TRU Newsletter

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Revised Conceptual Framework

Background

The International Accounting Standards Board (the IASB or the Board) has issued the revised Conceptual Framework for Financial Reporting (the revised Conceptual Framework) on 29 March 2018.The revised Conceptual Framework is effective immediately for the IASB and the IFRS Interpretations Committee. The amendments are effective for annual periods beginning on or after 1 January 2020 with earlier application is permitted. The amendments should be applied retrospectively unless retrospective application would be impracticable or involve undue cost or effort. In context of Nepal, revised conceptual framework has not been adapted yet.

The Conceptual 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. It maintains that the framework does not override any specific IFRS.

Chapters

Objective of financial reporting

Objective of financial statement is to provide financial information that is useful to users in making decisions relating to providing resources to the entity.

Users' decisions involve decisions about

- buying, selling or holding equity or debt instruments.
- providing or settling loans and other forms of credit and providing or settling loans other forms of credit and voting, or otherwise influencing management's actions.

To make these decisions, users assess

- prospects for future net cash inflows to the entity.
- management's stewardship of the entity's economic resources.

To make both these assessments, users need information about both

- the entity's economic resources, claims against the entity and changes in those resources and claims.
- how efficiently and effectively management has discharged its responsibilities to use the entity's economic resources.

Users of financial reports
Users of financial reports are an entity's existing and potential investors, lenders and other creditors. Those users must rely on financial reports for much of the financial information they need.

Financial statements and the reporting entity

This chapter describes the objective and scope of financial statements and provides a description of the reporting entity.

Reporting entity

- an entity that is required, or chooses, to prepare financial statements.
- not necessarily a legal entity—could be a portion of an entity or comprise more than one entity.

The term 'stewardship' has been reintroduced in the revised version. Users of financial reports need information to help them assess management's stewardship. The Conceptual Framework explicitly discusses this need as well as the need for information that helps users assess the prospects for future net cash inflows to the entity.

Financial statements: A particular form of financial reports that provide information about the reporting entity's assets, liabilities, equity, income and expenses.

Consolidated financial statements	Unconsolidated financial statements	Combined financial statements
Provide information about assets, liabilities, equity, income and expenses of both the parent and its subsidiaries as a single reporting entity.	Provide information about assets, liabilities, equity, income and expenses of parent only.	Provide information about assets, liabilities, equity, income and expenses of two or more entities that are not all linked by a parent-subsidiary relationship.

Qualitative characteristics of useful financial information

The chapter explains the fundamental qualitative characteristics (relevance and faithful representation) and the enhancing qualitative characteristics (comparability, verifiability. timeliness and understandability) of useful financial information and notes the cost constraint. Materiality is noted as an entity-specific aspect of relevance. The chapter reintroduces an explicit reference to the notion of prudence and states that the exercise of prudence supports neutrality.

Prudence - Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgments under conditions of uncertainty. Prudence does not allow for overstatement or understatement of assets, liabilities, income or expenses.

Measurement uncertainty – Measurement uncertainty does not prevent information from being useful. However, in some cases the most relevant information may have such a high level of measurement uncertainty that the most useful information is information that is slightly less relevant but is subject to lower measurement uncertainty.

Boundary of a reporting entity

Determining the appropriate boundary of a reporting entity can be difficult if, for example, the entity is not a legal entity. In such cases, the boundary is determined by considering the information needs of the users of the entity's financial statements. Those users need information that is relevant and that faithfully represents what it intends to represent. A reporting entity does not comprise an arbitrary or incomplete collection of assets, liabilities, equity, income and expenses.

Fundamental Qualitative characteristics of Financial Statement

- comparability,
- verifiability,
- timeliness, and
- Understandability

Elements of financial statement

This chapter has included refined definitions of an asset and a liability, and the definitions of income and expenses have been updated only to reflect that refinement.

The definition of equity as the residual interest in the assets of the entity after deducting all its liabilities is unchanged.

