

May 2015

Exposure Draft ED/2015/3

Conceptual Framework for Financial Reporting

Comments to be received by 26 October 2015

IASB[®]

 IFRS[®]

**Exposure Draft
Conceptual Framework
for Financial Reporting**

Comments to be received by 26 October 2015

Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form. Comments need to be received by **26 October 2015** and should be submitted in writing to the address below, by email to commentletters@ifrs.org or electronically using our 'Comment on a proposal' page.

All comments will be on the public record and posted on our website unless the respondent requests confidentiality. Such requests will not normally be granted unless supported by good reason, for example, commercial confidence. Please see our website for details on this and how we use your personal data.

Disclaimer: the IASB, the IFRS Foundation, the authors and the publishers do not accept responsibility for any loss caused by acting or refraining from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

International Financial Reporting Standards (including International Accounting Standards and SIC and IFRIC Interpretations), Exposure Drafts and other IASB and/or IFRS Foundation publications are copyright of the IFRS Foundation.

Copyright © 2015 IFRS Foundation®

ISBN for this part: 978-1-909704-82-4; ISBN for the set of two parts: 978-1-909704-81-7

All rights reserved. Copies of the Exposure Draft may only be made for the purpose of preparing comments to the IASB provided that such copies are for personal or internal use, are not sold or otherwise disseminated, acknowledge the IFRS Foundation's copyright and set out the IASB's address in full.

Except as permitted above no part of this publication may be translated, reprinted, reproduced or used in any form either in whole or in part or by any electronic, mechanical or other means, now known or hereafter invented, including photocopying and recording, or in any information storage and retrieval system, without prior permission in writing from the IFRS Foundation.

The approved text of International Financial Reporting Standards and other IASB publications is that published by the IASB in the English language. Copies may be obtained from the IFRS Foundation. Please address publications and copyright matters to:

IFRS Foundation Publications Department
30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7332 2730 Fax: +44 (0)20 7332 2749
Email: publications@ifrs.org Web: www.ifrs.org



The IFRS Foundation logo/the IASB logo/the IFRS for SMEs logo/'Hexagon Device', 'IFRS Foundation', 'IFRS Taxonomy', 'eIFRS', 'IASB', 'IFRS for SMEs', 'IAS', 'IASs', 'IFRIC', 'IFRS', 'IFRSs', 'SIC', 'International Accounting Standards' and 'International Financial Reporting Standards' are Trade Marks of the IFRS Foundation.

Further details of the Trade Marks, including details of countries where the Trade Marks are registered or applied for, are available from the IFRS Foundation on request.

The IFRS Foundation is a not-for-profit corporation under the General Corporation Law of the State of Delaware, USA and operates in England and Wales as an overseas company (Company number: FC023235) with its principal office as above.

CONTENTS

from paragraph

SUMMARY AND INVITATION TO COMMENT	
INTRODUCTION	IN1
CHAPTER 1—THE OBJECTIVE OF GENERAL PURPOSE FINANCIAL REPORTING	
Introduction	1.1
Objective, usefulness and limitations of general purpose financial reporting	1.2
Information about a reporting entity’s economic resources, claims against the entity and changes in resources and claims	1.12
Economic resources and claims	1.13
Changes in economic resources and claims	1.15
Financial performance reflected by accrual accounting	1.17
Financial performance reflected by past cash flows	1.20
Changes in economic resources and claims not resulting from financial performance	1.21
Information about the efficiency and effectiveness of the use of the entity’s resources	1.22
CHAPTER 2—QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION	
Introduction	2.1
Qualitative characteristics of useful financial information	2.4
Fundamental qualitative characteristics	2.5
<i>Relevance</i>	2.6
<i>Faithful representation</i>	2.14
<i>Applying the fundamental qualitative characteristics</i>	2.20
Enhancing qualitative characteristics	2.22
<i>Comparability</i>	2.23
<i>Verifiability</i>	2.29
<i>Timeliness</i>	2.32
<i>Understandability</i>	2.33
<i>Applying the enhancing qualitative characteristics</i>	2.36
The cost constraint on useful financial reporting	2.38
CHAPTER 3—FINANCIAL STATEMENTS AND THE REPORTING ENTITY	
Introduction	3.1
The role of financial statements	3.2
Going concern assumption	3.10
The reporting entity	3.11
Boundary of the reporting entity	3.13
Direct control only	3.19
Both direct and indirect control	3.21
CHAPTER 4—THE ELEMENTS OF FINANCIAL STATEMENTS	
Introduction	4.1

Definition of an asset	4.5
Rights	4.8
Potential to produce economic benefits	4.13
Control	4.17
Definition of a liability	4.24
Obligation to transfer an economic resource	4.27
Present obligation	4.31
<i>No practical ability to avoid the transfer</i>	4.32
<i>Past event</i>	4.36
Executory contracts	4.40
Equity	4.43
Definitions of income and expenses	4.48
Reporting the substance of contractual rights and obligations	4.53
Unit of account	4.57
CHAPTER 5—RECOGNITION AND DERECOGNITION	
Introduction	5.1
The recognition process	5.2
Recognition criteria	5.9
Relevance	5.13
<i>Existence uncertainty and separability</i>	5.15
<i>Low probability of a flow of economic benefits</i>	5.17
<i>Measurement uncertainty</i>	5.20
Faithful representation	5.22
Cost	5.24
Derecognition	5.25
Modification of contracts	5.33
CHAPTER 6—MEASUREMENT	
Introduction	6.1
Measurement bases and the information that they provide	6.4
Historical cost	6.6
Current value	6.19
<i>Fair value</i>	6.21
<i>Value in use and fulfilment value</i>	6.34
Summary of information provided by different measurement bases	6.47
Factors to consider when selecting a measurement basis	6.48
Relevance	6.53
Faithful representation	6.57
Enhancing qualitative characteristics	6.59
Factors specific to initial measurement	6.64
<i>Exchanges of items of similar values</i>	6.66
<i>Transactions with holders of equity claims</i>	6.69
<i>Exchanges of items of different values</i>	6.70
<i>Internally constructed assets</i>	6.72
More than one relevant measurement basis	6.74
Measurement of equity	6.78

CHAPTER 7—PRESENTATION AND DISCLOSURE	
Introduction	7.1
The objective and scope of financial statements	7.2
Presentation and disclosure as communication tools	7.8
Classification	7.10
Aggregation	7.14
Presentation and disclosure objectives and principles	7.16
Information about financial performance	7.19
CHAPTER 8—CONCEPTS OF CAPITAL AND CAPITAL MAINTENANCE	
Concepts of capital	8.1
Concepts of capital maintenance and the determination of profit	8.3
Capital maintenance adjustments	8.10
APPENDICES	
A Cash-flow-based measurement techniques	
B Glossary	
APPROVAL BY THE IASB	

The [draft] *Conceptual Framework for Financial Reporting*

Summary and invitation to comment

The *Conceptual Framework for Financial Reporting* (the ‘*Conceptual Framework*’) describes the objective of, and the concepts for, general purpose financial reporting. It is a practical tool that:

- (a) assists the International Accounting Standards Board (IASB) to develop Standards that are based on consistent concepts;
- (b) assists preparers to develop consistent accounting policies when no Standard applies to a particular transaction or event, or when a Standard allows a choice of accounting policy; and
- (c) assists others to understand and interpret the Standards.

The IASB’s existing *Conceptual Framework* was developed by its predecessor body, the International Accounting Standards Committee, in 1989. The material on the objective of financial reporting and on the qualitative characteristics of financial information was revised by the IASB in 2010 as the result of a joint project with the US national standard-setter, the Financial Accounting Standards Board (FASB). This Exposure Draft sets out the proposals for a revised *Conceptual Framework*. It has been developed in the light of responses received on the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the ‘Discussion Paper’), which was published in July 2013.

The reasons for the proposals in this Exposure Draft are summarised in the Basis for Conclusions that accompanies this Exposure Draft.

Why is the IASB revising the *Conceptual Framework*?

Although the existing *Conceptual Framework* has helped the IASB when developing International Financial Reporting Standards (IFRS):

- (a) some important areas are not covered;
- (b) the guidance in some areas is unclear; and
- (c) some aspects of the existing *Conceptual Framework* are out of date.

Consequently, in 2004 the IASB and the FASB initiated a joint project to revise their *Conceptual Frameworks*. However, in 2010 they suspended work on that project in order to concentrate on other projects.

In 2011 the IASB carried out a public consultation on its agenda. Most respondents to that consultation identified the *Conceptual Framework* as a priority project for the IASB. Consequently, the IASB restarted its *Conceptual Framework* project in 2012.¹

The objective of the project is to improve financial reporting by providing a more complete, clear and updated set of concepts. Thus, this Exposure Draft:

¹ The work since the restarting of the project in 2012 has not been conducted jointly with the FASB.

