

Conceptual Framework: nature and purpose

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What if no Conceptual Framework?



What if no Conceptual Framework?

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Higher variability between and lower quality of standards over time because:

- Standard-setters/stakeholders would base judgement on personal beliefs and experiences
- No consistency between issues and over time; standards will reflect an ever-changing set of beliefs and experiences
- Expedient response may be to rewrite the standard to address the new issue or circumstance, leading to inconsistent standards
- It will be difficult for standard-setters to respond to self-interested stakeholders who advocate a particular approach to a standard

• the collective set of beliefs, experiences and incentives that underlie each standard will differ from standard to standard

• the standards will likely be biased

• the inconsistent standards from this process will appear to be unrelated and arbitrary rules

Guarantees rule-based system

No Conceptual Framework – past UK experience

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- Standard-setting started by setting boundaries to the use of equity accounting, with little reflection on what the resulting information meant, or purported to mean
- Deferred tax (SSAP15): balance sheet number (arguably) was informative, but P&L charge was not
- Pensions (SSAP 24): balance sheet number was meaningless but P&L charge (arguably) was sensible

Nature and purpose of a Conceptual Framework



Nature and purpose of a Conceptual Framework (CF)

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- Conceptual Framework Project (FASB 1976): a CF is a **constitution**, a coherent system of interrelated objectives and fundamentals that can lead to consistent standards and that prescribes the nature, function, and limits of financial accounting and financial statements
 - A constant thread of reason, a basis for solution, to guide standard-setters
- The IFRS Foundation Constitution has as its first objective:
 - “To develop in the public interest, a single set of high quality, understandable, enforceable, and globally accepted financial reporting standards **based upon clearly articulated principles.**”
 - The clearly articulated principles should be found in the CF

Conceptual Framework, a Constitution?

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Constitution can be described as:

- Capturing a natural or supreme law or capturing a foundational political consensus, that in turn:
 - Prescribes the basis for governance in a society or organisation
 - Establishes the basic or fundamental law from which all other laws are derived
- The broad dual roles for a constitution are:
 - Specifying the institutions and processes of decision-making
 - Found in Due Process Handbook, not in the Conceptual Framework
 - The prescription of procedure is written in the Due Process Handbook
 - Influencing the substantive content of the laws and norms
 - Found in the Conceptual Framework
 - Guides from first principles while setting boundaries for legitimate alternatives
 - Sets the basis and bounds for standard setting and accounting policy choice

Conceptual Framework: principles and rules

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- **Principles**
 - exist at a higher, more fundamental level than rules
 - lead rather than prescribe
 - rely on human judgment and reasoning in their application
- **Rules**
 - are both prescribed and prescribe
 - focus on regulating behavior
 - result in a compliance mentality

A principled system of financial reporting requires

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- A critical role for “the conceptual framework” to resolving accounting issues and defining common fundamental principles
 - for standard-setters
 - for practitioners
- Ideally all standards should consistently embed the common fundamental principles
- The use of standards that prescribe general levels of presentation or disclosure in preference to detailed prescriptions in each topical standard
- More concise standards with less prescription and detail in the individual standards.
- A common basis for accounting education

Historical versus ideal: chronological development

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Historical

- Practice evolved across separate national environments
- National standards developed
 - Some sharing across jurisdictions
- Conceptual Frameworks are written – pulling concepts from existing standards; some standards are inconsistent with CFs
- International standards developed along with an international conceptual framework
- Iterative process of mutual influence among the CF, standards, and practice with the CF’s principles becoming more complete and rigorous over time

Ideal

- Develop fundamental principles in a CF
- Consistent standards flow from CF
 - Standards consistently embed the common fundamental principles
- Practice reflects standards with the principles in the CF forming an overarching basis
 - Management policy choices reflect CF principles when set in the absence of a specific standard



How does it help?

How does it help?

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- CF requires standard-setting to be a rigorous process
 - Establishes fundamental principles
 - Establishes bounds for legitimate argument
 - Limits opportunistic lobbying
- CF enhances consistency across standards
 - Standards reflecting CF principles will be more consistent than those that reflect the unconstrained views of specific standard-setters at any point in time
 - Consistent standards are easier to understand and interpret
 - Consistent standards limit structuring transactions so that they can fall under a more 'favourable' standard
- CF enhances quality
 - CF provides direction for improvements to existing standards
 - Consistent application of the CF in setting standards leads to coherent standards that collectively should be more relevant and representationally faithful

Questions the CF makes you answer

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- Is it an asset (liability) – as defined?
- Does it meet the recognition criteria?
- What is the measurement basis that is most relevant and representationally faithful
 - in both income/expenses and statement of financial position?
 - is it also comparable, verifiable, and understandable?
- How are changes in the amount of an asset (liability) best presented and disclosed?

Conclusion



Summary: purpose of the IFRS Conceptual Framework

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- Provide guidance to standard-setters on considerations relevant to selecting accounting methods and disclosures
- Assist preparers in selecting an accounting policy in the absence of a specific standard (or a related standard applied analogously)
- Enhance the dialogue between standard-setter and stakeholders:
 - Provide a common vocabulary and understanding
 - Help educate accountants

Presentation on our current set of improvements to follow



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