Element	Previous Definition	Revised Definition
Asset	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 An economic resource is a right that has the potential to produce economic benefits
Liability	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 An obligation is a duty or responsibility that the entity has '**no practical ability to avoid'**.

No practical ability to avoid

The revised Conceptual Framework discusses how the 'no practical ability to avoid' criterion is applied in the following circumstances:

- If a duty or responsibility arises from the entity's customary practices, published policies or specific statements then the entity has an obligation if it has no practical ability to act in a manner inconsistent with those practices, policies or statements.
- If a duty or responsibility is conditional on a particular future action that the entity itself may take then the entity has an obligation if it has no practical ability to avoid taking that action.

Unit of account: The right(s) or obligation(s), or group of rights and obligations, to which recognition criteria and measurement concepts are applied.

Selecting the unit of account

- Relevance: A unit of account is selected to provide relevant information about the asset or liability and any related income and expenses.
- Faithful representation: A unit of account is selected to provide a faithful representation of the substance of the transaction or other event from which the asset, liability and any related income or expenses have arisen.

Executory contract: An executory contract is a contract that is equally unperformed. It establishes a single asset or liability for the inseparable combined right and obligation to exchange economic resources.

Substance of contracts: To represent contractual rights and obligations faithfully, financial statements must report their substance. In some cases, the substance of such rights and obligations is clear from a contract's legal form. But, in other cases, the terms of the contract, or of a group or series of contracts, may require analysis to identify the substance of the rights and obligations.

Income has been defined as increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.

Expense has been defined as decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.

Recognition and Derecognition

This chapter discusses criteria for including assets and liabilities in financial statements (recognition) and guidance on when to remove them (derecognition).

Recognition

Previous	Revised
An entity should recognize an item that met the definition of an element if it was probable that economic benefits would flow to the entity and if the item had a cost or value that could be determined reliably.	The revised recognition criteria refer explicitly to the qualitative characteristics of useful information.

Recognition is appropriate if it results in both relevant information about assets, liabilities, equity, income and expenses and a faithful representation of those items, because the aim is to provide information that is useful to investors, lenders and other creditors.

The Conceptual Framework states that only items that meet the definition of an asset, a liability or equity are recognised in the statement of financial position and only items that meet the definition of income or expenses are to be recognised in the statement(s) of financial performance. However, their recognition depends on two criteria: their recognition provides users of financial statements with (1) relevant information about the asset or the liability and about any income, expenses or changes in equity and (2) a faithful representation of the asset or the liability and of any income, expenses or changes in equity. The framework also notes a cost constraint. New to the framework is the discussion of derecognition. The requirements as presented in the framework are driven by two aims: the assets and liabilities retained after the transaction or other event that led to derecognition must be presented faithfully and the change in the entity's assets and liabilities as a result of that transaction or other event must also be presented faithfully. The framework also describes alternatives when it is not possible to achieve both aims.

Recognition criteria

Relevance

Whether recognition of an item results in relevant information may be affected by, for example:

- low probability of a flow of economic benefits.
- existence uncertainty.

Faithful representation

Whether recognition of an item results in a faithful representation may be affected by, for example:

- measurement uncertainty.
- recognition inconsistency (accounting mismatch).
- presentation and disclosure.

Derecognition

Derecognition is the removal of all or part of a recognised asset of liability from an entity's statement of financial position. It goes on to say that derecognition normally occurs:

- For an asset, when the entity loses control of all or part of the recognised asset.
- For a liability, when the entity no longer has a present obligation for all or part of the recognised liability.

Derecognition should aim to faithfully represent those assets and liabilities retained after the transaction, if any, and any change in assets and liabilities as a result of the transaction that led to the derecognition.

Derecognition resulting from a transfer

Normally, a faithful representation of a transfer of an asset or liability is achieved by derecognition of the asset or liability with appropriate presentation and disclosure.

However, in limited cases, it may be necessary to continue to recognise a transferred component of an asset or liability together with a liability or asset for the proceeds received or paid, with appropriate presentation and disclosure.