- (a) is more complete than the existing *Conceptual Framework* because it addresses the following areas that are either not covered, or not covered in enough detail, in the existing *Conceptual Framework*:
 - (i) measurement;
 - (ii) financial performance (including the use of other comprehensive income);
 - (iii) presentation and disclosure;
 - (iv) derecognition; and
 - (v) the reporting entity.
- (b) clarifies some aspects of the existing *Conceptual Framework*. For example, this Exposure Draft:
 - (i) clarifies that the information needed to meet the objective of financial reporting includes information that can be used to help assess management’s stewardship of the entity’s resources;
 - (ii) explains the roles of prudence and substance over form in financial reporting;
 - (iii) clarifies that a high level of measurement uncertainty can make financial information less relevant;
 - (iv) clarifies that important decisions on, for example, recognition and measurement, are driven by considering the nature of the resulting information about both financial performance and financial position; and
 - (v) provides clearer definitions of assets and liabilities, and more extensive guidance to support those definitions.
- (c) updates the parts of the existing *Conceptual Framework* that are out of date. For example, this Exposure Draft clarifies the role of probability in the definitions of assets and liabilities.

Approach to, and scope of, the project

The IASB aims to make significant improvements to the *Conceptual Framework* without delay and expects to complete the revisions to the *Conceptual Framework* in 2016. To achieve this, the IASB is building on the existing *Conceptual Framework*—updating it, improving it and filling in gaps instead of fundamentally reconsidering all aspects of the *Conceptual Framework*.

Who will be affected by a revised *Conceptual Framework*?

Immediate effects

The *Conceptual Framework* is not a Standard and does not override specific Standards. Hence, the proposed changes to the *Conceptual Framework* will not have an immediate effect on the financial statements of most reporting entities. However, entities could be affected by the

changes if they need to use the *Conceptual Framework* to develop or select accounting policies when no Standard specifically applies to a transaction.²

The IASB proposes, in a separate Exposure Draft *Updating References to the Conceptual Framework*, to update references to the *Conceptual Framework* in Standards. The IASB proposes to set a transition period of approximately 18 months for that amendment. That would allow preparers time to identify, understand and adjust to possible implications of the revised *Conceptual Framework* when they are using it to develop or select an accounting policy.

Future effects

A more complete, clear and updated set of concepts will help the IASB to develop Standards that better meet the needs of investors, creditors and other lenders.

Because the *Conceptual Framework* will guide the IASB when it develops Standards, it will affect financial statements when entities implement new or revised Standards based on the revised *Conceptual Framework*.

However, the IASB will not automatically change existing Standards as a result of the changes to the *Conceptual Framework*. If an existing Standard works well in practice, the IASB will not propose an amendment to that Standard simply because of an inconsistency with the revised *Conceptual Framework*. Any decision to amend an existing Standard would require the IASB to go through its normal due process for adding a project to its agenda and developing an Exposure Draft and an amendment to that Standard.

What are the next steps in the project?

The IASB will consider the comments received on this Exposure Draft (from both the comment letters received and other consultations) when developing the revised *Conceptual Framework*. The IASB aims to finalise the revised *Conceptual Framework* in 2016.

Invitation to comment

The IASB invites comments on the proposals in this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

- (a) comment on the questions as stated;
- (b) indicate the specific paragraphs or group of paragraphs to which they relate;
- (c) contain a clear rationale; and
- (d) describe any alternative that the IASB should consider, if applicable.

Respondents need not comment on all of the questions and are encouraged to comment on any additional matters. However, the IASB is not requesting comments on all parts of Chapters 1 and 2, on how to distinguish liabilities from equity claims (see Chapter 4) or on Chapter 8.

² If no Standard specifically applies to a transaction, paragraph 11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires entities to consider the *Conceptual Framework* in developing and applying an accounting policy for that transaction. IAS 1 *Presentation of Financial Statements* requires entities to produce financial statements that provide a fair presentation of the entity's financial position, financial performance and cash flows.

The IASB will consider all comments received in writing by **26 October 2015**. The comment period for this Exposure Draft is the same as for the Exposure Draft *Updating References to the Conceptual Framework*. The IASB welcomes all comments, regardless of whether respondents submit comments on both Exposure Drafts or on only one of them.

Chapters 1 and 2—The objective of general purpose financial reporting and the qualitative characteristics of useful financial information

In 2010, as part of a joint project with the FASB, the IASB issued two chapters of a revised *Conceptual Framework*. These chapters deal with the objective of general purpose financial reporting and the qualitative characteristics of useful financial information.

When the IASB restarted work on the *Conceptual Framework* project in 2012, it decided not to fundamentally reconsider these chapters. However, many respondents to the Discussion Paper stated that the IASB should reconsider one or more aspects of these chapters. In response to these comments, the IASB now proposes:

- (a) to give more prominence, within the discussion of the objective of financial reporting, to the importance of providing information needed to assess management's stewardship of the entity's resources (see paragraphs 1.3–1.4, 1.13–1.16, 1.18, 1.20, 1.22–1.23 and BC1.6–BC1.10);
- (b) to reintroduce an explicit reference to the notion of prudence (described as caution when making judgements under conditions of uncertainty) and state that prudence is important for achieving neutrality (see paragraphs 2.18 and BC2.1–BC2.17); and
- (c) to state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form (see paragraphs 2.14 and BC2.18–BC2.20).

Some respondents to the Discussion Paper raised concerns that, since 2010, the *Conceptual Framework* has no longer identified reliability as a qualitative characteristic of useful financial information. Their main concern seems to be that measurement uncertainty makes financial information less useful. In response, the IASB proposes to clarify that measurement uncertainty is one factor that can make financial information less relevant. Hence, there is a trade-off between the level of measurement uncertainty and other factors that make information relevant (see paragraphs 2.12–2.13 and BC2.24(c)). Other aspects of reliability, as it was described in the pre-2010 *Conceptual Framework*, are very similar to aspects of the qualitative characteristic of faithful representation, as described in the existing *Conceptual Framework* and in the Exposure Draft. The IASB thinks that the term 'faithful representation' describes those aspects better than the term 'reliability'.

To help respondents provide comments, the proposed changes to these two chapters are shown in mark-up. The IASB is not requesting comments on other aspects of these chapters and does not expect to make substantive changes to the other aspects of these chapters.

Question 1—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?

Why or why not?

Chapter 3—Financial statements and the reporting entity

Chapter 3 discusses:

- (a) the role of financial statements; and
- (b) the reporting entity.

The role of financial statements

The Exposure Draft describes the role of financial statements. Among other things, it:

- (a) states that financial statements are prepared from the perspective of the entity as a whole, instead of from the perspective of any particular group of investors, lenders or other creditors (see paragraphs 3.9 and BC3.3); and
- (b) sets out the going concern assumption, which has been brought forward largely unchanged from the existing *Conceptual Framework* (see paragraphs 3.10 and BC3.4).

Description and boundary of a reporting entity

Paragraphs 3.11–3.12 and BC3.5–BC3.9 discuss reporting entities. A reporting entity is described as an entity that chooses, or is required, to prepare general purpose financial statements.

Paragraphs 3.13–3.25 and BC3.10–BC3.17 discuss the boundary of a reporting entity. These paragraphs state that when one entity (the parent) has control over another entity (the subsidiary), the boundary of the reporting entity can be determined by either direct control only (leading to unconsolidated financial statements) or by direct and indirect control (leading to consolidated financial statements).

The IASB thinks that, in general, consolidated financial statements are more likely to provide useful information to users of financial statements than unconsolidated financial statements.

Unconsolidated financial statements may also provide useful information. The IASB is of the view that if an entity chooses, or is required, to prepare unconsolidated financial statements, it would need to disclose how users may obtain the consolidated financial statements.

A reporting entity does not have to be a legal entity. If a reporting entity is not a legal entity, the boundary of the reporting entity needs to be set in such a way that the financial statements:

- (a) provide the relevant financial information needed by those existing and potential investors, lenders and other creditors who rely on the financial statements; and
- (b) faithfully represent the economic activities of the entity.

Question 2—Description and boundary of a reporting entity
<p>Do you agree with:</p> <ul style="list-style-type: none"> (a) the proposed description of a reporting entity in paragraphs 3.11–3.12; and (b) the discussion of the boundary of a reporting entity in paragraphs 3.13–3.25? <p>Why or why not?</p>

Chapter 4—The elements of financial statements

Chapter 4 discusses the definitions of the elements of financial statements (for example, assets, liabilities, equity, income and expenses).

Definitions of elements

The IASB proposes to define the elements of the financial statements as follows:

<p>Asset (paragraphs 4.5–4.23 and BC4.23–BC4.44)</p>	<p>An asset is a present economic resource controlled by the entity as a result of past events.</p> <p>An economic resource is a right that has the potential to produce economic benefits.</p>
<p>Liability (paragraphs 4.24–4.39, BC4.4–BC4.22 and BC4.45–BC4.81)</p>	<p>A liability is a present obligation of the entity to transfer an economic resource as a result of past events.</p>
<p>Equity (paragraphs 4.43–4.47 and BC4.93–BC4.103)</p>	<p>Equity is the residual interest in the assets of the entity after deducting all its liabilities.</p>

continued...

