Conceptual Framework for Financial Reporting

Objectives of Financial Reporting

INTRODUCTION TO THE FRAMEWORK

Conceptual Framework
Project Working Group

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1. At its February meeting, the Board considered whether to form one or more formal working groups or informal resource groups for the project. The Board agreed to establish a formal working group, to focus on issues at the strategic level, such as the interrelationships between various parts of the framework. In addition, the Board agreed that one or more informal resource groups should be formed, when required, to assist the staff on more detailed issues.

2. The week after the IASB meeting, the FASB considered the same issues. The FASB decided:

> The staff should identify subject matter experts who can be called upon to provide Board members and staff with advice informally as needed. The FASB will consult with its Financial Accounting Standards Advisory Council for advice on broad, strategic issues in the project. The Board asked the technical Directors of the IASB and FASB to work together to determine whether the project should also be supported by a joint international working group.

3. FASB members noted that the project differed from the Boards' typical standards-level projects, which focus on particular aspects of accounting. Working groups for those projects mostly comprise individuals with expertise on a particular accounting topic, eg the Insurance Working Group. In contrast, the Conceptual Framework project addresses financial reporting issues generally. Consequently, any working group would be required to provide advice on a broad range of issues. Given that the two Boards each have a formal group that provides such advice—their respective advisory councils—there seems no need to form another formal working group.

4. IASB staff noted that, even if the IASB were to conclude that its existing Standards Advisory Council could serve as the project's working group, the SAC was being restructured. The restructured SAC is likely to focus on broader, strategic issues, rather than technical issues. Its membership will reflect that focus, and therefore may not

IN1. The Conceptual Framework for Financial Reporting sets forth the concepts that underlie financial accounting and reporting. The framework is a coherent system of interrelated objectives and fundamentals that prescribes the nature, function, and limitations of financial reporting.

IN2. Standard-setting bodies such as the IASB and the FASB are likely to be the major users and thus the most direct beneficiaries of the guidance provided by the framework. However, knowledge of the objectives and concepts the Boards use in developing standards of financial reporting should enable all who are interested in financial accounting standards to better understand the reasons for standard-setters' conclusions, thus enhancing their ability to participate effectively in the standard-setting process. Knowledge of the framework also should enable interested parties to better understand the content and limitations of information provided by financial reporting, thereby furthering their ability to use that information effectively. Knowledge of the concepts on which standard-setters base their conclusions, if used with care, also may provide guidance to preparers and auditors in resolving new or emerging problems of financial accounting and reporting in the absence of applicable authoritative pronouncements.

Comment [MSOffice1]: This paragraph is adapted from the Preface to CON 1, with some material added.

IN3. The conceptual framework is neither an International Financial Reporting Standard issued by the IASB nor a Statement of Financial Accounting Standards issued by the FASB. The framework does not define standards for particular accounting issues, nor does it override any standards currently in effect. Some preexisting standards may be inconsistent with the concepts set forth in this framework. The framework does not override those standards, nor does it, by itself, provide a sufficient rationale for not complying with those standards. The Boards may reconsider such standards in the future, depending on the extent to which the topics satisfy the criteria for adding a project to the respective Board's agenda.

Comment [MSOffice2]: Most of this paragraph is adapted from paragraphs 3 and 4 of the IASB framework.

IN4. The Boards expect to continue developing the framework, both in later phases of the conceptual framework project and as they consider conceptual issues in standards projects.[1]

CHAPTER 1: OBJECTIVES OF FINANCIAL REPORTING

Introduction

OB1. This chapter establishes the objectives of general purpose external financial reporting. Its focus is on financial reporting by business entities in the private sector. The Boards decided to focus first on business entities in the private sector and then consider the extent to which, if any, the objectives (as well as other aspects of the framework) should differ for other types of entities, such as not-for-profit entities in the private sector.

OB2. The objectives of financial reporting are the foundation of the framework. Other aspects of the framework—qualitative characteristics, elements of financial statements, definition of a reporting entity, recognition and measurement criteria, and presentation and display—flow logically from the objectives and help ensure that financial reporting achieves the objectives to the maximum extent feasible.

Financial Statements and Financial Reporting

Comment [MSOffice3]: This section is based on pars. 5-7 of CON 1; par. 8 on auditing was omitted.

OB3. The objectives pertain to financial reporting and are not restricted to information communicated by financial statements. However, the objectives draw no clear boundary between financial reporting and financial statements and leave the scope of financial reporting broad. The Boards will consider what information should be provided in the main body of the financial statements and what information should be provided outside

[1] Paragraphs BC5–BC11 explain the need for and goals of the current project to revisit certain aspects of the conceptual framework.

financial statements, including in the accompanying notes, in a later part of the conceptual framework project dealing with presentation and display of financial information.[2]

OB4. Financial statements are a central feature of financial reporting. The financial statements now typically provided are a balance sheet or statement of financial position, an income statement or statement of financial performance, a statement of cash flows, a statement of retained earnings, and a statement of other changes in owners' or stockholders' equity. The Boards will consider whether changes are needed to the identity, number, or form of financial statements in the later phase of the project dealing with presentation and display of financial information (paragraph OB3).

OB5. Information communicated by means of financial reporting other than the main body of the financial statements may take various forms and relate to various matters. Some information is provided in the notes accompanying the financial statements. Corporate annual reports, prospectuses, and annual reports filed with governmental agencies are common examples of reports that include financial statements, other financial information, and nonfinancial information. News releases, management's forecasts or other descriptions of its plans or expectations, and descriptions of an entity's social or environmental impact are examples of reports giving financial information other than financial statements or giving only nonfinancial information.

