

Snapshot: Review of the *Conceptual Framework*

This Snapshot introduces the IASB's Discussion Paper A Review of the *Conceptual Framework for Financial Reporting*.

Project objectives:	to improve financial reporting by providing the IASB with a complete and updated set of concepts to use when it develops or revises International Financial Reporting Standards (IFRSs).
Project stage:	the Discussion Paper is the first step towards revising the <i>Conceptual Framework</i> . It is designed to obtain initial views and comments from parties with an interest in financial reporting.
Next steps:	the IASB will consider the comments received on the Discussion Paper and then develop an Exposure Draft containing proposals for a revised <i>Conceptual Framework</i> . The IASB aims to publish the Exposure Draft in 2014 and finalise the revised <i>Conceptual Framework</i> in 2015.
Comment deadline:	14 January 2014

Background

The IASB uses the *Conceptual Framework* when it develops or revises its IFRSs.

The *Conceptual Framework* sets out the underlying concepts for the preparation and presentation of financial statements and forms the basis for specific recognition and measurement requirements in IFRSs.

The *Conceptual Framework* should enable the IASB to reach consistent conclusions on a variety of complex financial reporting matters. It should also assist other parties when accounting for items not covered by a particular IFRS.

The *Conceptual Framework* should address matters that are fundamental to the accounting process. These matters include:

- (a) definitions of assets, liabilities, equity, income and expense; and
- (b) the recognition, measurement, presentation and disclosure of those items.

The existing *Conceptual Framework* has helped the IASB to develop IFRSs that have improved financial reporting. However, the IASB wants to improve the *Conceptual Framework* because:

- (a) some important areas are not covered. For example, it provides very little guidance on measurement, presentation and disclosure.
- (b) some parts are out of date and fail to reflect the current thinking of the IASB. Some other parts are unclear and less helpful than they could be.

In 2010, the IASB revised the chapters of the *Conceptual Framework* that describe the objective of financial reporting and the characteristics of useful financial information. It also published an Exposure Draft on the reporting entity and performed substantial work on other areas. However, the IASB suspended work on the *Conceptual Framework* in 2010 so that it could focus on more urgent projects that arose from the financial crisis.

In 2011, the IASB carried out a public consultation on its future agenda (the '2011 Agenda Consultation'). Many respondents to that consultation identified the *Conceptual Framework* as a priority project for the IASB. Consequently, the IASB resumed the project.

Before suspending the project in 2010, the IASB undertook the project in partnership with the United States national standard-setter, the Financial Accounting Standards Board (FASB). The project is now an IASB-only project.

Overview of the Discussion Paper

The best way for interested parties to influence the future direction of financial reporting is by commenting on the *Conceptual Framework* Discussion Paper and on the Exposure Draft that will follow in due course.

The Discussion Paper is the first step towards a revised *Conceptual Framework*. The purpose of the Discussion Paper is to obtain feedback on the main areas that the IASB will consider when it starts to develop more specific ideas into complete proposals.

When developing the Discussion Paper, the IASB focused on those areas that have caused it problems in practice or that needed updating to reflect concepts developed by the IASB in other projects.

These include:

- (a) definitions of assets and liabilities;
- (b) recognition and derecognition of assets and liabilities;
- (c) measurement;
- (d) equity;
- (e) profit or loss and other comprehensive income (OCI); and
- (f) presentation and disclosure.

Each of these topics is addressed in the following pages.

As soon as the IASB completes its revision of the *Conceptual Framework*, it will start using the revised version to help it develop new or revised IFRSs. Thus, decisions in this project will shape the decisions that the IASB ultimately makes in all future projects to develop or revise IFRSs.

Definitions of assets and liabilities

The Discussion Paper suggests improvements to the existing definitions of assets and liabilities, and additional guidance to support those definitions.

Assets and liabilities are the basic building blocks from which the statement of financial position is constructed.

The IASB believes that the existing definitions of assets and liabilities have worked well, but that they could be refined.

The Discussion Paper suggests revised definitions that:

- (a) focus more clearly on the fact that **an asset is a resource**, and a **liability is an obligation**; and
- (b) clarify the status of those resources and obligations that are not certain to result in inflows and outflows of economic benefits.

The Discussion Paper also explores whether the IASB should add further guidance about some of the terms used in the revised definitions of assets and liabilities.

Revised definitions

Assets

An asset of an entity is a present economic resource controlled by the entity as a result of past events.

Liabilities

A liability of an entity is a present obligation of the entity to transfer an economic resource as a result of past events.