...continued

<p>Income (paragraphs 4.48–4.52, BC4.2–BC4.3 and BC4.104–BC4.105)</p>	<p>Income is increases in assets or decreases in liabilities that result in increases in equity, other than those relating to contributions from holders of equity claims.</p>
<p>Expenses (paragraphs 4.48–4.52, BC4.2–BC4.3 and BC4.104–BC4.105)</p>	<p>Expenses are decreases in assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to holders of equity claims.</p>

This Exposure Draft continues to define income and expenses in terms of changes in assets and liabilities, but emphasises in various places that important decisions on, for example, recognition and measurement, are driven by considering the nature of the resulting information about both financial performance and financial position. The IASB explains the reasons for this in paragraph BC4.3.

The IASB is not proposing now to change the definitions of liabilities and equity to address the problems that arise in classifying instruments with characteristics of both liabilities and equity. It is exploring those problems in its Financial Instruments with the Characteristics of Equity research project. That project will help the IASB to decide, in due course, whether it should add a project on amending Standards, the *Conceptual Framework* or both to its active agenda. The IASB expects that any such project would not lead to changes in the Exposure Draft's proposals for identifying whether the reporting entity has a present obligation to transfer an economic resource. Those proposals are not designed to address problems in distinguishing between liabilities and equity.

<p>Question 3—Definitions of elements</p>
<p>Do you agree with the proposed definitions of elements (excluding issues relating to the distinction between liabilities and equity):</p> <p>(a) an asset, and the related definition of an economic resource;</p> <p>(b) a liability;</p> <p>(c) equity;</p> <p>(d) income; and</p> <p>(e) expenses?</p> <p>Why or why not? If you disagree with the proposed definitions, what alternative definitions do you suggest and why?</p>

Present obligation

The definition of a liability refers to a ‘present obligation’. Paragraphs 4.31–4.39 propose guidance on that term (see also paragraphs BC4.48–BC4.81). Paragraph 4.31 proposes that an entity has a present obligation to transfer an economic resource if both:

- (a) the entity has no practical ability to avoid the transfer; and
- (b) the obligation has arisen from past events; in other words, the entity has received the economic benefits, or conducted the activities, that establish the extent of its obligation.

Question 4—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?

Other guidance on the elements

The Exposure Draft provides other guidance on the definitions of the elements (see paragraphs 4.8–4.10, 4.43–4.52, BC4.23–BC4.44 and BC4.93–BC4.110), on executory contracts (see paragraphs 4.40–4.42 and BC4.82–BC4.92), on reporting the substance of contractual rights and contractual obligations (see paragraphs 4.53–4.56 and BC4.111) and on the unit of account (see paragraphs 4.57–4.63 and BC4.112–BC4.116).

Question 5—Other guidance on the elements
Do you have any comments on the proposed guidance?
Do you believe that additional guidance is needed? If so, please specify what that guidance should include.

Chapter 5—Recognition and derecognition

Chapter 5 discusses recognition and derecognition.

Recognition criteria

Paragraphs 5.9–5.24 and BC5.5–BC5.48 discuss recognition criteria. Paragraph 5.9 proposes that assets and liabilities (and any related income, expenses or changes in equity) should be recognised if such recognition provides users of financial statements with:

- (a) relevant information about the asset or the liability and about any income, expenses or changes in equity;
- (b) a faithful representation of the asset or the liability and of any income, expenses or changes in equity; and
- (c) information that results in the benefits exceeding the cost of providing that information.

The supporting discussion identifies circumstances in which those criteria may not be met, including some cases in which:

- (a) it is uncertain whether an asset exists, or is separable from goodwill, or whether a liability exists;
- (b) there is only a low probability that an inflow or outflow of economic benefits will result; and
- (c) a measurement of an asset or a liability is available (or can be obtained) but the level of measurement uncertainty is so high that the resulting information has little relevance and no other relevant measure is available (or can be obtained).

Question 6—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

Paragraphs 5.25–5.36 and BC5.49–BC5.59 discuss derecognition. They propose that accounting requirements for derecognition should aim to represent faithfully both:

- (a) the assets and liabilities (if any) retained after the transaction or other event that led to the derecognition; and
- (b) the change in the entity's assets and liabilities as a result of that transaction or other event.

Most decisions about derecognition are straightforward. The discussion on this topic focuses on cases when these two aims conflict with each other. The Exposure Draft describes the alternatives available and discusses what factors the IASB would need to consider when developing or revising particular Standards.

Question 7—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?

Chapter 6—Measurement

Chapter 6 discusses:

- (a) different measurement bases, the information that they provide and their advantages and disadvantages; and
- (b) factors to consider when selecting a measurement basis.

Measurement bases

Paragraphs 6.4–6.47 and BC6.15–BC6.37 discuss measurement bases. They categorise measurement bases as historical cost or current value and describe the following measurement bases:

- (a) historical cost; and
- (b) current value:

- (i) fair value; and
- (ii) value in use for assets and fulfilment value for liabilities.

Appendix A provides guidance on cash-flow-based measurement techniques. These are sometimes used to estimate the results of applying a specified measurement basis.

Question 8—Measurement bases	
Has the IASB:	
(a)	correctly identified the measurement bases that should be described in the <i>Conceptual Framework</i> ? If not, which measurement bases would you include and why?
(b)	properly described the information provided by each of the measurement bases, and their advantages and disadvantages? If not, how would you describe the information provided by each measurement basis, and its advantages and disadvantages?

Factors to consider when selecting a measurement basis

Paragraphs 6.48–6.73 and BC6.41–BC6.67 discuss the factors to consider when selecting a measurement basis. They discuss how considering the qualitative characteristics of useful financial information affects the selection of a measurement basis. In addition, paragraph 6.50 notes that, as with all other areas of financial reporting, the cost constraint affects the selection of a measurement basis.

Question 9—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?	

More than one relevant measurement basis

Paragraphs 6.74–6.77 and BC6.68 discuss situations in which more than one measurement basis is needed to provide relevant information about an asset, liability, income or expenses. They state that:

- (a) in most cases, the most understandable way to provide that information is to use one measurement in both the statement of financial position and the statement(s) of financial performance, and to use the other measurement basis for disclosure only; and
- (b) in some cases, more relevant information is provided by using a current value measurement basis in the statement of financial position and a different measurement basis to determine the related income or expenses in the statement of profit or loss.

Question 10—More than one relevant measurement basis

Do you agree with the approach discussed in paragraphs 6.74–6.77 and BC6.68? Why or why not?

Chapter 7—Presentation and disclosure

Chapter 7 discusses:

- (a) the objective and scope of financial statements;
- (b) presentation and disclosure as communication tools; and
- (c) information about financial performance.

This Exposure Draft includes high-level concepts that describe what information is included in the financial statements and how that information should be presented and disclosed. The IASB is also working on the Disclosure Initiative, which is a collection of implementation and research projects aimed at improving disclosure in IFRS financial reporting. In the Disclosure Initiative, the IASB will seek to develop the concepts proposed in this Exposure Draft to provide additional guidance on presentation and disclosure. In addition, the IASB is undertaking a research project to explore whether it should add a project on performance reporting to its agenda.

The objective and scope of financial statements

Paragraphs 7.2–7.7 and BC7.4–BC7.16 discuss the objective and scope of financial statements. Financial statements provide information about an entity’s assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management’s stewardship of the entity’s resources. Some of this information is provided by the recognition of items that meet the definition of an element in the statements of financial position and financial performance. Financial statements also provide additional information about recognised items and items that meet the definition of an element but that have not been recognised.

Forward-looking information about likely or possible future transactions and events is included in financial statements only if that information is relevant to understanding the entity’s assets, liabilities and equity that existed at the end of, or during, the period (even if they are unrecognised), or income and expenses for the period.

Presentation and disclosure as communication tools

Paragraphs 7.8–7.18 and BC7.17–BC7.23 discuss presentation and disclosure as communication tools.

The Exposure Draft states that efficient and effective communication of the information presented or disclosed in the financial statements improves its relevance and contributes to a faithful representation of the assets, liabilities, equity, income and expenses. Efficient and effective communication includes:

- (a) classifying information in a structured manner that reports similar items together and dissimilar items separately;

- (b) aggregating information so that it is not obscured by unnecessary detail; and
- (c) using presentation and disclosure objectives and principles instead of rules that could lead to a purely mechanistic compliance.

Question 11—Objective and scope of financial statements and communication

Do you have any comments on the discussion of the objective and scope of financial statements, and on the use of presentation and disclosure as communication tools?

Information about financial performance

Paragraphs 7.19–7.27 and BC7.24–BC7.57 discuss the presentation of information about financial performance.

This Exposure Draft does not specify whether the statement(s) of financial performance comprise a single statement or two statements. It describes the statement, or section, of profit or loss as the primary source of information about an entity’s financial performance for the period, and requires a total or subtotal for profit or loss to be provided.³ It does not define profit or loss, but states that the income and expenses included in the statement of profit or loss are the primary source of information about an entity’s financial performance for the period.

Question 12—Description of the statement of profit or loss

Do you support the proposed description of the statement of profit or loss? Why or why not?

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.

