Conceptual Framework for Financial Reporting 2018

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History of the Framework

April 1989	*Framework for the Preparation and Presentation of Financial Statements* (the Framework) was approved by the IASC Board
July 1989	Framework was published
April 2001	Framework adopted by the IASB.
September 2010	*Conceptual Framework for Financial Reporting 2010* approved by the IASB
March 2018	*Conceptual Framework for Financial Reporting 2018* (the Framework) published

Related Interpretations

None

Amendments under consideration by the IASB

None

Please note that we are in the process of updating this page.

Status and purpose and status of the Framework

The Framework's purpose is to assist the IASB in developing and revising IFRSs that are based on consistent concepts, to help preparers to develop consistent accounting policies for areas that are not covered by a standard or where there is choice of accounting policy, and to assist all parties to understand and interpret IFRS. [SP1.1]

In the absence of a Standard or an Interpretation that specifically applies to a transaction, management must use its judgement in developing and applying an accounting policy that results in information that is relevant and reliable. In making that judgement, IAS 8.11 (https://www.iasplus.com/en/standards/ias/ias8) requires management to consider the definitions, recognition criteria, and measurement concepts for assets, liabilities, income, and expenses in the Framework. This elevation of the importance of the Framework was added in the 2003 revisions to IAS 8.

The Framework is not a Standard and does not override any specific IFRS. [SP1.2]

If the IASB decides to issue a new or revised pronouncement that is in conflict with the Framework, the IASB must highlight the fact and explain the reasons for the departure in the basis for conclusions. [SP1.3]

The Framework

Scope

The Framework addresses:

- the objective of general purpose financial reporting
- qualitative characteristics of useful financial information
- financial statements and the reporting entity
- the elements of financial statements
- recognition and derecognition
- measurement
- presentation and disclosure
- concepts of capital and capital maintenance

Chapter 1: The Objective of general purpose financial reporting

The primary users of general purpose financial reporting are present and potential investors, lenders and other creditors, who use that information to make decisions about buying, selling or holding equity or debt instruments, providing or settling loans or other forms of credit, or exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources. [1.2]

The primary users need information about the resources of the entity not only to assess an entity's prospects for future net cash inflows but also how effectively and efficiently management has discharged their responsibilities to use the entity's existing resources (i.e., stewardship). [1.3-1.4]

The IFRS Framework notes that general purpose financial reports cannot provide all the information that users may need to make economic decisions. They will need to consider pertinent information from other sources as well. [1.6]

The IFRS Framework notes that other parties, including prudential and market regulators, may find general purpose financial reports useful. However, these are not considered a primary user and general purpose financial reports are not primarily directed to regulators or other parties. [1.10]

Information about a reporting entity's economic resources, claims, and changes in resources and claims

Economic resources and claims

Information about the nature and amounts of a reporting entity's economic resources and claims assists users to assess that entity's financial strengths and weaknesses; to assess liquidity and solvency, and its need and ability to obtain financing. Information about the claims and payment requirements assists users to predict how future cash flows will be distributed among those with a claim on the reporting entity. [1.13]

A reporting entity's economic resources and claims are reported in the statement of financial position. [See IAS 1.54-80A]

Changes in economic resources and claims

Changes in a reporting entity's economic resources and claims result from that entity's performance and from other events or transactions such as issuing debt or equity instruments. Users need to be able to distinguish between both of these changes. [1.15]

Financial performance reflected by accrual accounting

Information about a reporting entity's financial performance during a period, representing changes in economic resources and claims other than those obtained directly from investors and creditors, is useful in assessing the entity's past and future ability to generate net cash inflows. Such information may also indicate the extent to which general economic events have changed the entity's ability to generate future cash inflows. [1.18-1.19]

The changes in an entity's economic resources and claims are presented in the statement of comprehensive income. [See IAS 1.81-105]

Financial performance reflected by past cash flows

Information about a reporting entity's cash flows during the reporting period also assists users to assess the entity's ability to generate future net cash inflows and to assess management's stewardship of the entity's economic resources. This information indicates how the entity obtains and spends cash, including information about its borrowing and repayment of debt, cash dividends to shareholders, etc. [1.20]

