

2013

Technical Summary

## ***The Conceptual Framework for Financial Reporting***

as issued at 1 January 2013

*This extract has been prepared by IFRS Foundation staff and has not been approved by the IASB. For the requirements reference must be made to the Conceptual Framework for Financial Reporting 2010.*

The *IASB Framework* was approved by the IASC Board in April 1989 for publication in July 1989, and adopted by the IASB in April 2001. In September 2010, as part of a bigger project to revise the *Framework* the IASB revised the objective of general purpose financial reporting and the qualitative characteristics of useful information. The remaining of the document from 1989 remains effective.

This *Conceptual Framework* sets out the concepts that underlie the preparation and presentation of financial statements for external users.

The *Conceptual Framework* deals with:

- (a) the objective of financial reporting;
- (b) the qualitative characteristics of useful financial information;
- (c) the definition, recognition and measurement of the elements from which financial statements are constructed; and
- (d) concepts of capital and capital maintenance.

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 about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit. Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial reports are directed.

General purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Therefore those users need to consider pertinent information from other sources. Other parties, such as regulators and members of the public other than investors, lenders and

other creditors, may also find general purpose financial reports useful. However, those reports are not primarily directed to these other groups..

In order to meet their objectives, financial statements are prepared on the accrual basis of accounting. Accrual accounting depicts the effects of transactions and other events and circumstances on a reporting entity's economic resources and claims in the periods in which those effects occur, even if the resulting cash receipts and payments occur in a different period. This is important because information about a reporting entity's economic resources and claims and changes in its economic resources and claims during a 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.

The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future.

Qualitative characteristics identify the types of information that are likely to be most useful to the existing and potential investors, lenders and other creditors for making decisions about the reporting entity on the basis of information in its financial report (financial information). If financial information is to be useful, it must be relevant (ie must have predictive value and confirmatory value, based on the nature or magnitude, or both, of the item to which the information relates in the context of an individual entity's financial report) and faithfully represents what it purports to represent (ie information must be complete, neutral and free from error). The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable. The IASB acknowledges that cost may be a constrain on preparing useful financial information..

The elements directly related to the measurement of financial position are assets, liabilities and equity. These are defined as follows:

- (a) 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.
- (b) 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.
- (c) Equity is the residual interest in the assets of the entity after deducting all its liabilities.

The elements of income and expenses are defined as follows:

- (a) 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.
- (b) 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.

An item that meets the definition of an element should be recognised if:

- (a) it is probable that any future economic benefit associated with the item will flow to or from the entity;  
and
- (b) the item has a cost or value that can be measured with reliability.

Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the balance sheet and income statement. This involves the selection of the particular basis of measurement.

The concept of capital maintenance is concerned with how an entity defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured; it is a prerequisite for distinguishing between an entity's return on capital and its return of capital; only inflows of assets in excess of amounts needed to maintain capital may be regarded as profit and therefore as a return on capital. Hence, profit is the residual amount that remains after expenses (including capital maintenance adjustments, where appropriate) have been deducted from income. If expenses exceed income the residual amount is a loss.

The Board recognises that in a limited number of cases there may be a conflict between the *Conceptual Framework* and an IFRS. In those cases where there is a conflict, the requirements of the IFRS prevail over those of the *Conceptual Framework*. As, however, the Board will be guided by the *Conceptual Framework* in the development of future IFRSs and in its review of existing IFRSs, the number of cases of conflict between the *Conceptual Framework* and IFRSs will diminish through time. The *Conceptual Framework* will be revised from time to time on the basis of the IASB's experience of working with it.