Because the IASB is of the view that income and expenses included in the statement of profit or loss are the primary source of information about an entity’s financial performance for the period, there is a rebuttable presumption that all income and all expenses will be included in that statement. Paragraph 7.24 proposes, for the reasons explained in BC7.42–BC7.48, that income or expenses could be reported outside the statement of profit or loss and included in other comprehensive income (OCI) only if:

- (a) the income or expenses relate to assets or liabilities measured at current values; and
- (b) excluding those items from the statement of profit or loss would enhance the relevance of the information in the statement of profit or loss for the period.

³ Profit or loss is reported as a subtotal within a separate section of a single statement or as a total within a separate statement of profit or loss. For brevity, this Exposure Draft uses the term ‘statement of profit or loss’ to cover both types of presentation.

Question 13—Reporting items of income or 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? Why or why not?

If you disagree, what alternative do you suggest and why?

Paragraphs 7.26 and BC7.51–BC7.57 propose a presumption that items of income or expenses included in other comprehensive income in one period will be reclassified into the statement of profit or loss in some future period (recycled), if doing so will enhance the relevance of the information included in the statement of profit or loss for that future period. This presumption could be rebutted, for example, if there is no clear basis for identifying the period in which that reclassification would enhance the relevance of the information in the statement of profit or loss. If there is no such basis, it may indicate that the income or expense should not be included in other comprehensive income.

Question 14—Recycling

Do you agree that the *Conceptual Framework* should include the rebuttable presumption described above? Why or why not?

If you disagree, what do you propose instead and why?

Chapter 8—Concepts of capital and capital maintenance

The existing discussion of capital maintenance is included in this Exposure Draft substantially unchanged from the existing *Conceptual Framework*. The IASB would consider revising the *Conceptual Framework* discussion of capital maintenance if it were to carry out future work on accounting for high inflation. No such work is currently planned (see paragraphs BCIN.24 and BC8.1).

Other questions for respondents**Effects of the proposed changes to the *Conceptual Framework***

The Summary and invitation to comment and paragraphs BCE.1–BCE.31 discuss the effects of the proposed changes to the *Conceptual Framework*.

Question 15—Effects of the proposed changes to the *Conceptual Framework*

Do you agree with the analysis in paragraphs BCE.1–BCE.31? Should the IASB consider any other effects of the proposals in the Exposure Draft?

Business activities

As discussed in paragraphs BCIN.28–BCIN.34, this Exposure Draft does not include a general discussion on the role of a business model in financial reporting, but does discuss how the way in which an entity conducts its business activities may affect:

- (a) the unit of account;
- (b) measurement; and
- (c) presentation and disclosure, including how to classify assets, liabilities and items of equity, income and expenses. Classification of items of income and expenses includes determining whether to include them in other comprehensive income instead of in the statement of profit or loss.

Question 16—Business activities
--

Do you agree with the proposed approach to business activities? Why or why not?

Long-term investment

Paragraphs BCIN.35–BCIN.44 discuss the implications of long-term investment and long-term financing for the *Conceptual Framework*. The IASB has concluded that:

- (a) the proposals in this Exposure Draft provide sufficient tools for the IASB to make appropriate standard-setting decisions if future projects consider:
 - (i) how to measure the long-term investments (or liabilities) of entities whose business activities include long-term investment; or
 - (ii) whether such entities should report changes in the carrying amount of those investments (or liabilities) in the statement of profit or loss or other comprehensive income.⁴
- (b) the *Conceptual Framework* contains sufficient and appropriate discussion of primary users and their information needs, and the objective of general purpose financial reporting, to address appropriately the needs of long-term investors.

Question 17—Long-term investment

Do you agree with the IASB’s conclusions on long-term investment? Why or why not?

⁴ The IASB has no current or planned project to consider these questions.

Other comments

Question 18—Other comments

Do you have comments on any other aspect of the Exposure Draft? Please indicate the specific paragraphs or group of paragraphs to which your comments relate (if applicable).

As previously noted, the IASB is not requesting comments on all parts of Chapters 1 and 2, on how to distinguish liabilities from equity claims (see Chapter 4) or on Chapter 8.

How to comment

Comments should be submitted using one of the following methods.

Electronically Visit the ‘Comment on a proposal’ page, which can be found at:
(our preferred method) go.ifrs.org/comment

Email Email comments can be sent to: commentletters@ifrs.org

Postal IFRS Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom

All comments will be on the public record and posted on our website unless confidentiality is requested. Such requests will not normally be granted unless supported by good reason, for example, commercial confidence. Please see our website for details on this and how we use your personal data.

Introduction

- IN1 The [draft] *Conceptual Framework for Financial Reporting* (the ‘*Conceptual Framework*’) describes the objective of, and the concepts for, general purpose financial reporting. The purpose of the [draft] *Conceptual Framework* is to:
- (a) assist the International Accounting Standards Board (IASB) to develop Standards that are based on consistent concepts;
 - (b) assist preparers to develop consistent accounting policies when no Standard applies to a particular transaction or event, or when a Standard allows a choice of accounting policy; and
 - (c) assist all parties to understand and interpret the Standards.
- IN2 The [draft] *Conceptual Framework* is not a Standard. Nothing in this [draft] *Conceptual Framework* overrides any specific Standards.
- IN3 To meet the overall objective of general purpose financial reporting, the IASB may sometimes specify requirements that depart from aspects of the [draft] *Conceptual Framework*. If the IASB does so, it will explain the departure in the Basis for Conclusions on the Standard in question.
- IN4 The [draft] *Conceptual Framework* may be revised from time to time on the basis of the IASB’s experience of working with it.
- IN5 The [draft] *Conceptual Framework* reflects and contributes to the stated mission of the IFRS Foundation, including the IASB, to develop International Financial Reporting Standards (IFRS) that bring transparency, accountability and efficiency to financial markets around the world. The IASB’s work serves the public interest by fostering trust, growth and long-term financial stability in the global economy. The [draft] *Conceptual Framework*:
- (a) contributes to transparency by providing the foundation for Standards that enhance the international comparability and quality of financial information, enabling investors and other market participants to make informed economic decisions.
 - (b) strengthens accountability by reducing the information gap between the providers of capital and the people to whom they have entrusted their money. Standards based on the [draft] *Conceptual Framework* provide information that is needed to hold management to account. As a source of globally comparable information, IFRS based on the [draft] *Conceptual Framework* is also of vital importance to regulators around the world.
 - (c) contributes to economic efficiency by helping investors to identify opportunities and risks across the world, thus improving capital allocation. For businesses, the use of a single, trusted accounting language based on the [draft] *Conceptual Framework* will lower the cost of capital and reduce international reporting costs.

Chapter 1—The objective of general purpose financial reporting

This chapter, which the IASB originally issued in 2010, is carried forward from Chapter 1 of the existing *Conceptual Framework*. The IASB proposes only limited changes to this chapter. To highlight the changes, they are shown in mark-up. Deleted text is struck through and new text is underlined. The format of the numbering has also been changed (for example, from ‘OB1’ to ‘1.1’), but this is not shown as a mark-up.

Introduction

- 1.1 The objective of general purpose financial reporting forms the foundation of the *Conceptual Framework*. Other aspects of the *Conceptual Framework*—~~a reporting entity concept, flow logically from the objective:~~
- (a) the qualitative characteristics of, ~~and the constraint on,~~ useful financial information, ~~and the cost constraint on such information~~ (Chapter 2);
 - (b) financial statements and the reporting entity (Chapter 3);
 - (c) elements of financial statements (Chapter 4);
 - (d) recognition and derecognition (Chapter 5);
 - (e) measurement (Chapter 6);
 - (f) presentation and disclosure (Chapter 7); and
 - (g) capital maintenance (Chapter 8).
- ~~—flow logically from the objective.~~

Objective, usefulness and limitations of general purpose financial reporting

- 1.2 The objective of general purpose financial reporting⁵ 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.⁶ Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.
- 1.3 Decisions by existing and potential investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases. Similarly, decisions by existing and potential lenders and other creditors about providing or settling loans and other forms of credit depend on the principal and interest payments or other returns that they expect. Investors’, lenders’ and other creditors’ expectations about

⁵ Throughout this *Conceptual Framework*, the terms *financial reports* and *financial reporting* refer to *general purpose financial reports* and *general purpose financial reporting* unless specifically indicated otherwise.

⁶ Throughout this *Conceptual Framework*, the term *entity* refers to the *reporting entity* unless specifically indicated otherwise.

returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity and their assessment of management's stewardship of the entity's resources. Consequently, existing and potential investors, lenders and other creditors need information to help them ~~assess the prospects for future net cash inflows to an entity~~ make those assessments.

- 1.4 To ~~assess an entity's prospects for future net cash inflows,~~ help existing and potential investors, lenders and other creditors make those assessments, they need information about:
- (a) the resources of the entity, claims against the entity, and changes in those resources and claims (see paragraphs 1.12-1.21); and
 - (b) how efficiently and effectively the entity's management and governing board⁷ have discharged their responsibilities to use the entity's resources (see paragraphs 1.22-1.23). ~~Examples of such responsibilities include protecting the entity's resources from unfavourable effects of economic factors such as price and technological changes and ensuring that the entity complies with applicable laws, regulations and contractual provisions. Information about management's discharge of its responsibilities is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions.~~⁸
- 1.5 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.⁹
- 1.6 However, general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks.
- 1.7 General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity.
- 1.8 Individual primary users have different, and possibly conflicting, information needs and desires. The ~~Board~~ IASB, in developing financial reporting standards, will seek to provide the information set that will meet the needs of the maximum number of primary users. However, focusing on common

7 Throughout this *Conceptual Framework*, the term *management* refers to *management and the governing board of an entity* unless specifically indicated otherwise.