Potential Users of Financial Reports and Their Information Needs

OB6. Many people base economic decisions on their relationships to and knowledge about business entities and thus are potentially interested in the information provided by financial reporting. Potential users and their information needs include:

Comment [MSOffice4]: A combination of par. 24 of CON 1 and first part of par. 9 of IASB.

[2] This and all subsequent references to issues to be considered in later phases of the conceptual framework project will call for revisions to the wording of this chapter to indicate where the eventual Board conclusions on those issues appear. For convenience, this footnote is not repeated for each such reference.

a. *Equity investors*. Providers of risk capital to a business entity and their advisors are interested in the entity's ability to generate favorable cash flows because their decisions relate to the amounts, timing, and uncertainties of future cash flows. To an equity investor, a business entity is a source of cash in the form of dividends and perhaps appreciated market prices. Equity investors are directly concerned with the ability of the entity to generate favorable cash flows and also with how the market's perception of that ability affects the relative prices of its securities.

Comment [MSOffice5]: CON 1 uses the term *expected* cash flows, but CON 7 reserves that term for the single amount that reflects amounts, timing, and uncertainty of future cash flows.

b. *Lenders.* Lenders, including investors in debt securities, also provide capital to a business entity. Lenders thus also are interested in the entity's ability to generate favorable cash flows because their decisions are related to the amounts, timing, and uncertainties of future cash flows. To a lender, a business entity is a source of cash in the form of interest, repayments of borrowings, and perhaps also appreciated market prices of debt securities.

c. *Suppliers and other trade creditors*. Trade creditors provide goods or services rather than financial capital. They are interested in financial information that helps them to assess the likelihood that amounts an entity owes them will be paid when due.

d. *Employees*. Employees and their representatives are interested in evaluating the stability and profitability of their employer. They are interested in information that helps them to assess the entity's ability to pay salaries and wages and to provide incentive compensation and retirement and other benefits.

e. *Customers*. To its customers, a business entity is a source of goods or services, and customers are interested in assessing the entity's ability to continue to provide those goods or services, especially if they have a long-term involvement with, or are dependent on, the entity.

f. *Governments and their agencies*. Governments and their agencies are interested in the activities of a business entity because they are in various ways responsible for the efficient allocation of economic resources. They also need information to help in regulating the activities of business entities, determining and applying taxation policies, and preparing national income and similar statistics.

g. *Members of the public*. A business entity may affect members of the public in a variety of ways. For example, an entity may make a substantial contribution to the local economy by providing employment opportunities, patronizing local suppliers, paying taxes, and making charitable contributions. Financial reporting may assist members of the public and their representatives by providing information about the trends and recent developments in the entity's prosperity and the range of its activities.

OB7. As used in this framework, *investors* includes holders of equity securities, holders of partnership interests, and other owners (category a in paragraph OB6); as well as their advisors. *Creditors* includes institutional and individual lenders (category b in paragraph OB6); and their advisors. Like equity investors, creditors as used in the framework generally provide cash to an entity with the expectation of receiving a return *on*, as well as a return *of* the cash provided, that is, they expect to receive more cash than they provided. Suppliers, employees, customers, or members of the other categories in paragraph OB6 might at a particular point in time have a claim for payment by the entity. For example, a supplier might have a right to payment for goods delivered, or a customer might have a right to a cash refund. Those parties function in dual roles in relation to an entity. For convenience, claims by such parties are not included in the category *creditors* as used in the framework, but information that satisfies the needs of investors and creditors also is likely to be useful to them.

OB8. All of the potential users discussed in paragraph OB6 have either a direct or an indirect interest in a business entity's ability to generate future net cash inflows. For example, although a business entity is not a direct source of cash flows to its customers, the entity can continue to provide goods or services to customers only by generating sufficient cash to pay for the resources it uses in providing those goods or services and to satisfy its other obligations.

OB9. Management and the directors of an entity also are interested in its ability to generate future net cash inflows because that is a significant part of their responsibility and accountability to the entity's owners. Although management is interested in the information provided by financial reporting, management is able to prescribe the form and content of the information it needs.

Comment [MSOffice6]: Adapted from paragraphs 11 of the IASB framework and 30 of CON 1.

OB10. Financial reporting is but one source of information needed by those who make economic decisions about business entities. Business entities and those who have economic interests in them are affected by numerous factors that interact with each other

Comment [MSOffice7]: This par. is taken largely from par. 22 of CON 1, but par. 10 of IASB framework contains similar ideas.

in complex ways. Those who use financial information for economic decisions need to combine information provided by financial reporting with pertinent information from other sources, for example, information about general economic conditions or expectations, political events and political climate, or industry outlook.

General Purpose External Financial Reporting

OB11. **The information provided by financial reporting is directed to the needs of a wide range of users rather than to the needs of a single group of users, such as common shareholders or common shareholders of the parent company in consolidated financial statements. Accordingly, financial reports reflect the perspective of the entity rather than the perspective of existing common shareholders or any other single group**.

Comment [MSOffice8]: The wording is taken primarily from par. 28 of CON 1, revised to better fit the phrasing of decisions in the current project.