The changes in the entity's cash flows are presented in the statement of cash flows. [See IAS 7]

Changes in economic resources and claims not resulting from financial performance

Information about changes in an entity's economic resources and claims resulting from events and transactions other than financial performance, such as the issue of equity instruments or distributions of cash or other assets to shareholders is necessary to complete the picture of the total change in the entity's economic resources and claims. [1.21]

The changes in an entity's economic resources and claims not resulting from financial performance is presented in the statement of changes in equity. [See IAS 1.106-110]

Information about use of the entity's economic resources

Information about the use of the entity's economic resources also indicates how efficiently and effectively the reporting entity's management has used these resources in its stewardship of those resources. Such information is also useful for predicting how efficiently and effectively management will use the entity's economic resources in future periods and, hence, what the prospects for future net cash inflows are. [1.22]

Chapter 2: Qualitative characteristics of useful financial information

The qualitative characteristics of useful financial reporting identify the types of information are likely to be most useful to users in making decisions about the reporting entity on the basis of information in its financial report. The qualitative characteristics apply equally to financial information in general purpose financial reports as well as to financial information provided in other ways. [2.1, 2.3]

Financial information is useful when it is relevant and represents faithfully what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable. [2.4]

Fundamental qualitative characteristics

Relevance and faithful representation are the fundamental qualitative characteristics of useful financial information. [2.5]

Relevance

Relevant financial information is capable of making a difference in the decisions made by users. Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value, or both. The predictive value and confirmatory value of financial information are interrelated. [2.6-2.10]

Materiality is an entity-specific aspect of relevance based on the nature or magnitude (or both) of the items to which the information relates in the context of an individual entity's financial report. [2.11]

Faithful representation

General purpose financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only be relevant, it must also represent faithfully the phenomena it purports to represent. Faithful representation means representation of the substance of an economic phenomenon instead of representation of its legal form only. [2.12]

A faithful representation seeks to maximise the underlying characteristics of completeness, neutrality and freedom from error. [2.13]

A neutral depiction is supported by the exercise of **prudence**. Prudence is the exercise of caution when making judgements under conditions of uncertainty. [2.16]

Applying the fundamental qualitative characteristics

Information must be both relevant and faithfully represented if it is to be useful. [2.20]

Enhancing qualitative characteristics

Comparability, verifiability, timeliness and understandability are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully represented. [2.23]

Comparability

Information about a reporting entity is more useful if it can be compared with a similar information about other entities and with similar information about the same entity for another period or another date. Comparability enables users to identify and understand similarities in, and differences among, items. [2.24-2.25]

Verifiability

Verifiability helps to assure users that information represents faithfully the economic phenomena it purports to represent. Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. [2.30]

Timeliness

Timeliness means that information is available to decision-makers in time to be capable of influencing their decisions. [2.33]

Understandability

Classifying, characterising and presenting information clearly and concisely makes it understandable. While some phenomena are inherently complex and cannot be made easy to understand, to exclude such information would make financial reports incomplete and potentially misleading. Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information with diligence. [2.34-2.36]

Applying the enhancing qualitative characteristics

Enhancing qualitative characteristics should be maximised to the extent necessary. However, enhancing qualitative characteristics (either individually or collectively) cannot render information useful if that information is irrelevant or not represented faithfully. [2.37]

The cost constraint on useful financial reporting

Cost is a pervasive constraint on the information that can be provided by general purpose financial reporting. Reporting such information imposes costs and those costs should be justified by the benefits of reporting that information. The IASB assesses costs and benefits in relation to financial reporting generally, and not solely in relation to individual reporting entities. The IASB will consider whether different sizes of entities and other factors justify different reporting requirements in certain situations. [2.39, 2.43]

Chapter 3: Financial statements and the reporting entity

Objective and scope of financial statements

The objective of financial statements is to provide information about an entity's assets, liabilities, equity, income and expenses that is useful to financial statements users in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources. [3.2]

This information is provided in the statement of financial position and the statement(s) of financial performance as well as in other statements and notes. [3.3]

Reporting period

Financial statements are prepared for a specified period of time and provide comparative information and under certain circumstances forward-looking information. [3.4-3.6]

