International Financial Reporting Standards

Conceptual Framework for Financial Reporting

August 2015

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Session overview

Background

What is the Conceptual Framework?

It is a practical tool that assists:

- the IASB to develop Standards
- preparers to develop consistent accounting policies
- others to understand and interpret IFRS

It underpins the decisions made by the IASB when setting Standards

- It will affect future Standards developed by the IASB

It addresses fundamental issues:

- What is the objective of financial reporting?
- What makes financial information useful?
- What are assets, liabilities, equity, income and expenses, when should they be recognised and how should they be measured, presented and disclosed?

It is not a Standard and does not override Standards

Why are we revising the Conceptual Framework?

The existing *Conceptual Framework* has proved useful but some improvements are needed

Gaps	Unclear	Out of date
For example, it provides very little guidance on measurement or presentation and disclosure.	For example, it is unclear what role measurement uncertainty should play in decisions about recognition and measurement.	For example, the existing guidance on when assets and liabilities should be recognised is out of date.

Identified as a priority project by respondents to the IASB's 2011 Agenda Consultation

History of the Conceptual Framework

1989 Framework	2010 Framework	2013 Discussion Paper	2015 Exposure Draft
Objective	Objective		Objective
Qualitative characteristics	Qualitative characteristics		Qualitative characteristics
Elements	Elements	Elements	Elements
Measurement	Measurement	Measurement	Measurement
Recognition	Recognition	Recognition	Recognition
		Derecognition	Derecognition
		Presentation & disclosure	Presentation & disclosure
	Reporting entity *Exposure Draft*		Reporting entity

Objective and qualitative characteristics

Objective and qualitative characteristics

The objective of general purpose financial reporting is to provide **useful financial information**

Relevance

- Relevant financial information is capable of making a difference in a decision made by users

Faithful representation

- Representation of relevant economic phenomena and faithful representation of the phenomena that it purports to represent
- Complete, neutral and free from error

Enhancing characteristics

Comparability • Verifiability • Timeliness • Understandability

Cost constraint

Objective of financial reporting

- No fundamental rethink of the existing chapters but changes proposed in response to comments received on the 2013 Discussion Paper

Stewardship	• Place more emphasis, on the importance of providing information needed to assess management's stewardship of the entity's resources
Primary users of financial statements	• Confirm focus on existing and potential investors, lenders and other creditors – Includes long-term investors

Qualitative characteristics

Prudence	• Reintroduce an explicit reference to the notion of prudence (exercise of caution when making decisions under conditions of uncertainty) • No overstatement or understatement of assets, liabilities, income or expenses (ie neutral)
Reliability	• If an estimate is too uncertain, it might not provide relevant information (measurement uncertainty) • Trade-off against other factors that affect relevance • Retain faithful representation as a label for that qualitative characteristic
Substance over form	• Reintroduce explicit reference to substance over form as part of faithful representation