OB12. The objectives of general purpose external financial reporting by business entities in the private sector[3] stem primarily from the information needs of external users who lack the authority to prescribe the financial information they need from an entity and therefore must rely on the information provided by management. Information needed to satisfy the specialized needs of management and other potential users, such as taxing authorities, credit rating agencies, or bank lenders, who are able to prescribe the information they need from an entity, is beyond the scope of this conceptual framework. However, the Boards might decide in a standards-level project to require additional information designed to satisfy the information needs of particular groups of users.

[3] For convenience, the remainder of the framework uses the phrases *general purpose external financial reporting*, *general purpose external financial reports*, *financial reporting*, and *financial reports* interchangeably. All such phrases should be understood as referring to *general purpose external financial reporting by business entities in the private sector*.

OB13. Paragraphs OB14–OB28 describe the objectives of financial reporting. The objectives are derived from the needs of users and potential users of financial reporting information and proceed from the more general to the more specific.

Information Useful in Investment and Credit Decisions

OB14. Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar economic decisions.

Comment [MSOffice9]: Par. 34 of CON 1. The last sentence is omitted as it pertains to understandability—a QC rather than an objective, per se.

OB15. The primary users of general purpose financial reporting are present and potential investors and creditors (and their advisors). However, general purpose external financial reporting is directed toward the common interest of various potential users in the ability of an entity to generate future net cash inflows (paragraph OB8). Thus, the objectives are focused on information useful for making rational investment and credit decisions for reasons that are largely pragmatic, not to narrow their scope. The objectives need a focus to avoid being vague or highly abstract. Investors and creditors are the most prominent external groups who use the information provided by financial reporting and who generally lack the authority to prescribe the information they want. Investors' and creditors' decisions and their uses of information have been studied and described to a much greater extent than those of other external groups, and their decisions significantly affect the allocation of resources in the economy. Information provided to meet investors' and creditors' needs is likely also to be useful to members of other groups who are interested in essentially the same financial aspects of business entities as investors and creditors.

Comment [MSOffice10]: This is paragraph 30 of CON 1.

OB16. Financial information that is useful in making investment and credit decisions is likely also to be useful for other purposes, including assessing how management has discharged its stewardship responsibility to owners (shareholders) for the custody and

Comment [MSOffice11]: Based on decisions at the July meetings; the last two sentences are adapted from paragraph 14 of the IASB framework.

safekeeping of the entity's resources and for their efficient and profitable use.[4] Present and potential shareholders and other users of financial reports wish to assess how well management has discharged its stewardship responsibilities because they need to make economic decisions, such as whether to buy, sell, or hold the entity's securities; or whether to replace or reappoint management. That is, external users of financial reports would not be interested in assessing how well management has fulfilled its stewardship responsibilities if they did not need to make economic decisions.

Information Useful in Assessing Cash Flow Prospects

Comment [MSOffice12]: Wording comes largely from par. 50 of CON 1, with some nonessential material deleted.

Comment [MSOffice13]: Paragraph 53 of CON 1, edited slightly for conciseness.

OB17. Financial reporting should provide information to help present and potential investors and creditors and other users assess the amounts, timing, and uncertainty of prospective net cash inflows to the entity.

Comment [MSOffice14]: A combination of the first sentence of par. 15 of IASB framework and the last sentence of par. 37 of CON 1. The 2 frameworks differ in whether the initial focus of the cash flow objective is on cash flows to investors and creditors or cash flows to the entity. We chose to focus the statement of the objective on cash flows to the entity, which is consistent with the IASB and also is directed toward information that financial reporting can provide.

OB18. An entity's investors and creditors are directly interested in the amounts, timing, and uncertainty of their cash receipts from dividends, interest, and sale, redemption, or maturity of securities or loans. However, the prospects for those cash receipts depend on the entity's present cash resources and, more importantly, on its ability to generate enough cash to pay its employees and suppliers and satisfy its other operating needs, to reinvest in operations, to meet its obligations when due, and to pay cash dividends. Cash receipts by investors and creditors also may be affected by perceptions of investors and creditors generally about the entity's cash-generating ability, which affect market prices of the entity's securities.

OB19. Paragraphs OB20–OB28 describe the financial reporting information that has long been considered useful in assessing a business entity's cash flow prospects and why

Comment [MSOffice15]: Paragraph added as part of the effort to clarify and sharpen the link between this objective and the next one.

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[4]Stewardship responsibilities also include protecting the entity's resources to the extent possible from unfavorable economic impacts of factors in the economy such as inflation or deflation and technological and social changes and ensuring that the entity complies with applicable laws, regulations, and contractual provisions. The framework uses the term *stewardship* in that sense.

it is useful for that purpose. The Boards will consider in a later phase of the conceptual framework project how best to present that information in financial reports, as well as the boundaries of financial reporting. Consideration of the boundaries of financial reporting will include the question of whether financial reports should provide forecasts of the outcome of events, such as forecasts of future cash flows or of net income for future periods.