Equity

= Assets - Liabilities

Recognition and derecognition of assets and liabilities

The Discussion Paper suggests improvements to the guidance on when assets and liabilities should be recognised and suggests new guidance on when assets and liabilities should be derecognised.

Recognition of an asset or a liability is the process of including, in the financial statements, an item that meets the definition of an asset or a liability.

Derecognition of an asset or a liability is the process of removing, from the financial statements, an asset or a liability that has previously been recognised.

Recognition

Although the existing *Conceptual Framework* includes criteria for the recognition of assets and liabilities, those criteria need to be updated to reflect the current thinking of the IASB and other developments.

The Discussion Paper suggests that an entity should recognise all its assets and liabilities, unless the IASB decides that:

- (a) recognising an asset or a liability would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or
- (b) no measure of an asset or a liability would result in a sufficiently faithful representation of both that asset or liability and the resulting income or expense.

Derecognition

The existing *Conceptual Framework* does not address derecognition, although the IASB has addressed the derecognition of various assets or liabilities in some of its recent IFRSs.

The Discussion Paper suggests that an entity should derecognise an asset or a liability (or part of an asset or a liability) when it no longer meets the recognition criteria.

If, following a transaction, an entity retains part of a previously recognised asset or liability, the Discussion Paper suggests that the IASB may need to consider how best to reflect the transaction and the resulting changes to the underlying economic resource or obligation. For example, the IASB may decide to require enhanced disclosure, separate presentation or continued recognition of the asset or liability.

Measurement

The Discussion Paper suggests guidance that could assist the IASB in selecting the most appropriate measurement basis for an asset or a liability.

Measurement is the process of determining the amount to be included in the financial statements for an asset or a liability.

The existing *Conceptual Framework* provides little guidance on measurement and when a particular measurement basis should be used.

The Discussion Paper describes guidance on measurement that could be included in a revised *Conceptual Framework*.

The Discussion Paper suggests that the IASB should limit the number of measurement bases used in financial statements to enhance their understandability and comparability.

However, the Discussion Paper also suggests that a single measurement basis for all assets and liabilities may not provide the most relevant information.

In addition the Discussion Paper suggests that, in selecting an appropriate measurement basis for a particular asset or liability, the IASB should consider:

- (a) how the asset contributes to future cash flows or how the entity will fulfil or settle the liability; and
 - (b) what information that measurement basis will produce in the statement of financial position and the statement of comprehensive income.
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For example, fair value might be the most relevant measurement basis for a financial asset that has complex features and is held for trading, but depreciated cost might be more relevant for an asset—such as property, plant and equipment—that contributes to future cash flows indirectly.

Equity

The Discussion Paper suggests that the definition of equity should remain unchanged. The Discussion Paper also suggests that an entity should provide information about different classes of equity.

Equity is the residual interest in the assets of the entity after deducting all its liabilities.

Different classes of equity

Financial statements do not typically provide enough information about the claims of different classes of equity investors, such as the effect of senior equity claims on subordinate equity claims.

The Discussion Paper suggests that entities should use an enhanced statement of changes in equity to provide more information about different classes of equity.

Distinction between equity and liabilities

Existing IFRSs do not apply the definition of a liability consistently when distinguishing liabilities from equity instruments. The resulting requirements can be complex, difficult to understand and difficult to apply.

The Discussion Paper does not propose to change the existing definition of equity. To distinguish between equity instruments and liabilities, the IASB would use the existing definition of equity, and the definition of a liability, which focuses on whether the entity has an obligation to deliver economic resources.

An enhanced statement of changes in equity would provide more information about the different classes of equity claims and show how wealth is transferred between those classes. It might also enable the IASB to simplify the IFRSs that distinguish liabilities from equity instruments.

Profit or loss and other comprehensive income

The Discussion Paper suggests that the IASB should introduce principles to assist the IASB when it decides which items of income and expense should be recognised in profit or loss, and which should be recognised in OCI.

Recycling is the process of reclassifying items of income or expense that were previously recognised in OCI to profit or loss in a subsequent period.

Many respondents to the 2011 Agenda Consultation noted that it is important for the *Conceptual Framework* project to address profit or loss, OCI and the ‘recycling’ of amounts from OCI to profit or loss. Currently, there is no principle in IFRS to determine:

- (a) which items of income or expense should be presented in profit or loss and which should be presented in OCI; and
- (b) whether, and when, items previously recognised in OCI should be recycled from OCI into profit or loss.