Measurement

The revised Conceptual Framework describes what information measurement bases provide and explains the factors to consider when selecting a measurement basis.

Historical cost measurement bases

- historical cost provides information derived, at least in part, from the price of the transaction or other event that gave rise to the item being measured.
- historical cost of assets is reduced if they become impaired and historical cost of liabilities is increased if they become onerous.
- one way to apply a historical cost measurement basis to financial assets and financial liabilities is to measure them at amortized cost

Current value measurement bases

Current value provides information updated to reflect conditions at the measurement date.

Current value measurement bases	Explanation
Fair Value	• The price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. • Reflects market participants' current expectations about the amount, timing and uncertainty of future cash flows.
Value in use (for assets) Fulfilment value (for liabilities)	Reflects entity-specific current expectations about the amount, timing and uncertainty of future cash flows.
Current cost	Reflects the current amount that would be: • paid to acquire an equivalent asset. • received to take on an equivalent liability.

Factors to consider in selecting a measurement basis:

The factors to be considered when selecting a measurement basis are **relevance** and **faithful representation**, because the aim is to provide information that is useful to investors, lenders and other creditors.

A) Relevance

Relevance of information provided by a measurement basis is affected by:

a) Characteristics of the asset or liability

- the variability of cash flows.
- sensitivity of the value to market factors or other risks.

For example, amortised cost cannot provide relevant information about a derivative.

b) Contribution to future cash flows

- whether cash flows are produced directly or indirectly in combination with other economic resources.
- the nature of the entity's business activities.

For example, if assets are used in combination to produce goods or services, historical cost can provide relevant information about margins achieved in a period.

B) Faithful representation

Whether a measurement basis can provide a faithful representation is affected by:

a) Measurement inconsistency

If financial statements contain measurement inconsistencies (accounting mismatch), those financial statements may not faithfully represent some aspects of the entity's financial position and financial performance.

b) Measurement uncertainty

Measurement uncertainty does not necessarily prevent the use of a measurement basis that provides relevant information. But if too high might make it necessary to consider selecting a different measurement basis.

Selecting a measurement basis

In selecting a measurement basis, it is necessary to consider the nature of the information in both the statement of financial position and the statement of financial performance.

The relative importance of each factor to be considered depends upon the facts and circumstances of individual cases.

Consideration of the factors and the cost constraint is likely to result in the selection of different measurement bases for different assets, liabilities, income and expenses.

Exemption

IFRS 3 Business Combinations

To avoid unintended consequences, acquirers are required to apply the definitions of an asset and a liability and supporting concepts in the previous, rather than the revised Conceptual Framework.

Regulatory account balances

When developing accounting policies for regulatory account balances applying IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, entities are required to refer to the previous, rather than the revised Conceptual Framework. This avoids entities revising those accounting policies twice within a short period: once for the revised Conceptual Framework and again when a revised Standard on rate-regulated activities is issued.

Presentation and Disclosure

New Chapter included on concepts on presentation and disclosure and guidance on including income and expenses in the statement of profit or loss and other comprehensive income.

The statement of profit or loss

- The statement of profit or loss is the primary source of Information about an entity's financial performance for the reporting period.
- Profit or loss could be a section of a single statement of financial performance or a separate statement .
- The statement of financial performance include a total (subtotal) for profit or loss.
- In principle, all income and expenses are classified and included in the statement of profit or loss.

Other comprehensive income

- In exceptional circumstances, the Board may decide to exclude from the statement of profit or loss income or expenses arising from a change in current value of an asset or liability and include those income and expenses in other comprehensive income.
- The Board may make such a decision when doing so would result in the statement of profit or loss providing more relevant information or a more faithful representation.

Recycling

- In principle, income and expenses included in other comprehensive income in one period are recycled to the statement of profit or loss in a future period when doing so results in the statement of profit or loss providing more relevant information or a more faithful representation.
- When recycling does not result in the statement of profit or loss providing more relevant information or a more faithful representation, the Board may decide income and expenses included in other comprehensive income are not to be subsequently recycled.

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