Information about an Entity's Resources, Claims to Those Resources, and Changes in Resources and Claims

OB20. **To provide investors and creditors with information useful in assessing prospective net cash inflows to an entity, financial reporting should provide information about the economic resources of the entity (its assets), the claims to those resources (its liabilities and owners' equity), and the effects of transactions, other events, and circumstances that change resources and claims to them**.[5]

Financial Position

OB21. Information about a business entity's economic resources and the claims to them—its financial position—can tell a user of its financial reports much about the entity's ability to generate favorable cash flows. That information helps investors, creditors, and others identify the entity's financial strengths and weaknesses and assess its liquidity and solvency. Moreover, it provides direct indications of the cash flow potentials of some resources and of the cash needed to satisfy many, if not most, obligations. That is, some of an entity's resources, such as accounts or notes receivable, are direct sources of future cash receipts, and many obligations, such as accounts or notes payable, are direct causes of future cash payments. However, many of the cash flows

Comment [MSOffice16]: This paragraph includes material from par. 16 of IASB framework and par. 41 of CON 1, revised to "sharpen" the link between the second and third objective.

[5]Economic resources, claims to those resources, changes in resources and claims, and their representations in financial statements are the subject of another phase in the conceptual framework project, which will focus on elements of financial statements of business entities in the private sector.

generated by a business entity's operations are the joint result of combining several of its resources to produce or provide and market goods or services. Although those cash flows cannot be identified with individual resources (or some obligations), investors, creditors and others need to know the nature and quantity of the resources available for use in a business entity's operations, which is provided by information about its financial position.

OB22. Information about a business entity's financial structure, as reflected in its financial position, helps users assess future needs for additional borrowing or other financing and how successful it is likely to be in obtaining that financing. It also helps users predict how future cash flows will be distributed among those with a claim on the entity's resources.

Comment [MSOffice17]: This paragraph is adapted from par. 16 of IASB framework.

Information about Changes in Resources and the Claims to Them

OB23. Information about the past and prospective effects of transactions, other events, and circumstances that change an entity's resources and claims to them also helps a user of its financial reports in assessing the entity's ability to generate favorable net cash flows. That information could be presented in a variety of forms. The most useful forms include information about an entity's financial performance, its cash flows, and changes in resources and claims that do not affect cash.

Financial Performance

OB24. Information about an entity's financial performance during a period indicates the extent to which the entity has increased its resource base, and thus its capacity for generating cash flows, through its operations rather than by obtaining additional financing from creditors or owners—the return it has produced on the resources it controls. In the long run, a business entity must produce a positive return on its resource base if it is to generate net cash inflows and thus provide a cash return to its investors and creditors. The variability of that return also is important, especially in assessing the uncertainty of future cash flows, as is information about the components of that return. Although investment and credit decisions reflect investors' and creditors' expectations about an entity's future financial performance, those expectations usually are based at least partly on evaluations of its past performance.

OB25. Accrual accounting attempts to record the financial effects on an entity of transactions and other events and circumstances that have cash consequences for the entity in the periods in which those transactions and other events occur, or circumstances arise, rather than only in the periods in which the entity receives or pays cash. Accrual accounting is concerned with the process by which the cash an entity expends on resources and activities is returned as more (or perhaps less) cash, not just with the beginning and end of that process. It recognizes that the buying, producing, selling, and other operations of an entity during a period, as well as other events that affect its performance, often do not coincide with the cash receipts and payments of the period. Therefore, the financial reporting information provided about both an entity's financial performance and its financial position is based on accrual accounting, which generally is considered to provide a better basis for assessing cash flow prospects than information solely about its current cash receipts and payments.

Comment [MSOffice18]: A combination of par. 44 of CON 1 and par.22 of IASB framework.

Cash Flows

OB26. Financial reporting should provide information about how an entity obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, including cash dividends and other distributions to owners, and about other factors that may affect the entity's liquidity or solvency. Investors, creditors, and others use information about cash flows to aid in understanding an entity's operations,

Comment [MSOffice19]: This paragraph and the next are taken largely from par. 49 of CON 1. The last sentence of this paragraph is taken from the UK framework.

evaluating its financing and investing activities, assessing its liquidity or solvency, or interpreting information provided about financial performance. Cash flow information provides a different perspective on the entity's economic activities—a perspective that is largely free from the effects of allocation to accounting periods as well as from valuation issues.

Changes in Resources and Claims That Do Not Affect Cash

OB27. Financial reporting should provide information about changes in an entity's resources and claims that do not directly affect cash. Examples include acquiring resources in exchange for obligations, settling obligations by transfers of noncash resources, and converting creditors' claims into ownership claims. Investors, creditors, and others need that information to fully understand the information provided about financial position and financial performance, as well as information about cash receipts and payments.

Explanations and Interpretations

OB28. Financial reporting should include explanations and interpretations and other information needed to help users understand the financial information provided. The usefulness of financial information to investors, creditors, and others in forming expectations about a business entity may be enhanced by management's explanations of the information. Management knows more about the entity and its affairs than investors, creditors, or other external parties and can often increase the usefulness of financial information by identifying certain transactions, other events, and circumstances that affect the enterprise and explaining their financial impact on it. In addition, financial reporting often provides information that depends on, or is affected by, management's estimates and judgment. Investors, creditors, and others are aided in evaluating estimates and judgmental information by explanations of underlying assumptions or methods used,

Comment [MSOffice20]: This paragraph comes primarily from paragraph 54 of CON 1; par.21 of IASB framework contains somewhat similar information.

including disclosure of significant uncertainties about principal underlying assumptions or estimates.

Appendix A

BASIS FOR CONCLUSIONS

Introduction

BC1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this framework. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Why Revisit the Boards' Conceptual Frameworks?

Comment [MSOffice21]: This section leans heavily on the related article by Todd revised to broaden the notions to include the international framework and the communications paper by Halsey and Kimberley.

What Is the Conceptual Framework and Why Is It Needed?

