Underlying changes in Conceptual Framework

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Abstract:

Any set of financial reporting standards used worldwide, usually called „the best practise", works within conceptual framework. This article deals with the IFRS conceptual framework that is continuously amended to correspond with financial reporting practise. The aim of this paper is to compare revised Conceptual Framework issued by IASB in 2018 with the Framework to IFRS in previous versions and highlight main differences.

Keywords: *Conceptual Framework, financial reporting, qualitative characteristics, IFRS, measurement*

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1 Introduction

Even though that in the "Purpose and status" of Conceptual Framework (IFRS 2015) there is declared that "The Conceptual Framework is not an IFRS and hence does not define standards for any particular measurements or disclosure issue and nothing in the Conceptual Framework overrides any specific IFRS" it is said in the Preface to IFRS ((paragraph 8) that the objective of the Conceptual Framework is to "facilitate the consistent and logical formulation of IFRSs". Briefly said, the Conceptual Framework is indispensable and helps to ensure that the Standards are conceptually consistent.

Recent works on revision of the Conceptual Framework from 1989 started as a common project of IASB and the US national standard FASB (Financial Accounting Standards Board). IASB and FASB initiated a joint project to revise their conceptual frameworks (as mentioned in Discussion Paper DP/2013/1) in 2004. In 2010, the IASB and the FASB issued two chapters of revised conceptual framework: "The Objective of general purpose of financial reporting" in chapter 1 and "Qualitative characteristics of useful financial information" in chapter 3. These chapters were result of its first phase of the conceptual framework project. Chapter 1 and chapter 3 became effective as they were published and form the existing Conceptual Framework. At the same time, discussion paper and an exposure draft on the concept of a reporting entity was published. During that period definitions of the elements of financial statements and measurement concepts were discussed. Unfortunately, joint project on Conceptual Framework was suspended in 2010 due to other projects on IASB´s and FASB´s agendas. Two years later, IASB carried out a public consultation on its agenda. Feedback received from agenda consultation reinforced the importance of giving priority to this project. Conceptual framework project was identified as priority one. Consequently, the IASB restarted this project but it was no longer conducted jointly with the FASB. IASB planned to complete revisions to the conceptual framework by the end of 2015. In developing the revised Conceptual Framework, the IASB focused on (Discussion Paper DP/2013/1):

- Elements of the financial statements (including the boundary between liabilities and equity),
- Recognition and derecognition,
- Measurement,
- Presentation and disclosure (including the question of what should be presented in other comprehensive income (OCI), and

- The reporting entity.

IASB´s aim is to select concepts that will result in financial statements that meet the objective of financial reporting, not to justify existing requirements and practice. Consequently, the IASB restarted its Conceptual Framework project in 2012, and independently developed an Exposure Draft of the Conceptual Framework for Financial Reporting in 2015. The final version of the revised Conceptual Framework was issued on March 29, 2018. The revised Conceptual Framework has an effective date of 1 January 2020.

The 2018 revised Conceptual Framework sets out (Conceptual Framework 2018):

- the objective of general purpose financial reporting;
- the qualitative characteristics of useful financial information;
- a description of the reporting entity and its boundary;
- definitions of an asset, a liability, equity, income and expenses and guidance supporting these definitions;
- criteria for including assets and liabilities in financial statements (recognition) and guidance on when to remove them (derecognition);
- measurement bases and guidance on when to use them;
- concepts and guidance on presentation and disclosure; and
- concepts relating to capital and capital maintenance.

The goal of IASB is to update concepts in Conceptual Framework that will result in better IFRS Standards.

2 Overview of literature and methodology

Conceptual Framework is the topic that appears in works of researchers and academics. Mostly it is used as a background for research of other topics in detail, normally there are not many critical works. There are only some examples of criticism of IFRS Framework in literature. Critical research has been published by Godfrey and coll. (2010) with the opinion that the Framework of the International Financial Reporting Standards (IFRS) has required significant consolidation and rewriting of chapters. Barker and Teixeira (2018) published their criticism in article „Gaps in the IFRS Conceptual Framework ". According to Gornik-Tomaszewski et al. (2018) a conceptual framework can be seen as a structured theory of accounting. A conceptual framework is intended to set forth objectives and fundamental concepts that will be the basis for the development of accounting standards. Comprehensive textbook on IFRS explained from a framework-based perspective is represented by Burton and Jermakowicz (2015). Some researches concern only selected topics from conceptual framework like Žárová (2017) who addressed materiality, prepare research on the role of conceptual framework in law-based accounting regulation (Žárová, 2010) or comments qualitative characteristics of useful information (Žárová, 2015).

The aim of this paper is to compare revised Conceptual Framework issued by IASB in 2018 with the Framework to IFRS in previous versions and highlight main differences. As the paper analyses main differences between two version of conceptual frameworks, content analysis was used. Then method of comparison was used to compare two editions of conceptual frameworks.