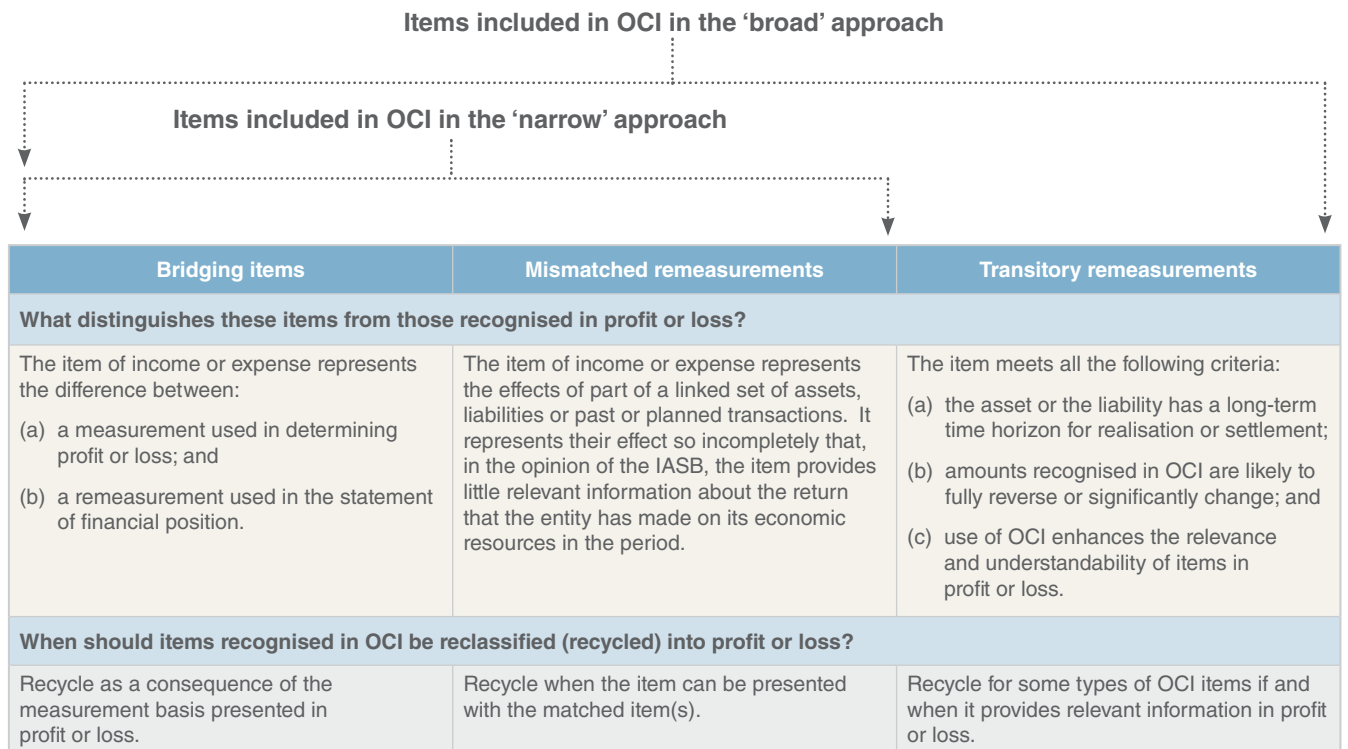
The Discussion Paper suggests that the *Conceptual Framework*:

- (a) should require a profit or loss total or subtotal that also results, or could result, in some items of income or expense being recycled; and
 - (b) should limit the use of OCI to items of income or expense resulting from changes in current measures of assets and liabilities (remeasurements). However, not all such remeasurements would be eligible for recognition in OCI.
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The Discussion Paper discusses two approaches that describe which items could be included in OCI:

- (a) a 'narrow' approach; and
- (b) a 'broad' approach.

Both of these approaches would require items of income and expense to be recognised in profit or loss, unless they are eligible for inclusion in OCI.