BC2. The conceptual framework is a coherent system of interrelated objectives and fundamentals that prescribes the nature, function, and limitations of financial reporting. The objectives identify the goals and purposes of financial reporting, and the fundamentals are the underlying concepts of financial accounting and reporting. Those concepts provide guidance on identifying the boundaries of financial reporting, selecting the transactions, other events, and circumstances to be accounted for, how they should be recognized and measured, and how they should be summarized and reported.

BC3. Both the FASB and the IASB concluded early in their lives that they needed a framework to provide direction and structure to financial accounting and reporting. (That conclusion was shared by many other national standard setters, each of which developed a conceptual framework to help guide its decisions on financial reporting issues.) Standard setters cannot fulfill their missions without a sound and unified conceptual underpinning that helps in deciding whether one solution to financial reporting issue is better than other potential solutions.

BC4. Without the guidance provided by an agreed-upon framework, standard setting ends up being based on the personal conceptual frameworks developed by each member of the stand-setting body. Standard setting that is based on such personal frameworks can produce agreement on specific standard-setting issues only if enough of those frameworks happen to intersect on those issues. Even those agreements may prove transitory because, as the membership of the standard-setting body changes over time, the mix of personal conceptual frameworks changes as well. As a result, a standard-setting body may reach significantly different conclusions about similar (or even identical) issues than it did previously, with standards not being consistent with one another and past decisions not being indicative of future ones. That concern is not merely hypothetical—significant difficulties in reaching agreement in its first standards projects was a major reason that the original FASB members decided to devote substantial effort to develop a conceptual framework.

Why Revisit the Boards' Frameworks Jointly Now?

BC5. A common goal of the FASB and IASB, shared by their constituents, is for their standards to be "principles based." To be principles based, standards cannot be a collection of conventions but rather must be rooted in fundamental concepts.For standards on various issues to result in coherent financial accounting and reporting, the fundamental concepts need to constitute a framework that is sound, comprehensive, and internally consistent.

BC6. The FASB's current Concepts Statements and the IASB's *Framework for the Presentation of Financial Statements,*[6] both developed approximately two decades ago, articulate concepts that go a long way toward being an adequate foundation for principles-based standards, and the Boards have used them for that purpose. For

[6] For convenience, the remainder of this appendix refers to that document as the IASB's *Framework*.

example, the basis for conclusions of each of the FASB's and IASB's standards[7] discusses how the Board's conclusions are consistent with the pertinent concepts.

BC7. To provide the best foundation for ongoing efforts to develop principles-based standards, the concepts developed two decades or more in the past need to be updated and refined to ensure that the framework responds to changes in business practices and the economic environment since they were initially developed. The Boards also need to eliminate any internal consistencies and fill some "holes" in the preexisting frameworks. For example, neither framework includes a robust concept of a reporting entity. The FASB's Concepts Statements included no definition of a reporting entity or discussion of how to identify one. Paragraph 8 of the IASB's *Framework* provided a one-sentence definition of a reporting entity as: "…an entity for which there are users who rely on the financial statements as their major source of financial information about the entity," but with no related discussion of either why that definition is appropriate or how it should be applied.

Comment [MSOffice22]: Note to Board Members: We have drafted this document to refer to pronouncements that it will supercede in the past tense, which is our practice for an Exposure Draft. Whether that is appropriate may depend on the nature of this document i.e., how many rounds of comment the Boards will seek.

BC8. Another common goal of the FASB and IASB is to converge their standards. The Boards have been pursuing a number of projects that are aimed at achieving short-term convergence on specific issues, as well as several major projects that are being conducted jointly or in tandem. Moreover, the Boards are aligning their agendas more closely to achieve convergence in future standards. The Boards will encounter difficulties converging their standards if they base their decisions on different frameworks.

How Are the Boards Conducting the Joint Conceptual Framework Project?

BC9. The Boards considered how best to conduct the joint conceptual framework project and concluded that a comprehensive approach like that taken by the FASB in

[7] Standards developed by the IASB's predecessor body did not include formal bases for conclusions, but each of the International Financial Reporting Standards (IFRSs) issued by the IASB since its inception contains a basis for conclusions.

developing its Concepts Statements would not be an efficient use of their resources because many aspects of their frameworks do not need revision. Instead, the Boards adopted an approach that focuses mainly on the issues that are likely to yield standard-setting benefits in the near term. Those "cross-cutting" issues appear time and time again in different projects and in a variety of different guises. In addition, the project will focus on filling holes in and eliminating differences between the IASB's and FASB's preexisting frameworks. The converged framework will be a single document (like the IASB's preexisting framework) rather than a series of Concepts Statements (like the FASB's preexisting conceptual framework). In drafting the converged framework, the Boards are seeking to eliminate redundancies and any unnecessary material to enable a clear and concise focus on the concepts.

BC10. The first step in the joint conceptual framework project was to identify the cross-cutting issues that the project should seek to resolve. The Boards then decided to conduct the project in several phases, some of which might proceed concurrently. The Boards also decided to focus initially on business entities in the private sector. Once concepts for those entities are developed, the Boards will consider the applicability of the concepts to financial reporting by other entities, such as not-for-profit entities in the private sector.