8 Note for readers of this Exposure Draft: the deleted text forms the basis for paragraphs 1.22-1.23.

9 Throughout this *Conceptual Framework* the terms *primary users* and *users* refer to those existing and potential investors, lenders and other creditors who must rely on general purpose financial reports for much of the financial information they need.

information needs does not prevent the reporting entity from including additional information that is most useful to a particular subset of primary users.

- 1.9 The management of a reporting entity is also interested in financial information about the entity. However, management need not rely on general purpose financial reports because it is able to obtain the financial information it needs internally.
- 1.10 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.
- 1.11 To a large extent, financial reports are based on estimates, judgements and models rather than exact depictions. The *Conceptual Framework* establishes the concepts that underlie those estimates, judgements and models. The concepts are the goal towards which the Board IASB and preparers of financial reports strive. As with most goals, the *Conceptual Framework's* vision of ideal financial reporting is unlikely to be achieved in full, at least not in the short term, because it takes time to understand, accept and implement new ways of analysing transactions and other events. Nevertheless, establishing a goal towards which to strive is essential if financial reporting is to evolve so as to improve its usefulness.

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

- 1.12 General purpose financial reports provide information about the financial position of a reporting entity, which is information about the entity's economic resources and the claims against the reporting entity. Financial reports also provide information about the effects of transactions and other events that change a reporting entity's economic resources and claims. Both types of information provide useful input for decisions about providing resources to an entity.

Economic resources and claims

- 1.13 Information about the nature and amounts of a reporting entity's economic resources and claims can help users to identify the reporting entity's financial strengths and weaknesses. That information can help users to assess the reporting entity's liquidity and solvency, its needs for additional financing and how successful it is likely to be in obtaining that financing. That information can also help users to assess management's stewardship of the reporting entity's economic resources. Information about priorities and payment requirements of existing claims helps users to predict how future cash flows will be distributed among those with a claim against the reporting entity.
- 1.14 Different types of economic resources affect a user's assessment of the reporting entity's prospects for future cash flows differently. Some future cash flows result directly from existing economic resources, such as accounts receivable. Other cash flows result from using several resources in combination to produce

and market goods or services to customers. Although those cash flows cannot be identified with individual economic resources (or claims), users of financial reports need to know the nature and amount of the resources available for use in a reporting entity's operations.

Changes in economic resources and claims

- 1.15 ~~Some~~ Changes in a reporting entity's economic resources and claims result from that entity's financial performance (see paragraphs ~~OB17–OB20~~ 1.17–1.20) and other changes in them result from other events or transactions such as issuing debt or equity instruments (see paragraph ~~OB24~~ 1.21). To properly assess both the prospects for future cash flows from the reporting entity and management's stewardship of the entity's resources, users need to be able to ~~distinguish between both of these~~ identify those two types of changes.
- 1.16 Information about a reporting entity's financial performance helps users to understand the return that the entity has produced on its economic resources. Information about the return the entity has produced ~~provides an indication of how well management has discharged its responsibilities to make efficient and effective use of the reporting entity's resources~~ can help users to assess management's stewardship of the reporting entity's economic resources. Information about the variability and components of that return is also important, especially in assessing the uncertainty of future cash flows. Information about a reporting entity's past financial performance and how its management discharged its stewardship responsibilities is usually helpful in predicting the entity's future returns on its economic resources.

Financial performance reflected by accrual accounting

- 1.17 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.
- 1.18 Information about a reporting entity's financial performance during a period, reflected by changes in its economic resources and claims other than by obtaining additional resources directly from investors and creditors (see paragraph ~~OB24~~ 1.21), is useful in assessing the entity's past and future ability to generate net cash inflows. That information indicates the extent to which the reporting entity has increased its available economic resources, and thus its capacity for generating net cash inflows through its operations rather than by obtaining additional resources directly from investors and creditors. Information about a reporting entity's financial performance during a period can also help users to assess management's stewardship of the reporting entity's economic resources.
- 1.19 Information about a reporting entity's financial performance during a period may also indicate the extent to which events such as changes in market prices or

interest rates have increased or decreased the entity's economic resources and claims, thereby affecting the entity's ability to generate net cash inflows.

Financial performance reflected by past cash flows

- 1.20 Information about a reporting entity's cash flows during a period also helps users to assess the entity's ability to generate future net cash inflows and to assess management's stewardship of the entity's resources. It indicates how the reporting entity obtains and spends cash, including information about its borrowing and repayment of debt, cash dividends or other cash distributions to investors, and other factors that may affect the entity's liquidity or solvency. Information about cash flows helps users understand a reporting entity's operations, evaluate its financing and investing activities, assess its liquidity or solvency and interpret other information about financial performance.

Changes in economic resources and claims not resulting from financial performance

- 1.21 A reporting entity's economic resources and claims may also change for reasons other than financial performance, such as issuing additional ownership shares. Information about this type of change is necessary to give users a complete understanding of why the reporting entity's economic resources and claims changed and the implications of those changes for its future financial performance.

Information about the efficiency and effectiveness of the use of the entity's resources

- 1.22 Information about how efficiently and effectively the entity's management has discharged its responsibilities to use the entity's resources helps users assess management's stewardship of those resources. Such information is also useful for predicting how efficiently and effectively management will use the entity's resources in future periods and, hence, is useful for assessing the entity's prospects for future net cash inflows. Information about management's discharge of its responsibilities is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions.
- 1.23 Examples of management's responsibilities to use the entity's resources include protecting the entity's resources from unfavourable effects of economic factors, such as price and technological changes, and ensuring that the entity complies with applicable laws, regulations and contractual provisions.

Chapter 2—Qualitative characteristics of useful financial information

This chapter, which the IASB originally issued in 2010, is carried forward from Chapter 3 of the existing *Conceptual Framework*. The IASB proposes only limited changes to this chapter. To highlight the changes, they are shown in mark-up. Deleted text is struck through and new text is underlined. The format of the numbering has also been changed (for example, from ‘QC1’ to ‘2.1’), but is not shown as a mark-up.

Introduction

- 2.1 The qualitative characteristics of useful financial information discussed in this chapter 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).
- 2.2 Financial reports provide information about the reporting entity’s economic resources, claims against the reporting entity and the effects of transactions and other events and conditions that change those resources and claims. (This information is referred to in the *Conceptual Framework* as information about the economic phenomena.) Some financial reports also include explanatory material about management’s expectations and strategies for the reporting entity, and other types of forward-looking information.
- 2.3 The qualitative characteristics of useful financial information¹⁰ apply to financial information provided in financial statements, as well as to financial information provided in other ways. Cost, which is a pervasive constraint on the reporting entity’s ability to provide useful financial information, applies similarly. However, the considerations in applying the qualitative characteristics and the cost constraint may be different for different types of information. For example, applying them to forward-looking information may be different from applying them to information about existing economic resources and claims and to changes in those resources and claims.

Qualitative characteristics of useful financial information

- 2.4 If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

Fundamental qualitative characteristics

- 2.5 The fundamental qualitative characteristics are *relevance* and *faithful representation*.

¹⁰ Throughout this *Conceptual Framework*, the terms *qualitative characteristics* and *cost constraint* refer to the qualitative characteristics of, and the *cost* constraint on, useful financial information.

Relevance

- 2.6 Relevant financial information is capable of making a difference in the decisions made by users. Information may be capable of making a difference in a decision even if some users choose not to take advantage of it or are already aware of it from other sources.
- 2.7 Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.
- 2.8 Financial information has predictive value if it can be used as an input to processes employed by users to predict future outcomes. Financial information need not be a prediction or forecast to have predictive value. Financial information with predictive value is employed by users in making their own predictions.
- 2.9 Financial information has confirmatory value if it provides feedback about (confirms or changes) previous evaluations.
- 2.10 The predictive value and confirmatory value of financial information are interrelated. Information that has predictive value often also has confirmatory value. For example, revenue information for the current year, which can be used as the basis for predicting revenues in future years, can also be compared with revenue predictions for the current year that were made in past years. The results of those comparisons can help a user to correct and improve the processes that were used to make those previous predictions.

