Unit 1: conceptual framework for financial reporting

2.1.2 The purpose of the conceptual framework

- To assist the IASB in developing and revising standards based on consistent concepts
- Discusses the factors the IASB needs to consider in making judgments when application of the concepts does not lead to a single answer
- All parties to understand and interpret IFRS

Conceptual framework provides the foundation for standards that:

- Contribute to transparency
- Strengthen accountability
- Contribute to economic efficiency

Why do we need an accounting framework?
↓
To compare and for uniformity

Extra info:

- Every standard needs to be inline with the conceptual framework.
- Conceptual framework tells us what is the purpose and objective of accounting
- It is the basis for every accounting principle that is applied by entities
- Conceptual framework is not a standard, There are exceptions that may depart from IFRS → Does not override any IFRS

2.2 The objective of general purpose financial reporting

Provide the following:

- Financial information
- about the reporting entity
- that is useful
- to existing and potential investors, lenders and other creditors
- in making decisions
- about providing resources to the entity

Typical decisions:

- Buying, selling or holding equity and debt instruments
- Providing or settling loans and other forms of credit
- Exercising rights to vote on (or otherwise influence) management's actions that affect the use of the entity's economic resources

Decisions depend on:

- Returns users expect from their investment
- Returns in the form of: dividends; principal and interest payments and market price increases

Expectations about returns based on:

Financial position - economic resources of the entity (assets) + claims against it (liabilities)

- An assessment of the amount, timing and uncertainty of future net cash inflows to the entity → Will I be able to make money out of this?
- An assessment of management's stewardship of the entity's economic resources → Will my money be safe?

Information that is needed:

- Information about the economic resources of the entity
- Info about claims against the entity (Financial position)
- Changes in economic resources and claims (issuing debt/equity instruments/as a result of the entity's financial position
- Info on efficiently and effectively management has discharged its responsibilities to use the entity's economic resources

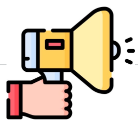
Stewardship:

- Ensures that management's role in protecting and efficiency utilising the entity's economic resources is clearly reported
- Includes acting prudently in the face of uncertainty and safeguarding investors' interests through sound decision-making

Users:

Primary users:	Secondary users:
Investors (existing and potential)	The government and other government institutions
Lenders	Customers
Other creditors	Employees
	Community

- Primary users cannot demand direct information
- Rely on GPFR for most financial needs
  ↳ (cannot provide all info)
- Obtain info from other sources (economy, politics industry and company-related matters)



Management has access to the in-depth and in detail information

GPFR are NOT primarily intended for use of management and regulators

They are designed to meet the common information needs of users who lack the ability to obtain specific, tailored information directly from the entity

GPFR are not intended to provide info about the value of the reporting entity but to provide info to the users in order for them to be able to estimate the value of the entity

Shortcomings (problems) of GPFR:

- Does not and cannot provide all required information (Cannot tell you that the owner is sick)
- Does not show value of entity (provides information to users to estimate value)
- Provides information to meet the needs of maximum number of primary users
- Additional information (that is useful to particular subset) may be included
- Not specifically directed at:
  Management
  Regulators
  Members of the public

Extra info:

- Information in financial reports is often based on estimates, judgements and models, rather than exact calculations.
- The conceptual framework establishes certain concepts that underlie those estimates, judgements and models

  ▷ Basically like a solution to the problem

The accrual basis of accounting:

Information about a reporting entity's economic resources and claims, and changes in its economic resources and claims during a particular period, provides a better basis for assessing the entity's past and future performance, than information solely about cash receipts and payments during that period.

Reason we apply the accrual basis in financial reports

Depicts effects of transactions and other events and circumstances on an entity's economic resources and claims in the periods in which it occurs, even if the resulting cash receipts and payments occur in a different period.

Why is it useful?

- Approach enhances the relevance and reliability of financial reports
- Provides users with a more accurate depiction of the entity's financial health and future cash flows
- Recognising events when they occur rather than when cash is exchanged better aligns with decision-making needs of users

Example:

Entity A has a 31 December 2024 reporting period. Entity A's annual warehouse insurance policy is effective from 1 October 2024 – 30 September 2025. Entity A paid an upfront payment of R120 000 on 1 October 2024 for the full annual policy. Should the full R120 000 be recognised as an expense in FY24?

Solution:

No. The portions should be split between the FY24 and FY25 year (based on months)

Who is responsible for preparation?

- Companies act 71 of 2008
- Management is responsible
- Directors will be held liable

2.3 Qualitative characteristics of useful financial information