Objectives of Financial Reporting

Introduction

BC11. The cross-cutting issues, together with issues of convergence, that pertain to the objectives of financial reporting are:

a. Should the objectives focus only on financial statements or more broadly on financial reporting?

b. Is the purpose of financial reporting to provide information to a wide range of users or only to existing common shareholders?

c. Should the objectives continue to focus on general purpose financial reporting or should the focus be on different financial reports for different types of users? For example, does the e**X**tensible **B**usiness **R**eporting **L**anguage (XBRL) make *general purpose* financial statements obsolete?

d. What should be the role of stewardship (accountability) in the objectives? Should providing information helpful in assessing how management has fulfilled its stewardship responsibilities be a separate objective? Does the overriding objective of providing information useful in making economic decisions adequately cover the role of stewardship (accountability) in the objectives?

e. What should be the interaction between financial reporting and management's perspective?

f. Should the main purpose of the balance sheet be to provide information that helps particular groups of users, such as creditors or regulators, assess the entity's solvency?

g. Should information about entity performance provided by measures of comprehensive income and its components be designated as the primary focus of financial reporting?

h. Should financial reports include environmental and social information?

Financial Statements or Financial Reporting?

BC12. FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises,* focused on financial reporting. The IASB's preexisting framework focused only on financial statements. That difference is not as significant as it might first appear because the primary focus of the FASB's framework is on financial statements. Initial plans for the FASB's framework contemplated development of concepts to establish the boundaries of financial reporting and to distinguish between information that should be provided in financial statements and information to be provided in financial reporting outside financial statements. Work on those concepts was begun but never completed.

BC13. As indicated in paragraph OB3, the objectives in this framework are not restricted to information communicated in financial statements but pertain to financial reporting as a whole. The Boards concluded that the objectives should be broad enough to encompass information that might eventually be provided by financial reporting outside financial statements. However, financial statements are a central feature of financial reporting, and most of the cross-cutting issues that need to be resolved in the near-term so that the Boards can make progress on standards projects involve financial statements. Therefore, the Boards also concluded that consideration of specific issues concerning the boundaries of financial reporting and distinctions between financial statements and other parts of financial reporting should be deferred to a later phase of the conceptual framework project.

BC14. The Boards do not expect that resolution of issues in that later phase will eliminate or significantly change any of the objectives of financial reporting set forth in Chapter 1 of the framework, although additional objectives might be added. For example, whether general purpose financial reporting should include prospective or forecasted information and, if so, how such information should be provided, has long been the subject of debate. The Board's eventual consideration of those matters might result in adding a related objective to those set forth in Chapter 1.

BC15. In addition, questions have arisen about whether financial reporting should include environmental or social information (cross-cutting issue h in paragraph BC11). An example is the extent to which an entity should provide detailed information on what it is doing to ensure that its operations do not harm the sustainability of the environment, perhaps including but not necessarily limited to its compliance with environmental regulations. The Boards deferred consideration of that issue to the later phase of the project dealing with the boundaries of financial reporting; it thus is not discussed further in this appendix.

Provide Information to a Wide Range of Users or Only to Existing Common Shareholders?

BC16. Both the FASB's and the IASB's preexisting frameworks discuss the objectives of financial reporting in terms of information that is useful to a wide range of users in making economic decisions. Both frameworks list a wide variety of present and potential users including, among others, investors, creditors, employees, customers, and governmental agencies.

BC17. In standards-level projects, questions continue to be raised about whether financial reporting should be directed to, or reflect the perspective of, existing common shareholders only. In effect, to narrow the focus to existing common shareholders would be to adopt a proprietary perspective rather than an entity perspective, which is consistent with the existing focus on a wide range of users. One area in which the question of entity perspective versus proprietary perspective has arisen is consolidation policy and procedures. Under the entity perspective, consolidated financial statements include the full amount of the assets and liabilities controlled, directly or indirectly, by the parent company. Under the proprietary (or parent company) perspective, consolidated financial statements would include only that part of each asset or liability "owned" by the parent company. That method is usually referred to as pro rata consolidation.[8]

BC18. The Boards concluded that the focus on a wide range of users (and the entity perspective) is more consistent with today's sophisticated economic environment, especially the capital markets, than a narrower focus on existing common shareholders (and the proprietary prospective), and thus should be retained. Although existing common shareholders and their advisors are important users of financial reports, many other groups need financial information about the entity and are not able to require

[8]Pro rata consolidation is most consistent with the parent company perspective. However, a variation sometimes seen in practice in the United States is to reflect the full fair value of subsidiary assets and liabilities at the date the parent obtains a controlling financial interest but only for the percentage that the parent acquires. The subsidiary's carryover basis is used for the part not acquired.

management to provide that information. For example, capital market participants include not only existing common shareholders but also prospective common shareholders as well as present and prospective holders of other kinds of shares, bonds, options, and other types of securities. Further, many who are not capital market participants, such as present and prospective lenders, suppliers, customers, employees, their advisors, and the general public, frequently use financial reports.

BC19. The Boards also note that a broader focus on the needs of a range of users is consistent not only with countries with a corporate governance model defined in the context of shareholders, but also with countries with a corporate governance model that focuses on "stakeholders," which is broader than shareholders. That is of particular concern to the IASB.

Should the Objectives Designate a Primary Group of Users?

BC20. Both the IASB's and the FASB's preexisting frameworks identify a particular group of primary users. Information that satisfies the needs of that particular group of users is considered likely to meet most of the needs of other users. The IASB's *Framework* focuses on the information needs of *investors* (and their advisors), which appears to mean holders of equity instruments, such as shareholders, because *lenders* are listed separately. The FASB's Concepts Statement 1 focuses on information for investment and credit decisions; that is, present and potential *investors and creditors* (and their advisors) are the primary users on which the objectives are focused.