Materiality

- 2.11 Information is material if omitting it or misstating it could influence decisions that the primary users of general purpose financial reports (see paragraph 1.5) make on the basis of financial information about a specific reporting entity. In other words, 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. Consequently, the ~~Board~~ IASB cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

Measurement uncertainty

- 2.12 One factor affecting the relevance of financial information is the level of measurement uncertainty. Measurement uncertainty arises when a measure for an asset or a liability cannot be observed directly and must instead be estimated. The use of estimates is an essential part of the preparation of financial information and does not necessarily undermine its relevance, but the estimate needs to be properly described and disclosed (see paragraph 2.20).
- 2.13 An estimate can provide relevant information, even if the estimate is subject to a high level of measurement uncertainty. Nevertheless, if measurement uncertainty is high, an estimate is less relevant than it would be if it were subject to low measurement uncertainty. Thus, there is a trade-off between the level of measurement uncertainty and other factors that make information relevant. For example, for some estimates, a high level of measurement uncertainty may outweigh those other factors to such an extent that the

resulting information may have little relevance. On the other hand, a high level of measurement uncertainty does not prevent the use of an estimate if that estimate provides the most relevant information.

Faithful representation

- 2.14 Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent. A faithful representation provides information about the substance of an economic phenomenon instead of merely providing information about its legal form. Providing information only about a legal form that differs from the economic substance of the underlying economic phenomenon would not result in a faithful representation.
- 2.15 To be a perfectly faithful representation, a depiction would have three characteristics. It would be *complete, neutral* and *free from error*. Of course, perfection is seldom, if ever, achievable. The Board's IASB's objective is to maximise those qualities to the extent possible.
- 2.16 A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations. For example, a complete depiction of a group of assets would include, at a minimum, a description of the nature of the assets in the group, a numerical depiction of all of the assets in the group, and a description of what the numerical depiction represents (for example, ~~original cost~~, ~~adjusted~~ historical cost or fair value). For some items, a complete depiction may also entail explanations of significant facts about the quality and nature of the items, factors and circumstances that might affect their quality and nature, and the process used to determine the numerical depiction.
- 2.17 A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users. Neutral information does not mean information with no purpose or no influence on behaviour. On the contrary, relevant financial information is, by definition, capable of making a difference in users' decisions.
- 2.18 Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. The exercise of prudence means that assets and income are not overstated and liabilities and expenses are not understated. Equally, the exercise of prudence does not allow for the understatement of assets and income or the overstatement of liabilities and expenses, because such mis-statements can lead to the overstatement of income or the understatement of expenses in future periods.
- 2.19 Faithful representation does not mean accurate in all respects. Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not

mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.

~~A faithful representation, by itself, does not necessarily result in useful information. For example a reporting entity may receive property, plant and equipment through a government grant. Obviously, reporting that an entity acquired an asset at no cost would faithfully represent its cost, but that information would probably not be very useful. A slightly more subtle example is an estimate of the amount by which an asset's carrying amount should be adjusted to reflect an impairment in the asset's value. That estimate can be a faithful representation if the reporting entity has properly applied an appropriate process, properly described the estimate and explained any uncertainties that significantly affect the estimate. However, if the level of uncertainty in such an estimate is sufficiently large, that estimate will not be particularly useful. In other words, the relevance of the asset being faithfully represented is questionable. If there is no alternative representation that is more faithful, that estimate may provide the best available information.¹¹~~

Applying the fundamental qualitative characteristics

- 2.20 ~~Information must be both relevant and faithfully represented if it is to be useful. Neither a faithful representation of an irrelevant phenomenon nor an unfaithful representation of a relevant phenomenon helps users make good decisions. For example, an estimate can be faithfully represented if the reporting entity has properly applied an appropriate process, properly described the estimate and explained any uncertainties that significantly affect the estimate. However, if the estimate is not relevant, the information provided will not be useful.~~
- 2.21 The most efficient and effective process for applying the fundamental qualitative characteristics would usually be as follows (subject to the effects of enhancing characteristics and the cost constraint, which are not considered in this example). First, identify an economic phenomenon that ~~has the potential to be~~ is capable of being useful to users of the reporting entity's financial information. Second, identify the type of information about that phenomenon that would be most relevant if it is available and can be faithfully represented. Third, determine whether that information is available and can be faithfully represented. If so, the process of satisfying the fundamental qualitative characteristics ends at that point. If not, the process is repeated with the next most relevant type of information.

Enhancing qualitative characteristics

- 2.22 *Comparability, verifiability, timeliness and understandability* are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully represented. The enhancing qualitative characteristics may also help

¹¹ Note for readers of the Exposure Draft: the deleted paragraph is paragraph QC16 in the existing *Conceptual Framework*. Part of the paragraph is included in paragraph 2.20.

determine which of two ways should be used to depict a phenomenon if both are considered equally relevant and faithfully represented.

Comparability

- 2.23 Users' decisions involve choosing between alternatives, for example, selling or holding an investment, or investing in one reporting entity or another. Consequently, information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date.
- 2.24 Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. Unlike the other qualitative characteristics, comparability does not relate to a single item. A comparison requires at least two items.
- 2.25 Consistency, although related to comparability, is not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Comparability is the goal; consistency helps to achieve that goal.
- 2.26 Comparability is not uniformity. For information to be comparable, like things must look alike and different things must look different. Comparability of financial information is not enhanced by making unlike things look alike any more than it is enhanced by making like things look different.
- 2.27 Some degree of comparability is likely to be attained by satisfying the fundamental qualitative characteristics. A faithful representation of a relevant economic phenomenon should naturally possess some degree of comparability with a faithful representation of a similar relevant economic phenomenon by another reporting entity.
- 2.28 Although a single economic phenomenon can be faithfully represented in multiple ways, permitting alternative accounting methods for the same economic phenomenon diminishes comparability.

Verifiability

- 2.29 Verifiability helps assure users that information faithfully represents 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. Quantified information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified.
- 2.30 Verification can be direct or indirect. Direct verification means verifying an amount or other representation through direct observation, for example, by counting cash. Indirect verification means checking the inputs to a model, formula or other technique and recalculating the outputs using the same methodology. An example is verifying the carrying amount of inventory by checking the inputs (quantities and costs) and recalculating the ending inventory using the same cost flow assumption (for example, using the first-in, first-out method).

- 2.31 It may not be possible to verify some explanations and forward-looking financial information until a future period, if at all. To help users decide whether they want to use that information, it would normally be necessary to disclose the underlying assumptions, the methods of compiling the information and other factors and circumstances that support the information.

Timeliness

- 2.32 Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is. However, some information may continue to be timely long after the end of a reporting period because, for example, some users may need to identify and assess trends.

Understandability

- 2.33 Classifying, characterising and presenting information clearly and concisely makes it understandable.
- 2.34 Some phenomena are inherently complex and cannot be made easy to understand. Excluding information about those phenomena from financial reports might make the information in those financial reports easier to understand. However, those reports would be incomplete and therefore potentially misleading.
- 2.35 Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

Applying the enhancing qualitative characteristics

- 2.36 Enhancing qualitative characteristics should be maximised to the extent possible. However, the enhancing qualitative characteristics, either individually or as a group, cannot make information useful if that information is irrelevant or not faithfully represented.
- 2.37 Applying the enhancing qualitative characteristics is an iterative process that does not follow a prescribed order. Sometimes, one enhancing qualitative characteristic may have to be diminished to maximise another qualitative characteristic. For example, a temporary reduction in comparability as a result of prospectively applying a new financial reporting standard may be worthwhile to improve relevance or faithful representation in the longer term. Appropriate disclosures may partially compensate for non-comparability.

The cost constraint on useful financial reporting

- 2.38 Cost is a pervasive constraint on the information that can be provided by financial reporting. Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information. There are several types of costs and benefits to consider.

- 2.39 Providers of financial information expend most of the effort involved in collecting, processing, verifying and disseminating financial information, but users ultimately bear those costs in the form of reduced returns. Users of financial information also incur costs of analysing and interpreting the information provided. If needed information is not provided, users incur additional costs to obtain that information elsewhere or to estimate it.
- 2.40 Reporting financial information that is relevant and faithfully represents what it purports to represent helps users to make decisions with more confidence. This results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole. An individual investor, lender or other creditor also receives benefits by making more informed decisions. However, it is not possible for general purpose financial reports to provide all the information that every user finds relevant.
- 2.41 In applying the cost constraint, the ~~Board~~ IASB assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information. When applying the cost constraint in developing a proposed financial reporting standard, the ~~Board~~ IASB seeks information from preparers, users, auditors, academics and others about the expected nature and quantity of the benefits and costs of that standard. In most situations, assessments are based on a combination of quantitative and qualitative information.
- 2.42 Because of the inherent subjectivity, different individuals' assessments of the costs and benefits of reporting particular items of financial information will vary. Therefore, the ~~Board~~ IASB seeks to consider costs and benefits in relation to financial reporting generally, and not just in relation to individual reporting entities. That does not mean that assessments of costs and benefits always justify the same reporting requirements for all entities. Differences may be appropriate because of different sizes of entities, different ways of raising capital (publicly or privately), different users' needs or other factors.

The IASB proposes new Chapters 3–7. Because these are new chapters, no mark-up has been used.

Chapter 3—Financial statements and the reporting entity

Introduction

- 3.1 This chapter discusses:
- (a) the role of financial statements (paragraphs 3.2–3.10); and
 - (b) the reporting entity (paragraphs 3.11–3.25).