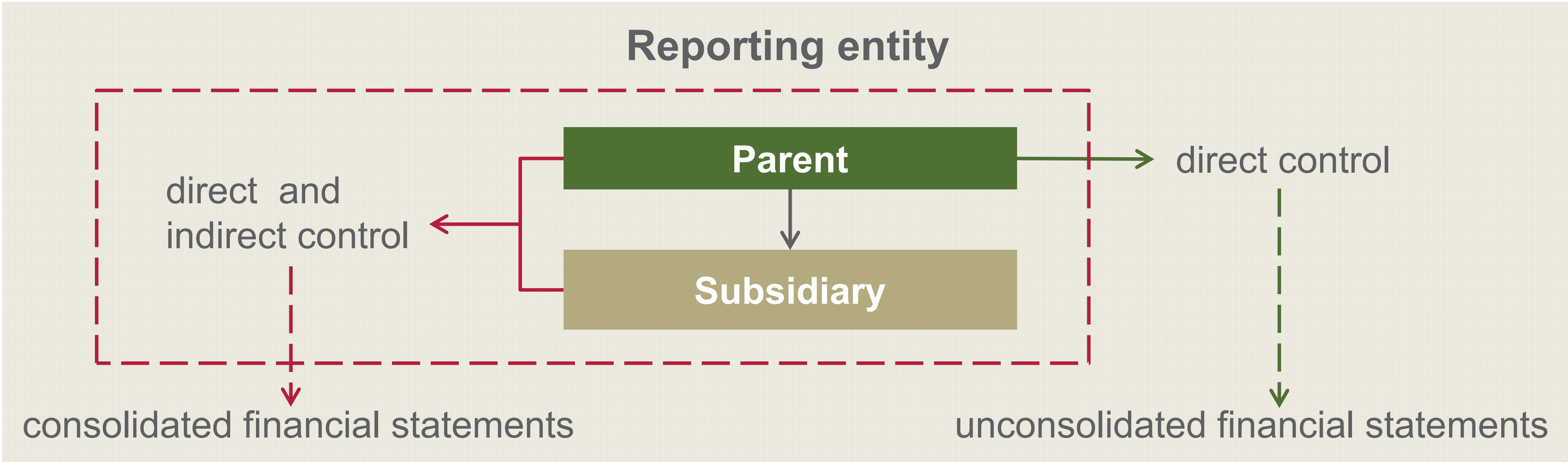
Questions from the Exposure Draft

Proposed changes to Chapters 1 and 2
Do you support the proposals: (a) to give more prominence, within the objective of financial reporting, to the importance of providing information needed to assess management's stewardship of the entity's resources? (b) to reintroduce an explicit reference to the notion of prudence (described as caution when making judgements under conditions of uncertainty) and to state that prudence is important in achieving neutrality; (c) to state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form; (d) to clarify that measurement uncertainty is one factor that can make financial information less relevant, and that there is a trade-off between the level of measurement uncertainty and other factors that make information relevant; and (e) to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information?

Reporting entity

Reporting entity

- A reporting entity is an entity that chooses, or is required, to present general purpose financial statements



- Other topics covered:
  - combined financial statements for two or more entities without a parent-subsidiary relationship
  - A reporting entity that is only part of a legal entity

Questions from the Exposure Draft

Description and boundary of a reporting entity
Do you agree with: (a) the proposed description of a reporting entity; and (b) the discussion of the boundary of a reporting entity? Why or why not?

Elements

Elements: Definitions of assets and liabilities

	Existing definitions	Exposure Draft
Asset (of an entity)	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.	A present economic resource controlled by the entity as a result of past events.
Liability (of an entity)	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.	A present obligation of the entity to transfer an economic resource as a result of past events.
Economic resource	Not defined	A right that has the potential to produce economic benefits.

Definitions of assets, liabilities and equity

Assets

A **present economic resource** controlled by the entity as a result of **past events**.

Liabilities

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.

- Proposed clarifications:
  - an asset is an existing economic resource (and a liability is a present obligation) and not future cash flows
  - any future cash flows need not be certain
- Additional guidance on the definitions of assets and liabilities
  - guidance on uncertain liabilities

Proposed description of present obligation

An entity has a present obligation to transfer an economic resource if both:

1. the entity has no practical ability to avoid the transfer; and
2. the obligation has arisen from past events, ie the entity has received the economic benefits, or conducted the activities, that establish the extent of its obligation.

For example:

- if the transfer is legally enforceable, or
- if action necessary to avoid the transfer would cause significant business disruption or have economic consequences significantly more adverse than the transfer itself.

Present obligation – example

Fact pattern

An entity must pay a levy if it is operating as a bank at the end of its financial reporting period.

The amount of the levy is 2% of the bank's liabilities at that date.

But if the financial reporting period is shorter or longer than one year, the levy is reduced or increased proportionately. So:

$$\text{Levy} = 2\% \times \text{liabilities} \times \frac{\text{length of financial reporting period (days)}}{365}$$

Application of proposed concepts

- Extent of obligation increases each day – levy increases by 1/365th of annual amount.
- If it is judged that the entity has no practical ability to avoid being a bank on the last day of its reporting period, a liability and expense arise progressively over period.

Elements: Definition of equity

- No amendments to existing definitions at this time
- No detailed guidance on how to distinguish liabilities from equity instruments
- Explore how to distinguish liabilities from equity, including whether to amend the definitions of liability and equity, in a research project

Questions from the Exposure Draft

Definitions of elements
Do you agree with the proposed definitions of elements (excluding issues relating to the distinction between liabilities and equity): (a) an asset, and the related definition of an economic resource; (b) a liability; and (c) equity Why or why not? If you disagree with the proposed definitions, what alternative definitions do you suggest and why?

Present obligation
Do you agree with the proposed description of a present obligation and the proposed guidance to support that description? Why or why not?

Recognition and Derecognition

Recognition

Recognition is the process of capturing an asset or a liability for inclusion in the financial statements

Existing criteria

- Meet the definition of an asset or a liability
- **Probable** that any future economic benefit associated with an asset or a liability will flow to the entity
- The asset or liability has a cost or value that can be measured **reliably**

Improvements are needed because:

- No consistent application of the probability criterion in Standards
- Using a reliable measurement criterion could be confusing as reliability is no longer a qualitative characteristic

Recognition

Exposure Draft

- Meet the definition of an asset or a liability
- Criteria to consider in deciding whether to recognise an asset or a liability:
  - relevance;
  - faithful representation; and
  - cost/benefit

Cases when recognition might not provide relevant information:

- Uncertainty about the existence of an asset or liability
- Low probability of an inflow or outflow of economic resources from/ to an asset/ liability
- High level of measurement uncertainty so that the resulting information has little relevance

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Derecognition

- The existing *Conceptual Framework* does not define derecognition
- The Exposure Draft proposes that approaches to derecognition should aim to **represent faithfully** both:
  - the assets and liabilities retained after a transaction or other event that led to the derecognition (including any asset or liability acquired, incurred or created as part of the transaction or other event); and
  - the change in the entity's assets and liabilities as a result of that transaction or other event.