BC21. The Boards concluded that specifying a relatively narrow group as the primary users of financial reports provides an important focus for the objectives and other parts of the conceptual framework. Without such a defined group of primary users, the framework would risk becoming overly abstract or vague.

BC22. Present and potential investors and creditors (and their advisors) are the most prominent external users of financial reports. They are interested in a business entity's ability to generate future net cash inflows and thus to distribute future cash flows to them in the form of dividends, interest, and repayment of borrowing. Other potential users of financial reports, for example, employees and customers, also have either a direct or an indirect interest in an entity's ability to generate future net cash inflows. Accordingly, the Boards decided to designate present and potential investors and creditors (and their advisors) as the primary users of financial reporting information.

General Purpose Financial Reports or Different Reports for Different Users?

BC23. In recent years, some of the Boards' constituents have suggested that the focus on a single set of financial statements intended to meet the needs of a wide range of users is no longer appropriate. They say that advances in technology that permit users of financial statements to "drill down" into an entity's financial information make general purpose financial reporting obsolete. One such advance is XBRL. Under XBRL, financial information is no longer treated as a block of text, such as an Internet page or a printed page. Instead, an identifying tag is assigned to each item of data, such as cash, receivables, long-term debt, total assets or total liabilities, revenues, or income from continuing operations. That permits users of financial information to receive and analyze such data using computer software designed to recognize XBRL tags. Using "tagged" data from XBRL, it might be practicable for business entities either to prepare or to make available the information necessary for different users to assemble different financial reports.

BC24. The idea of "different reports for different users" has some appeal. For example, rather than standard setters and their constituents spending years debating where (or whether) particular revenues or expenses should be presented in the performance statement, entities could provide a list of revenues and expenses (or even debits and credits, such as a trial balance), with explanatory notes, and leave it to users to assemble their own performance statements. Or, rather than producing a single performance statement, entities could provide different performance statements for different types of users, for example, different classes of equity participants.

BC25. The notion of "different reports for different users" also presents significant problems, however. For example, to make informed choices about which of several financial reports to select, or which information to select to assemble their own report (or perhaps a single statement, such as a performance statement), many users of financial reports (and their advisors) would need to have a greater understanding of accounting than they have now. Many users of financial reports are not accounting experts and may not have the time or inclination to acquire such expertise.

BC26. The reasons why the Boards have a joint project on performance reporting on their agendas illustrate some of the problems with leaving users to their own devices in preparing a performance statement. At various times, standard setters have tried to convince their constituents that no single "key" performance measure (such as *operating earnings* or *earnings per share*) provides an adequate picture of an entity's performance or satisfies the information needs of all groups of users. Instead, the emphasis should be on providing enough disaggregated information for users to be able to derive the performance measures that best suit their needs. However, constituents, including users, continue to ask standard setters to provide more guidance on how each of the variety of performance measures that currently exist should be computed. In other words, many, perhaps most, of the Boards' constituents continue to want general purpose financial information.

BC27. The notion of “different reports for different users” also raises cost-benefit concerns. Requiring entities to provide either a variety of different reporting packages or the information sufficient for users to assemble their own reporting packages would expand considerably the amount of information that entities must provide. That would increase both the costs of providing financial reports and the costs of using them in exchange for benefits that seem questionable, especially if users continue to want a general purpose financial report.

BC28. The Boards concluded that, at least for the time being, users’ information needs are best served by general purpose financial reports. Moreover, because users of the financial reports of business entities have a common interest in an entity’s ability to generate net cash inflows, a general purpose financial report that focuses on information helpful in assessing that ability is likely to continue to be needed regardless of how much detailed financial data are available to users.

What Should Be the Role of Stewardship in the Objectives?

BC29. The preexisting frameworks of both the IASB and the FASB focused on providing information that is useful in making economic decisions as the overriding objective of financial reporting. Both also discussed providing information helpful in assessing how management has fulfilled its stewardship responsibility to investors in the entity as part of that overriding objective. That is, information useful in making investment and credit and other economic decisions also is helpful in assessing how management has fulfilled its stewardship responsibilities, and users of financial reports assess stewardship for the purpose of making economic decisions. The Boards considered whether discussion of stewardship should be retained much as it was in the preexisting frameworks, or whether discussion of the objectives should either omit any discussion of stewardship or elevate providing information helpful in assessing stewardship to be a separate objective.

BC30. Financial reporting, and especially financial statements, usually cannot and does not separate management performance from entity performance. Entity successes and failures result from the interaction of numerous factors. Management's performance in discharging its stewardship responsibilities is a contributing factor, but so are events and circumstances that are often beyond the control of management, such as general economic conditions, supply and demand characteristics of entity inputs and outputs, and price changes. Financial reporting provides information about an entity during a period when it was under the direction of a particular management but does not directly provide information about that management's performance.

BC31. Arguably, the framework does not need a discussion of stewardship and accountability. As already noted, users of financial reports are interested in assessing stewardship for the purpose of making economic decisions. In addition, the information about economic resources, economic obligations, and changes in them that is needed for making investment and credit decisions is indistinguishable from information needed for assessing management's stewardship and accountability. Moreover, inclusion of a discussion of stewardship in the objectives has led to some misunderstandings. For example, some suggest that including a discussion of stewardship implies a greater focus on accounting information that reflects management's intent than is found in today's accounting and reporting. In summary, including a discussion of stewardship arguably adds nothing substantive to the objectives and runs the risk of leading to misunderstandings.

