanding	*Reality*
The IASB cares only about the balance sheet and believes that financial performance is just the difference between this year's balance sheet and last year's balance sheet.	Financial statements provide information about an entity's financial position (its economic resources and claims against the entity) and its financial performance. Moreover, to provide reasonably complete information about its financial performance, an entity must identify and measure its economic resources and the claims against the entity. Consequently, the IASB did not designate one type of information (about financial position or about financial performance) as the primary focus of financial reporting. (paragraph BC 1.32 of

Misunderstanding	*Reality*
	the *Basis for Conclusions* on the *Conceptual Framework*) In other words, although the Conceptual Framework's definitions of income and expense refer to changes in assets and liabilities, this does not mean that the IASB prioritises the statement of financial position over others. These statements are complementary—for example, financial performance information will sometimes capture how an entity has benefited from activities not captured on the statement of financial position (such as some intangible assets or a competitive advantage in market). Recent changes to IAS 1 indicate that the IASB does not believe that comprehensive income (ie the total of profit or loss and other comprehensive income) should be the only, or indeed main, measure of performance. In the presentation chapter of the Framework the IASB will consider how an entity can best present various components of financial performance to help users assess the amount, timing and uncertainty of the entity's cash flows.

Misunderstanding	*Reality*
The IASB will abolish the traditional income statement by merging it with 'Other Comprehensive Income' (OCI).	Clearly the IASB needs to clarify why different gains and losses should be classified or reported in different ways, which could ultimately change the way performance is reported. However, the IASB has no plans to eliminate profit or loss as a measure of performance Many respondents to recent exposure drafts and discussion papers have urged the IASB to consider: • whether to retain OCI as a separate category. • whether to present OCI in a statement separate from the income statement. • how to distinguish OCI from profit or loss. • whether some, all or no items presented initially in OCI should be 'recycled' subsequently to profit or loss. The IASB has not yet considered these issues, but will do so in this project.
The IASB will abolish hedge accounting.	As illustrated by recent decisions in developing IFRS 9 *Financial Instruments*, the IASB thinks that hedge accounting can enable entities to faithfully report financial position and performance. The IASB plans: • to add revised requirements on hedge accounting to IFRS 9 by the end of 2012.

Misunderstanding	*Reality*
	• to publish a discussion paper on accounting for macro hedges in 2013.
The IASB will create volatility that does not reflect economic reality.	The IASB does not believe that concealing or artificially smoothing volatility is appropriate when such volatility faithfully reflects economic effects that users need to understand if they are to understand the business. When volatility is real, accounting should reflect that reality and present its effects clearly. The IASB will consider how best to present the effects of volatility so that users can readily understand: • which aspects of an entity's business cause, and are subject to, volatility. • how various components of an entity's financial performance might be relevant for assessing the amount, timing and uncertainty of the entity's cash flows.
The IASB does not care about reporting transactions.	Much of financial reporting is currently transaction based and will continue to be so. Information about transactions is relevant to users. The IASB will consider how best to present and disclose income and expense to distinguish, for example: • amounts generated by transactions. • amounts generated by other events. • value changes.

Misunderstanding	*Reality*
The IASB has abandoned prudence, by: • prohibiting entities from booking liabilities when cash outflows are highly likely but do not meet the technical definition of a liability. • permitting entities to book unrealised gains.	The qualitative characteristics do not include prudence or conservatism that would be inconsistent with neutrality. Understating assets or overstating liabilities in one period frequently leads to overstating financial performance in later periods—a result that cannot be described as prudent or neutral. (BC3.27-29) The IASB removed prudence as a fundamental concept because of concerns over how this was interpreted and its use to justify excessive provisioning and hidden reserves. Nevertheless the IASB continues to exercise caution over how accounting standards are written to ensure that gains and losses are reported only when the IASB is confident that the amounts reported represent faithfully what has happened during the period.
The IASB wants to measure all liabilities in a way that implies the entity will not be able to pay its debts (the effect of 'own credit'), even when such an outcome is highly unlikely.	'Own credit' is a feature of amortised cost as well as of fair value measures for liabilities. Its recognition does not imply an entity will default. However, the performance implications of changes in own credit need to be carefully considered (the IASB's awareness of this is illustrated by the treatment of these changes in IFRS 9). Under IFRS 9, which is a recent standard, most non-derivative financial liabilities are measured at amortised cost, an amount that does not reflect changes in own credit.[1]
The IASB does not care about accounting mismatches that arise if assets are measured inconsistently with liabilities.	The IASB does not expect to conclude in the framework project that one single measurement attribute should be applied to all assets and liabilities. Although it is

[1] Own credit is implicit in amortised cost at inception, but subsequent changes in own credit do not affect amortised cost.

