Revised Conceptual Framework for Financial Reporting

July 2018

The IASB has recently published its revised 'Conceptual Framework for Financial Reporting'. The project was initiated in 2004 however due to a series of changed priorities and abandonment in 2010 followed by a phase by phase approach, the resultant framework does not constitute a substantial revision as was originally intended, but instead focuses on topics that were not yet covered or that showed obvious shortcomings that needed to be dealt with. The Board and Interpretations Committee will immediately begin using the revised Framework. It is effective for annual periods beginning on or after 1 January 2020 for preparers that develop an accounting policy based on the Framework.

The primary purpose of the Framework is to assist the IASB by identifying concepts that it will use when setting standards. The Framework is not an IFRS standard and does not override any standard, so nothing will change in the short term. The revised Framework will be used in future standard-setting decisions, but no changes will be made to current IFRS. Preparers can use the Framework to assist them in developing accounting policies where an issue is not addressed by an IFRS.

The Framework is structured into 8 chapters, however only chapters 1 to 7 were revised. Chapter 8 which discusses the concepts of capital and capital maintenance remains unchanged. The key changes in the chapters are summarized below:

Chapter	Details
Chapter 1 – The objective of general purpose financial reporting	• This chapter notes that the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity. • This chapter also newly highlights increasing the prominence of stewardship in financial reporting emphasizing the need to provide information that is useful in making resource allocation decisions.
Chapter 2 – Qualitative characteristics of useful financial information	• This chapter reintroduces an explicit reference to the notion of prudence and states that the exercise of prudence supports neutrality. Prudence is defined as the exercise of caution when making judgements under conditions of uncertainty. • Also new in this chapter is a clarification that faithful representation means representation of the substance of an economic phenomenon instead of representation of its legal form only.
Chapter 3 – Financial Statements and the reporting entity	• This chapter states that the objective of the financial statement is to provide information about an entity's assets, liabilities, equity, income and expenses that is useful to users in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources. • The chapter notes that financial statements are prepared for a specific period of time and provide comparative information and under certain circumstances forward looking information. It also states IASB's conviction that, generally, consolidated financial statements are more likely to provide useful information to users than unconsolidated financial statements. • New to the Framework is the definition of a reporting entity, which might be a legal entity or a portion of a legal entity.

<table>
<tr><th>Chapter</th><th>Details</th></tr>
<tr><td>Chapter 4 – The elements of Financial Statements</td><td>The main focus of this chapter is on the definition of assets, liabilities, equities, income and expenses.
Asset – A present economic resource controlled by the entity as a result of past events. An economic resource is right that has the potential to produce economic benefits
Liability – A present obligation of the entity to transfer an economic resource as a result of past events.
Equity – The residual interest in the assets of the entity after deducting all its liabilities.
Income – Increases in assets or decreases in liabilities that result in increases in equity, other than those relating to contributions from holders of equity claims
Expenses – Decreases in assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to holders of equity claims
New is the introduction of a separate definition of an economic resource to move the reference to future flows of economic benefits out of the definition of an asset and liability. The expression ‘economic resource’ instead of simply ‘resource’ stresses that the IASB no longer thinks of assets as physical objects but as sets of rights. The definition of assets and liabilities also no longer refer to ‘expected’ inflows or outflows. Instead, the definition of an economic resource refers to the potential of an asset/liability to produce/to require a transfer of economic benefits.</td></tr>
<tr><td>Chapter 5 – Recognition and derecognition</td><td>The Framework states that only items that meet the definition of an asset, a liability or equity are recognized in the statement of financial position and only items that meets the definition of income or expense are to be recognized in the statement of financial performance.
However, their recognition is dependent on providing the users with:
i) relevant information about the asset or liability and of any income or expense or changes in equity; and
ii) a faithful representation of the asset or liability and of any income or expense or changes in equity.
The Framework also discusses the concept of derecognition. The requirements are driven by 2 aims:
The assets and liabilities retained after the transaction or other event that led to derecognition must be presented faithfully; and
The change in the entity’s assets and liabilities as a result of that transaction or other event must also be presented faithfully.
The Framework also describes alternatives when it is not possible to achieve both aims.</td></tr>
<tr><td>Chapter 6 - Measurement</td><td>This chapter is dedicated to the description of different measurement bases such as historical cost, current value, fair value, value in use and current cost. It explains in detail about the information they provide and their advantages and disadvantages.
Current cost is newly introduced in The Framework as it is widely advocated.
The Framework also sets out factors to consider when selecting a measurement basis.</td></tr>
<tr><td>Chapter 7 – Presentation and Disclosure</td><td>The Framework states that the statement of profit or loss is the primary source of information about an entity’s financial performance for the reporting period and that only in ‘exceptional circumstances’ the Board may decide that income or expenses are to be included in other comprehensive income.</td></tr>
</table>