BC32. However, others contend that providing information useful in assessing how management has fulfilled its stewardship responsibilities should be a separate objective of financial reporting. They agree that management is responsible for both the safekeeping of an entity's assets and their efficient and profitable use. However, those constituents do not agree that information useful in assessing efficiency and profitability is necessarily sufficient for assessing how management has fulfilled its responsibility for the safekeeping of an entity's assets, and they think that matter needs further consideration. Some also suggest that stewardship is a broader notion than decision-usefulness, and some are concerned with the potential implications of subsuming stewardship within a decision-usefulness objective.

BC33. On balance, the Boards concluded that discussion of providing information useful in assessing how management has fulfilled its stewardship responsibility should remain as part of the overall objective of providing information useful in making economic decisions. Eliminating a discussion of stewardship, even with an explanation of why such a discussion is unnecessary, could imply that the Boards no longer thought that financial reports should provide information useful in assessing stewardship. That would be wrong because the Boards reaffirmed that information useful in making economic decisions also should be useful in assessing how management has fulfilled its stewardship responsibility.

BC34. The Boards also concluded that providing information helpful in assessing how management has fulfilled its stewardship responsibilities should not be a separate objective. As already discussed, the objective of providing information useful in making investment, credit, and other economic decisions encompasses providing information useful in assessing stewardship. Making stewardship a separate objective might imply that financial reporting should separate the effects of management's performance from events and circumstances that are beyond the control of management, such as general economic conditions, supply and demand characteristics of entity inputs and outputs, and price changes. The Boards concluded that such separation is not possible. To make stewardship a separate objective might exaggerate what it is feasible for financial reporting to accomplish.

What Should Be the Interaction between Financial Reporting and Management's Perspective?

BC35. A related issue to the role of stewardship in the objectives concerns the interaction between general purpose external financial reporting and management's perspective. The framework makes it clear (as did both of the preexisting frameworks) that general purpose financial reporting is directed to the needs of users who lack the ability to specify the information that management provides to them. An entity's management does not fit into that category. Hence, although the information provided in external financial reports is likely to be useful to management for various purposes, management has the ability to obtain whatever information it needs. Thus, general purpose external financial reporting is not directed to the information needs of management.

BC36. Two additional potential aspects of this cross-cutting issue pertain to later phases of the conceptual framework project. First, whether measurement principles should be based on management's perspective (or management's intent) will be considered in the phase of the project that deals with measurement concepts. Second, whether and how financial reporting should include management commentary will be addressed in the phase dealing with presentation and display of financial information.

Is the Purpose of the Balance Sheet to Help Particular Users Assess Solvency?

BC37. In response to suggestions by certain constituents, the Boards considered whether the main purpose of the balance sheet should be to provide information that helps particular groups of users, such as creditors or regulators, assess the entity's solvency. The Boards note that similar questions could be asked about the other financial statements, that is, should other individual financial statements be directed to the needs of particular users.

BC38. The question is not whether information provided in the financial statements should be helpful in assessing solvency—clearly it should. Assessing solvency is one part of making investment and credit (and other) decisions, and the overriding objective of general purpose external financial reporting is to provide information that is helpful in making economic decisions. However, some have suggested that the balance sheet should be directed toward the needs of creditors and regulators, possibly to the exclusion of other users. The Boards observed that to do so would be inconsistent with the objective of providing information to a wide range of users that is helpful in making a variety of economic decisions. The Boards thus rejected the notion of directing the balance sheet (or any other individual financial statement) toward the needs of particular groups of users. Nevertheless, in a standards project, one or both Boards might require disclosure of information intended to satisfy a particular need of creditors or some other group of users.

Should Providing Information about Entity Performance Be the Primary Focus of Financial Reporting?

BC39. Another issue concerns the relative importance of information about an entity's financial performance provided by measures of comprehensive income and its components.[9] FASB Concepts Statement 1 (paragraph 43) said that:

> The primary focus of financial reporting is information about an enterprise's performance provided by measures of [comprehensive income] and its components. Investors, creditors, and others who are concerned with assessing the prospects for enterprise net cash inflows are especially interested in that information.

[9]Concepts Statement 1 referred to "earnings and its components." However, FASB Concepts Statement No. 6, *Elements of Financial Statements*, substituted the term *comprehensive income* for the term *earnings*. The latter term was reserved for a component of comprehensive income.

The IASB *Framework*, on the other hand, did not elevate the importance of information about performance above that of other financial information.

BC40. The Boards understand that many users may have special interests in various kinds of information about financial performance, such as earnings per share. However, the Boards are not aware of evidence to suggest that information about financial performance is more important than other types of financial information, such as the information about economic resources and claims to them provided by a balance sheet. In addition, the elevation of information about performance above the importance of other financial information might be viewed as inconsistent with the approach to the definitions of elements taken in both the IASB's and the FASB's preexisting frameworks in which assets are "primary." That is, all elements except assets are defined in terms of either claims to assets (liabilities and equity) or changes in assets and the claims to them (revenues, expenses, investments by owners, and distributions to owners). Thus, the Boards concluded that the reference in Concepts Statement 1 to information about performance as the primary focus of financial reporting should not be carried forward into the converged framework.