Misunderstanding	*Reality*
	possible that accounting mismatches arise from time to time, the approaches taken in the projects on financial instruments and insurance contracts demonstrate that the IASB thinks it is important to address such mismatches.
The IASB is putting form above substance, by: • including in the balance sheet only those items that meet the IASB's technical definitions of assets and liabilities. • accounting for all items that meet its technical definitions of assets and liabilities. Users: • will not understand a balance sheet based on the IASB's technical definitions of assets and liabilities. • will not understand an income statement based solely on movements between two balance sheets.	The definitions of assets and liabilities refer to resources and obligations. These definitions are not just technicalities. Resources and obligations differ substantively from accounting entries that are merely unexpired residuals from a matching process. An organised summary of an entity's resources and obligations provides users with more relevant information about the entity's financial position than does a statement of unexpired residuals from a matching process. The IASB will consider how best to present income and expense, and where appropriate disaggregate them, so that they provide relevant information to users.
The IASB wants entities to account for all 'executory contracts', such as purchase and sale contracts and forward contracts.	In various standards and projects, the IASB has typically retained existing current practice that entities do not account for executory contracts until at least one of the parties begins to perform under the contract (unless the contract becomes onerous).

Misunderstanding	*Reality*
	The IASB has no plans to change that conclusion.
The IASB will use fair value to measure everything.	The IASB does not intend to require entities to measure all assets and liabilities at fair value. In previous discussions, both in this project and in others, IASB members have made it clear that they do not believe that a single measurement attribute is appropriate for all assets and liabilities. The measurement chapter of the Framework should, when developed, provide guidance for the IASB to use when it decides in particular projects which measurement attribute(s) to select for particular items.
The IASB wants entities to show the value of their whole business in the financial statements.	This is not only untrue but also practically impossible without adding a balancing figure that has no separate meaning. Paragraph OB7 of the Framework, issued in 2010, states: “General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity.”

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The IASB wants accounting that conflicts with entities' business models.	The business model plays an important role in several aspects of IASB standards, including: • the long-standing distinction between inventories and property, plant and equipment. • the classification requirements for financial assets, for which the IASB has recently re-affirmed that the business model would continue to be central. In developing the conceptual framework, the IASB needs to decide exactly what role the business model should play.
The IASB wants to measure all assets at break-up value, even when an entity has no wish or need to sell assets at such values.	As noted above, the IASB has no plans to require the use of a single measurement attribute for all assets. The IASB does require some assets to be measured at fair value. However, fair value does not reflect a break-up value. For example, for an asset used in a production process, fair value typically does not reflect a sale for scrap value only but is more likely to reflect the value after considering its use in an operating business activity.
The IASB will create accounting that is too complex.	The IASB will adopt a simple approach if it gives users of financial statements the information they need. The Framework, issued in 2010, notes that:

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	• classifying, characterising and presenting information clearly and concisely makes it understandable. (QC30) • some phenomena are inherently complex and cannot be made easy to understand. Excluding information about those phenomena from financial reports might make the information in those financial reports easier to understand. However, those reports would be incomplete and therefore potentially misleading. (QC31) • financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena. (QC32)
The IASB will create accounting that does not pass a cost-benefit test.	The IASB takes the costs benefit assessment very seriously. Paragraphs QC35-QC38 of the *Framework*, issued in 2010, note the need for the IASB to assess whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information. The IASB is paying increasing attention to the likely effects of its proposals. The IASB gains insight on those likely effects through formal exposure of proposals and through its fieldwork, analysis and outreach.
The IASB wants to use expected value (probability-weighted averages) for everything.	Expected value can sometimes be a valuable tool for measuring and presenting economic effects. The IASB discussed in February 2011 a staff

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	paper that considered what approach to use when an asset or a liability is measured by reference to future cash flows for which there is a range of possible outcomes. The paper reviewed the following approaches, and discussed when each was most likely to be more appropriate: • expected value • maximum amount that is more likely than not to occur • most likely outcome • minimum or maximum amount in range of possible outcomes • midpoint of range of possible outcomes • possible outcome nearest to expected value The paper did not recommend a single approach for all circumstances.
The IASB has ignored the important role of financial statements for assessing management's stewardship of the entity and its resources.	Paragraph OB4 of the Framework, issued in 2010, notes that users need information not only about the resources of the entity and claims against the entity, but also about "how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources". The IASB did not intend to imply that assessing prospects for future cash flow or assessing the quality of management's

Misunderstanding	*Reality*
	stewardship is more important than the other. Both are important for making decisions about providing resources to an entity, and information about stewardship is also important for resource providers who have the ability to vote on, or otherwise influence, management's actions. (paragraph BC1.27)
In developing standards, the IASB will insist on complying with an abstract and theoretical Conceptual Framework, rather than on providing users with useful information.	The Conceptual Framework is not an end in itself, but means to end: giving users information that is useful for economic decisions (at a cost that does not exceed the benefits). The IASB will continue to develop the Conceptual Framework with that aim in mind. In rare cases, the IASB may issue an IFRS conflicting with the *Conceptual Framework* if the IASB concludes that the departure is necessary for the IFRS to produce financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors for decisions about providing resources to the entity. In such cases, the IASB should describe the departure, and the reasons for it, in the Basis for Conclusions on the IFRS.