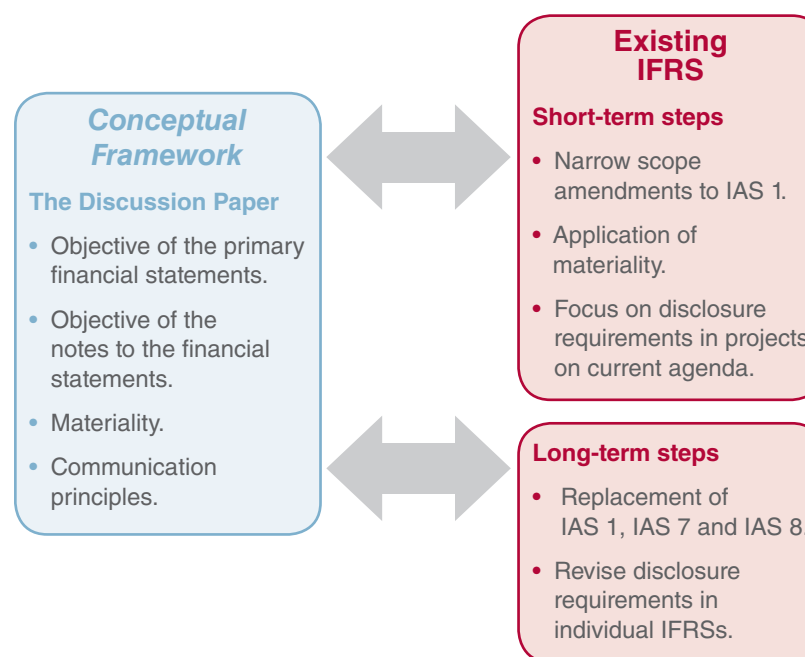


Presentation and disclosure

The IASB is addressing presentation and disclosure in its *Conceptual Framework* project and intends to improve existing IFRSs in the future.

Many respondents to the 2011 Agenda Consultation told the IASB that a framework for disclosure is needed to ensure that information disclosed is more relevant to investors and to reduce the burden on preparers. One aspect of the IASB's response is the development of disclosure concepts for the *Conceptual Framework*.

The IASB plans other work on disclosure including possible amendments to existing IFRSs.



The existing *Conceptual Framework* does not have a section on disclosure. The IASB will aim to develop concepts that it will be able to use when developing future disclosure requirements in IFRSs.

The Discussion Paper suggests that:

- (a) the objective of presenting information in the primary financial statements is to provide summarised information about recognised assets, liabilities, equity, income, expenses, changes in equity and cash flows, that has been classified and aggregated in a manner that is useful; and
- (b) the objective of disclosing information in the notes to the financial statements is to supplement the primary financial statements by providing additional useful information about the items recognised in (a) and unrecognised assets and liabilities.

The types of information that might be required to meet the disclosure requirements

Type of useful information	Examples of disclosures in the notes to the financial statements
Reporting entity.	<ul style="list-style-type: none"> • The group structure, for example, subsidiaries, associates, parent etc. • The business model. • Going concern.
Amounts recognised in the primary financial statements.	<ul style="list-style-type: none"> • Disaggregation of line items in the primary financial statements. • Relationships between line items, for example, hedging, offsetting etc.
Unrecognised assets or liabilities.	<ul style="list-style-type: none"> • Description of unrecognised assets and liabilities and why the items have not been recognised.
Risks.	<ul style="list-style-type: none"> • The financial risks to which the entity is exposed. • How the entity has managed those risks. • How management of risks has impacted the entity's financial statements, including sensitivity analysis.
Methods, assumptions and judgements.	<ul style="list-style-type: none"> • Accounting policies. • Measurement methodologies, including assumptions and inputs. • Quantification of the sensitivity of estimates to changes in assumptions and inputs. • Alternative measurements.

Additional matters discussed

The Discussion Paper also discusses several other areas of the *Conceptual Framework* without suggesting any major changes.

The objective of financial reporting and the qualitative characteristics of useful financial information

The IASB does not intend to fundamentally reconsider the chapters of the existing *Conceptual Framework* that deal with the objective of financial reporting and the qualitative characteristics of useful financial information. The IASB revised those chapters in 2010 and already uses those chapters when developing IFRSs. However the IASB will make changes to those chapters if it identifies areas that need clarification or improvement.

Some interested parties have raised concerns about how those chapters address stewardship, reliability and prudence. The IASB has included a summary of those concerns in the Discussion Paper to seek respondents' views on these matters. The IASB will consider those views in determining whether, and the extent to which, amendments to those chapters are required.

Reporting entities

In 2010, the IASB published an Exposure Draft on the concept of a reporting entity. The IASB intends to include a review of those proposals, including comments received on those proposals, as it develops an Exposure Draft on a revised *Conceptual Framework*.

Other matters

The Discussion Paper also discusses:

- business model;
 - unit of account;
 - going concern; and
 - capital maintenance.
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Further information

The Discussion Paper includes questions on the topics presented in the Discussion Paper. Respondents are invited to respond to any or all of those questions and to comment on any other matter that the IASB should consider when developing its Exposure Draft. The IASB's discussions will take place in public meetings. To access information about those public meetings, to view the Discussion Paper and to submit your comments, please visit www.ifrs.org.

The deadline for comments on the Discussion Paper is **14 January 2014**.

To stay up to date with the latest developments and to sign up for email alerts about the project, please visit the project homepage on <http://go.ifrs.org/Conceptual-Framework>.

International Accounting Standards Board (IASB)

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