The role of financial statements

- 3.2 General purpose financial reports provide information about the reporting entity's economic resources, claims against the entity and changes in those economic resources and claims (see paragraph 1.12). General purpose financial statements are a particular form of general purpose financial reports.¹²
- 3.3 In financial statements, the financial effects of transactions and other events are classified into the following elements: assets, liabilities, equity, income and expenses. Chapter 4 discusses the definitions of these elements.
- 3.4 The objective of financial statements is to provide information about an entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources.
- 3.5 Financial statements provide information about the financial effects of transactions and other events of a specified period. Those transactions and other events give rise to changes in the entity's assets, liabilities and equity. These changes, combined with the effects of transactions and other events from previous periods, give rise to the entity's assets, liabilities and equity at the end of the period.
- 3.6 Financial statements consist of statements, including a statement of financial position and statement(s) of financial performance, and notes to the financial statements. Assets, liabilities and equity are recognised in the statement of financial position. Income and expenses are recognised in the statement(s) of financial performance. However, not all assets and liabilities are necessarily recognised. Chapter 5 discusses the recognition and derecognition of assets, liabilities, equity, income and expenses.
- 3.7 Financial statements include monetary information about assets, liabilities, equity, income and expenses, which involves measurement. Chapter 6 discusses the measurement of assets, liabilities, equity, income and expenses.
- 3.8 Financial statements present, in the statement of financial position and the statement(s) of financial performance, information about assets, liabilities,

¹² Throughout this [draft] *Conceptual Framework*, the term *financial statements* refers to *general purpose financial statements* unless specifically indicated otherwise.

equity, income and expenses included in those statements. They also disclose other information that is relevant to users. Presentation and disclosure are discussed in Chapter 7.

- 3.9 Financial statements are prepared from the perspective of the entity as a whole, instead of from the perspective of any particular group of investors, lenders or other creditors.

Going concern assumption

- 3.10 This [draft] *Conceptual Framework* is based on the assumption that the reporting entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to liquidate or cease trading. If such an intention or need exists, the financial statements may have to be prepared on a different basis and, if so, the basis used is disclosed in the financial statements.

The reporting entity

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

- 3.12 A reporting entity is not necessarily a legal entity. It can comprise a portion of an entity, or two or more entities.

Boundary of the reporting entity

- 3.13 Financial statements provide information about the assets, liabilities, equity, income and expenses generated by the set of economic activities that lie within the boundary of the reporting entity.

- 3.14 When one entity (the parent) has control over another entity (the subsidiary), it would be possible to determine the boundary of the reporting entity using either:

- (a) direct control only (see paragraphs 3.19–3.20); or
- (b) both direct and indirect control (see paragraphs 3.21–3.25).¹³

- 3.15 In this [draft] *Conceptual Framework*:

- (a) financial statements of a reporting entity whose boundary is based on direct control only are called unconsolidated financial statements; and
- (b) financial statements of a reporting entity whose boundary is based on both direct and indirect control are called consolidated financial statements.

- 3.16 For financial statements to give a faithful representation of the economic activities of the reporting entity, they need to describe the set of economic activities included within the reporting entity.

¹³ The notion of control is discussed in paragraphs 4.17–4.23.

- 3.17 Financial statements are sometimes prepared for two or more entities that do not have a parent-subsidiary relationship with each other. These financial statements are referred to as combined financial statements.
- 3.18 If a reporting entity is not a legal entity, the boundary of the reporting entity needs to be set in such a way that the financial statements:
- (a) provide the relevant financial information needed by those existing and potential investors, lenders and other creditors who rely on the financial statements; and
 - (b) faithfully represent the economic activities of the entity.

Direct control only

- 3.19 In unconsolidated financial statements, the parent reports only on:
- (a) the economic resources it controls directly; and
 - (b) the direct claims against the parent.
- Hence, the investment in the controlled entity (the subsidiary) is reported as an asset.
- 3.20 The returns to investors, lenders and other creditors of a parent depend on the future net cash inflows to the parent entity. The lenders and other creditors of the parent often do not have a claim against the subsidiary. In addition, in some jurisdictions, dividends to holders of shares issued by the parent depend on the distributable profits of the parent. Hence, distinguishing economic resources held directly by the parent from those held by its subsidiaries can provide useful information to users of financial statements. One way to provide information about economic resources held directly by the parent, and about direct claims against the parent, is to determine the boundary of the reporting entity using direct control only.

Both direct and indirect control

- 3.21 In consolidated financial statements, the reporting entity reports on:
- (a) the economic resources that the parent controls directly and those that it controls indirectly by controlling its subsidiaries; and
 - (b) the direct claims against the parent and the indirect claims against it through claims against its subsidiaries.
- 3.22 The returns to investors, lenders and other creditors of a parent depend partly on the future net cash flows to the parent from the subsidiary. Those cash flows depend on the future net cash inflows to the subsidiary. To assess the prospects for future net cash inflows to the parent entity, investors, lenders and other creditors need information about:
- (a) the economic resources, claims and changes in economic resources and claims of both the parent and its subsidiaries as a single unit; and
 - (b) how efficiently and effectively the parent's management have discharged their responsibilities to use the resources of both the parent and its subsidiaries.

- 3.23 Consequently, in general, consolidated financial statements are more likely to provide useful information to users of financial statements than unconsolidated financial statements.
- 3.24 Consolidated financial statements of the parent are not intended to provide information to users of a subsidiary's financial statements. Investors, lenders and other creditors of a subsidiary seek information about the subsidiary's resources, and the claims against the subsidiary, from the financial statements of the subsidiary.
- 3.25 When an entity is required to present consolidated financial statements, the entity may also choose, or be required, to present unconsolidated financial statements. To enable users to receive the information they need about all the economic resources the parent controls, both directly and indirectly, and about claims against both the parent and its subsidiaries, it is necessary to disclose in the unconsolidated financial statements how users may obtain the consolidated financial statements.

Chapter 4—The elements of financial statements

Introduction

- 4.1 This chapter covers:
- (a) the definition of an asset (paragraphs 4.5–4.23);
 - (b) the definition of a liability (paragraphs 4.24–4.39);
 - (c) executory contracts (paragraphs 4.40–4.42);
 - (d) equity (paragraphs 4.43–4.47);
 - (e) the definitions of income and expenses (paragraphs 4.48–4.52);
 - (f) reporting the substance of contractual rights and obligations (paragraphs 4.53–4.56); and
 - (g) the unit of account (paragraphs 4.57–4.63).
- 4.2 Financial statements provide information about the financial effects of transactions and other events by grouping them into broad classes—the elements of financial statements.
- 4.3 The elements defined in this [draft] *Conceptual Framework* are:
- (a) assets, liabilities and equity, which relate to the reporting entity's financial position; and
 - (b) income and expenses, which relate to the reporting entity's financial performance.

4.4 The elements are linked to resources, claims and financial performance as discussed in Chapter 1 and are defined as follows:

Item discussed in Chapter 1	Element	Definition or description
Resources	An asset	An asset is 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.
Claims	A liability	A liability is a present obligation of the entity to transfer an economic resource as a result of past events.
	Equity	Equity is the residual interest in the assets of the entity after deducting all its liabilities.
Financial performance (changes in resources and claims)	Income	Income is 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	Expenses are decreases in assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to holders of equity claims.
Other changes in resources and claims	–	Contributions from, and distributions to, holders of equity claims.
	–	Exchanges that do not result in increases or decreases in equity (for example, acquiring an asset for cash).

Definition of an asset

- 4.5 An asset is a present economic resource controlled by the entity as a result of past events.
- 4.6 An economic resource is a right that has the potential to produce economic benefits.
- 4.7 Aspects of those definitions are discussed as follows:
- (a) rights (see paragraphs 4.8–4.12);
 - (b) potential to produce economic benefits (see paragraphs 4.13–4.16); and
 - (c) control (see paragraphs 4.17–4.23).

Rights

- 4.8 Rights that constitute economic resources may take the following forms:
- (a) rights established by contract, legislation or similar means, such as:
 - (i) rights arising from a financial instrument, for example, an investment in a debt instrument or in an equity instrument.
 - (ii) rights over physical objects, such as property, plant and equipment or inventories. Such rights may include ownership of a physical object, the right to use a physical object or the right to the residual value of a leased object.
 - (iii) rights to exchange economic resources with another party on favourable terms, for example, a forward contract to buy an economic resource (see paragraphs 4.40–4.42) or an option to buy an economic resource (see paragraph 4.15).
 - (iv) rights to benefit from the obligations of another party to stand ready to transfer an economic resource if an uncertain future event occurs (see paragraph 4.27).
 - (v) rights to receive goods or services.
 - (vi) intellectual property rights, for example, registered patents.
 - (b) rights arising from a constructive obligation of another party (see paragraph 4.34); and
 - (c) other rights that give the entity the potential to receive future economic benefits that are not available to all other parties, for example, rights to the economic benefits that may be produced by items such as know-how not in the public domain or by customer or supplier relationships (see paragraph 4.20).
- 4.9 Goods or services (for example, employee services) that are received and immediately consumed are momentarily rights to obtain economic benefits until they are consumed.
- 4.10 If an entity has rights that are identical to those held by all other parties, those rights do not give the entity the potential to receive economic benefits beyond

those available to all other parties. For example, rights of access to public goods, such as roads, or knowledge that is in the public domain are not economic resources for the entity if similar rights are available to all parties without significant cost.