Questions from the Exposure Draft

Recognition criteria
Do you agree with the proposed approach to recognition? Why or why not? If you do not agree, what changes do you suggest and why?

Derecognition
Do you agree with the proposed discussion of derecognition? Why or why not? If you do not agree, what changes do you suggest and why?

Measurement

Measurement bases

Measurement bases

Historical cost	Current value
Uses information derived from the transaction or event that created the asset or liability.	Uses information that is updated to reflect conditions at the measurement date.

Measurement based on:

Market participant's assumptions	Entity-specific assumptions
Fair Value	•Value in use (assets) •Fulfilment value (liabilities)

Selecting a measurement basis

For information provided by a particular measurement basis to be useful, it must be:

Relevant

Faithfully represented

Enhancing characteristics
Comparability • Verifiability • Timeliness • Understandability

Cost constraint

Factors when selecting a measurement basis

Relevance

- Information produced in both statement of financial position and statement(s) of financial performance
- How the asset or liability contributes to future cash flows
  - depends in part on business activities being conducted
- Characteristics of the asset or liability
  - eg nature or extent of variability in cash flows, sensitivity to risks etc
- Level of uncertainty
  - but sometimes a measurement with a high degree of uncertainty is the only relevant measurement

Factors when selecting a measurement basis

Faithful representation

- Consider how best to portray link between items

Others

- Understandability
  - Using new or different measurement bases could reduce understandability
  - Avoid unnecessary changes in measurement bases
- Cost constraint
  - Benefit of providing useful information needs to exceed the cost of doing so

Questions from the Exposure Draft

Question—Measurement bases
Has the IASB correctly identified the measurement bases that should be described in the Conceptual Framework? If not, which measurement bases would you include and why?

Question—Factors to consider when selecting a measurement basis
Has the IASB correctly identified the factors to consider when selecting a measurement basis? If not, what factors would you consider and why?

Presentation and disclosure

Presentation and disclosure

Exposure Draft

- Objective and scope of financial statements
- Classification, aggregation and offsetting
- Information in the notes
- Communication principles

Disclosure Initiative

- Portfolio of projects aimed at improving the effectiveness of disclosures:
  - Principles of Disclosure
  - Review of existing Standards
  - Materiality
  - Amendments to IAS 1 *Presentation of Financial Statements*
  - Amendments to IAS 7 *Statement of Cash Flows*: reconciliation of liabilities from financing activities

Presentation in profit or loss

This statement is the primary, but not the only, source of information about an entity's financial performance in the period

Statement of profit or loss

	20X5	20X4
Revenue from customers	234,439	212,367
Cost of sales	(112,764)	(106,259)
…	…	…
Taxes	(21,546)	(20,587)
…	…	…
Profit (loss) for the year	**18,897**	**16,763**

Profit or loss is a required total or subtotal

Rebuttable presumption that income and expenses are included in profit or loss

Presentation in OCI

Income and expenses included in OCI only if that enhances relevance of profit or loss in the period

Presumption that income and expenses included in OCI in one period are subsequently included in profit or loss (recycled)

Statement of comprehensive income

	20X5	20X4
Profit (loss) for the year	18,897	16,763
Currency translation	68	(51)
FV adjustment cash flow hedging	(2,764)	6,259
…	…	…
Taxes	(215)	87
Other comprehensive income for the year	*(2,546)*	*4,253*
Total comprehensive income for the year	**16,351**	**21,016**

OCI only for some income and expenses from changes in current measures of assets and liabilities

Questions from the Exposure Draft

Question—Description of the statement of profit or loss
Do you support the proposed description of the statement of profit or loss? If you think that the Conceptual Framework should provide a definition of profit or loss, please explain why it is necessary and provide your suggestion for that definition.

Question—Reporting items of income and expenses in other comprehensive income
Do you agree with the proposals on the use of other comprehensive income? Do you think that they provide useful guidance to the IASB for future decisions about the use of other comprehensive income? If you disagree, what alternative do you suggest and why?

Questions from the Exposure Draft

Question—Recycling
Do you agree that the *Conceptual Framework* should include [a rebuttable presumption that income and expenses included in OCI in one period are subsequently included in profit or loss (recycled)]? Why or why not? If you disagree, what do you propose instead and why?

Timeline and further information

Timeline

May 2015

Exposure Draft

26 October 2015
(150 days)
Comment deadline

2016
Revised
Conceptual Framework

Separate Exposure Draft *Updating References to Conceptual Framework* also published - same comment deadline

Further information

- Exposure Draft *Conceptual Framework for Financial Reporting*
  http://go.ifrs.org/ED-CF-May2015
- Conceptual Framework website
  http://go.ifrs.org/Conceptual-Framework
- Submit a comment letter
  http://go.ifrs.org/comment_CF
- Snapshot
  http://go.ifrs.org/CFSnapshot2015
- Register for email alerts
  http://eifrs.ifrs.org/eifrs/Register

Questions


individual comments
questions
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