Perspective adopted in financial statements and going concern assumption

Financial statements provide information about transactions and other events viewed from the perspective of the reporting entity as a whole and are normally prepared on the assumption that the reporting entity is a going concern and will continue in operation for the foreseeable future. [3.8-3.9]

The reporting entity

A reporting entity is an entity that is required, or chooses, to prepare financial statements. It can be a single entity or a portion of an entity or can comprise more than one entity. A reporting entity is not necessarily a legal entity. [3.10]

Determining the appropriate boundary of a reporting entity is driven by the information needs of the primary users of the reporting entity's financial statements. [3.13-3.14]

Consolidated and unconsolidated financial statements

Generally, consolidated financial statements are more likely to provide useful information to users of financial statements than unconsolidated financial statements. [3.18]

Chapter 4: The Framework: the remaining text

Chapter 4 contains the remaining text of the Framework approved in 1989. As the project to revise the Framework progresses, relevant paragraphs in Chapter 4 will be deleted and replaced by new Chapters in the IFRS Framework. Until it is replaced, a paragraph in Chapter 4 has the same level of authority within IFRSs as those in Chapters 1-3.

Underlying assumption

The IFRS Framework states that the going concern assumption is an underlying assumption. Thus, the financial statements presume that an entity will continue in operation indefinitely or, if that presumption is not valid, disclosure and a different basis of reporting are required. [F 4.1]

The elements of financial statements

Financial statements portray the financial effects of transactions and other events by grouping them into broad classes according to their economic characteristics. These broad classes are termed the elements of financial statements.

The elements directly related to financial position (balance sheet) are: [F 4.4]

- Assets
- Liabilities
- Equity

The elements directly related to performance (income statement) are: [F 4.25]

- Income
- Expenses

The cash flow statement reflects both income statement elements and some changes in balance sheet elements.

Definitions of the elements relating to financial position

- **Asset.** An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity. [F 4.4(a)]
- **Liability.** A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. [F 4.4(b)]
- **Equity.** Equity is the residual interest in the assets of the entity after deducting all its liabilities. [F 4.4(c)]

Definitions of the elements relating to performance

- **Income.** Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants. [F 4.25(a)]
- **Expense.** Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants. [F 4.25(b)]

The definition of income encompasses both revenue and gains. Revenue arises in the course of the ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent. Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an entity. Gains represent increases in economic benefits and as such are no different in nature from revenue. Hence, they are not regarded as constituting a separate element in the IFRS Framework. [F 4.29 and F 4.30]

The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity. Expenses that arise in the course of the ordinary activities of the entity include, for example, cost of sales, wages and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, property, plant and equipment. Losses represent other items that meet the definition of expenses and may, or may not, arise in the course of the ordinary activities of the entity. Losses represent decreases in economic benefits and as such they are no different in nature from other expenses. Hence, they are not regarded as a separate element in this Framework. [F 4.33 and F 4.34]

Recognition of the elements of financial statements

Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the following criteria for recognition: [F 4.37 and F 4.38]

- It is probable that any future economic benefit associated with the item will flow to or from the entity; and
- The item's cost or value can be measured with reliability.

Based on these general criteria:

An asset is recognised in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably. [F 4.44]

A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. [F 4.46]

Income is recognised in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means, in effect, that recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable). [F 4.47]

Expenses are recognised when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets (for example, the accrual of employee entitlements or the depreciation of equipment). [F 4.49]

Measurement of the elements of financial statements

Measurement involves assigning monetary amounts at which the elements of the financial statements are to be recognised and reported. [F 4.54]

The IFRS Framework acknowledges that a variety of measurement bases are used today to different degrees and in varying combinations in financial statements, including: [F 4.55]

- Historical cost
- Current cost
- Net realisable (settlement) value
- Present value (discounted)

Historical cost is the measurement basis most commonly used today, but it is usually combined with other measurement bases. [F. 4.56] The IFRS Framework does not include concepts or principles for selecting which measurement basis should be used for particular elements of financial statements or in particular circumstances. Individual standards and interpretations do provide this guidance, however.

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