3 Results and Discussion

Comparison is prepared on comparison of the revised Conceptual Framework issued by IASB in 2018 with the Framework to IFRS in previous versions including unrevised parts since 1989. Overview of changes or new parts in the latest edition:

- Clarified objective and qualitative characteristics
- New reporting entity, presentation & disclosure, derecognition and measurement
- Updated elements and recognition
- To be continued distinction between liabilities and equity

3. 1 Objective of general purpose financial reporting

Objective of financial reporting is to provide financial information useful to users in making decisions. Stewardship is changed into user´s needs. Users' decisions involve decisions about buying, holding or selling, providing or settling loans, voting and influencing management. 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 economic resources, claims and changes in those resources and claims how efficiently and effectively management has discharged its responsibilities.

3. 2 Qualitative characteristics

Fundamental qualitative characteristics relevance and faithful representation is in 2018 edition the same as in 2010 one. Information is relevant if it is capable of making a difference to the decisions made by users. Information must faithfully represent the substance of what it purports to represent. Enhancing characteristics are comparability, verifiability, timeliness and understandability. Underlying principle is cost constraint.

For clarifying aspects of faithful representation there is prudence reintroduced, where reliability is broader than in 2010 Conceptual Framework:

- Exercise of caution under conditions of uncertainty.
- Does not allow for overstatement or understatement of assets, liabilities, income or expenses.
- Supports neutrality.

To clarify measurement uncertainty:

- Arises when monetary amounts cannot be observed directly and need to be estimated.
- Does not prevent information from being useful.
- If very high, may affect whether a sufficiently faithful representation can be achieved.

Substance over form is back in comparison with the 2010 Conceptual Framework:

- Economic substance of the underlying economic phenomenon is normally the same as the legal form.
- If not, need to represent the substance to provide faithful representation.

Conceptual Framework cannot be more rigid as it is based on principles.

3. 3 Reporting entity

Reporting entity is added to the 2018 Conceptual Framework. Reporting entity is an entity that is required, or chooses, to prepare financial statements. Definition of financial statements are included. Reporting entity in not necessarily a legal entity but could be a portion of an entity or comprise more than one entity. Financial statements are described as a form of financial reports that provide information about the reporting entity's assets, liabilities, equity, income and expenses. Financial statements are either consolidated financial statements or unconsolidated financial statements or combined financial statements. Consolidated financial statements provide information about assets, liabilities, equity, income and expenses of both the parent and its subsidiaries as a single reporting entity. Unconsolidated financial statements provide information about assets, liabilities, equity, income and expenses of the parent only. Combined financial statements provide information about assets, liabilities, equity, income and expenses of two or more entities that are not all linked by a parent-subsidiary relationship.

3.4 Elements of financial statements, recognition criteria and derecognition criteria

Elements of financial statements related to financial position are defined by assets, liabilities and equity. Asset is a present economic resource controlled by the entity as a result of past events. Asset as an economic resource is a right that has the potential to produce economic benefits. Characteristics of probability was avoided from the 2018 edition. Liability is a present obligation of the entity to transfer an economic resource as a result of past events. Liability as an obligation is a duty or responsibility that the entity has no practical ability to avoid. Equity is the residual interest in the assets of the entity after deducting all its liabilities. Information about income and expenses is just as important as information about assets and liabilities. Income and expenses relate to financial performance. Income increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims. Expenses decrease in assets, or increase in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.

Recognition of the elements of financial statements is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition. 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

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

- measurement uncertainty
- recognition inconsistency
- presentation and disclosure of resulting income, expenses and changes in equity

Derecognition is newly introduced into the 2018 Conceptual Framework. Aims to faithfully represent both situations:

- Any assets and liabilities retained after the transaction that led to the derecognition.
- The change in the entity's assets and liabilities as a result of that transaction.

Derecognition for asset normally occurs when the entity losses control of all or part or the recognised asset. Derecognition for liability normally occurs when the entity no longer has a present obligation for all or part of the recognised liability.

3. 5 Measurement

Previous Conceptual Framework, from 1989, had very little guidance on measurement. The measurement proposal described different measurement bases and the information that they provide. The measurement proposal described factors to consider in selecting a measurement basis and likely to result in a mixed measurement model.

There was received a feedback from the measurement proposal:

- Much support for mixed measurement approach.
- A few proposed an aspirational goal of a single measurement basis, with different views on what that basis should be.
- Some suggested proposed guidance would be insufficient, and further work should be undertaken.

The revised Conceptual Framework categorises measurement bases as historical cost or current value and describes the measurement bases. Historical cost measurement uses amortised costs and current value measurements uses fair value, value in use, fulfilment value, current cost. IASB identified the factors to consider when selecting a measurement basis.

Conclusion concerning measurement basis. Historical cost is often less costly to measure and easier to verify but estimating consumption and impairment can be difficult. Fair value can be costly to measure and difficult to verify but not if observable market prices exist. Historical cost can reduce comparability as often results in identical assets and liabilities being measured at different amounts because of when they were acquired or incurred. Fair value Enhances comparability as identical assets or liabilities measured at fair value will, in principle, be measured at the same amount by entities that have access to the same markets.

Conclusions

The revised Conceptual Framework is an output of IASB´s work over last twenty-eight years and has an effective date of 1 January 2020 for companies. IASB is going to use the revised Conceptual Framework since the date of framework issue to develop standards. The revised Conceptual Framework reflects contemporary needs of financial reporting users including a large group of stakeholders.

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