- 4.11 An entity cannot have a right to receive economic benefits from itself, hence:
- (a) debt or equity instruments issued by the entity and repurchased and held by it (for example, treasury shares) are not economic resources of that entity; and
 - (b) in consolidated financial statements, debt or equity instruments issued by one member of the consolidated reporting entity and held by another member of that reporting entity are not economic resources of the reporting entity.
- 4.12 In principle, each of an entity's rights is a separate asset. However, for accounting purposes, related rights are often treated as a single asset, namely the unit of account (see paragraphs 4.57–4.63). For example, the following rights may arise from legal ownership of a physical object:
- (a) the right to use the object;
 - (b) the right to sell the object;
 - (c) the right to pledge the object; and
 - (d) other rights not mentioned separately in (a)–(c).

In many cases, the set of rights arising from legal ownership of a physical object is accounted for as a single item. Conceptually, the economic resource is the set of rights not the physical object. Nevertheless, describing the set of rights as the physical object will often provide the most concise, clear and understandable information.

Potential to produce economic benefits

- 4.13 For the economic resource to have the potential to produce economic benefits, it need not be certain, or even probable, that the resource will produce economic benefits. It is only necessary that the economic resource already exists and that there is at least one circumstance in which it would produce economic benefits.
- 4.14 The economic benefits produced by an economic resource could include:
- (a) receiving contractual cash flows;
 - (b) receiving another economic resource or exchanging economic resources with another party on favourable terms (see paragraphs 4.40–4.42);
 - (c) using the economic resource to produce cash inflows (or save cash outflows), for example;
 - (i) using the economic resource singly or in combination with other economic resources to produce goods or provide services;
 - (ii) using the economic resource to enhance the value of other economic resources;
 - (iii) pledging the economic resource to secure a loan;

- (iv) leasing the economic resource to another party; or
 - (v) receiving services to which the economic resource gives rights.
- (d) selling the economic resource in exchange for cash or other economic resources, or transferring the economic resource to fulfil liabilities; or
- (e) satisfying equity claims, in whole or in part, by distributing the economic resource to holders of equity claims.

4.15 Although an economic resource derives its value from its existing potential to produce future economic benefits, the economic resource is the existing right, not the future economic benefits. For example, a purchased option derives its value from its existing potential to produce economic benefits if the option is exercised. However, the economic resource is the existing right to exercise the option, not the future economic benefits.

4.16 There is a close association between incurring expenditure and acquiring assets, but the two do not necessarily coincide. Hence, when an entity incurs expenditure, this may provide evidence that future economic benefits have been sought, but is not conclusive proof that an asset has been obtained. Similarly, the absence of related expenditure does not preclude an item from meeting the definition of an asset. Assets can include, for example, rights that have been granted to the entity free of charge by a government or donated to the entity by another party.

Control

4.17 Control links the economic resource to the entity. Assessing control helps to identify what economic resource the entity should account for. For example, an entity may have a right to a proportionate share in a property without controlling the entire property. In such cases, the entity's asset is its share in the property, which it controls, not the property itself, which it does not.

4.18 An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that flow from it.

4.19 An entity has the ability to direct the use of an economic resource if it has the right to deploy that economic resource in its activities, or to allow another party to deploy the economic resource in that other party's activities.

4.20 Although control of an economic resource usually arises from legal rights, it can also arise if an entity has the present ability to prevent all other parties from directing the use of it and obtaining the benefits from the economic resource. For example, an entity may control know-how obtained from a development activity by having the present ability to keep that know-how secret.

4.21 For an entity to control a resource, the economic benefits from the resource must flow to the entity (either directly or indirectly) instead of another party. This aspect of control does not imply that the entity can ensure that the resource will produce economic benefits in all circumstances. Instead, it means that if the resource produces economic benefits, the entity is the party that will receive them.

- 4.22 Having exposure to significant variations in the amount of the economic benefits produced by an economic resource may indicate that the entity controls the resource. However, it is only one factor to consider in the overall assessment of control.
- 4.23 An agent is a party that is primarily engaged to act on behalf of, and for the benefit of, another party (the principal). If an entity holds an economic resource as an agent, the economic benefits arising from the resource flow to the principal instead of the agent. Consequently, the entity does not control the economic resource and it does not have an asset, nor does it have a liability because it has no obligation to transfer any economic resource that it controls or will control.

Definition of a liability

- 4.24 A liability is a present obligation of the entity to transfer an economic resource as a result of past events.
- 4.25 If one party has an obligation to transfer an economic resource (a liability), it follows that another party (or parties) has a right to receive that economic resource (an asset). The party (or parties) could be a specific person or entity, a group of people or entities, or society at large.
- 4.26 A requirement for one party to recognise a liability (or asset) and measure it at a specified amount does not imply that the other party must recognise the corresponding asset (or liability) or measure it at the same amount. Applying different recognition criteria or measurement requirements to the liability (or asset) of one party and the corresponding asset (or liability) of the other party may sometimes be an outcome of decisions intended to meet the objective of financial reporting.

Obligation to transfer an economic resource

- 4.27 An entity's obligation to transfer an economic resource must have the potential to require the entity to transfer an economic resource to another party. It need not be certain, or even probable, that the entity will be required to transfer an economic resource, but the obligation must already exist and there must be at least one circumstance in which it will require the entity to transfer an economic resource. One example of such an obligation is an obligation to stand ready to transfer an economic resource if an uncertain future event occurs.
- 4.28 Obligations to transfer an economic resource include, for example, obligations to:
- (a) pay cash;
 - (b) transfer other assets;
 - (c) exchange economic resources with another party on unfavourable terms (see paragraphs 4.40–4.42);
 - (d) provide services; or
 - (e) issue another obligation that will oblige the entity to transfer an economic resource.

- 4.29 Instead of fulfilling an obligation to transfer an economic resource, entities sometimes:
- (a) settle the obligation by negotiating a release from the obligation;
 - (b) transfer the obligation to a third party; or
 - (c) replace the obligation with another obligation to transfer an economic resource.
- 4.30 An equity claim does not contain an obligation to transfer economic resources. Furthermore, an equity claim is not an economic resource for the issuer. It follows that an obligation of an entity to transfer its own equity claims to another party is not an obligation to transfer an economic resource.

Present obligation

- 4.31 An entity has a present obligation to transfer an economic resource if both:
- (a) the entity has no practical ability to avoid the transfer; and
 - (b) the obligation has arisen from past events; in other words, the entity has received the economic benefits, or conducted the activities, that establish the extent of its obligation.

No practical ability to avoid the transfer

- 4.32 An entity has no practical ability to avoid a transfer if, for example, the transfer is legally enforceable, or any action necessary to avoid the transfer would cause significant business disruption or would have economic consequences significantly more adverse than the transfer itself. It is not sufficient that the management of the entity intends to make the transfer or that the transfer is probable.
- 4.33 If an entity prepares financial statements on a going concern basis, the entity:
- (a) has no practical ability to avoid a transfer that could be avoided only by liquidating the entity or ceasing trading; but
 - (b) has the practical ability to avoid (and hence does not have a liability for) a transfer that would be required only on the liquidation of the entity or on the cessation of trading.
- 4.34 Many obligations are legally enforceable as a consequence of a contract, legislation or similar means. Obligations can also arise, however, from an entity's customary practices, published policies or specific statements that require the transfer of an economic resource. If the entity has no practical ability to act in a manner inconsistent with those practices, policies or statements, the entity has an obligation. The obligation that arises in such situations is often described as a constructive obligation.
- 4.35 In some situations, the requirement for an entity to transfer an economic resource may be expressed as being conditional on a particular future action by the entity, such as conducting particular activities or exercising particular options within a contract. The entity has an obligation if it has no practical ability to avoid that action.

Past event

- 4.36 An entity has a present obligation as a result of a past event only if it has already received the economic benefits, or conducted the activities, that establish the extent of its obligation. The economic benefits received could include, for example, goods or services. The activities conducted could include, for example, operating in a particular market. If the economic benefits are received, or the activities are conducted, over time, a present obligation will accumulate over time (if, throughout that time, the entity has no practical ability to avoid the transfer).
- 4.37 An event establishes the extent of an obligation if it specifies either the amount of the future transfer or the basis for determining that amount. For example, an insurer may enter into a contract to provide insurance coverage in return for a single premium. When the insurer receives the premium, it has an obligation to provide insurance coverage because:
- (a) although the amount of any future transfer still depends on whether an insured event occurs, the insurer has no practical ability to avoid transferring an economic resource if an insured event occurs; and
 - (b) the insurer has received the premium that establishes that it must provide coverage to the extent specified by the contract, and this provides the basis for determining the amount of any future transfer.
- 4.38 A present obligation can exist at the end of the reporting period even if the transfer of economic resources cannot be enforced until some point in the future. For example, a financial liability may not require a payment to be made until a future date. The payment cannot be enforced until that future date, but the liability exists now. Similarly, a contractual obligation for the entity to perform work at a future date cannot be enforced by the counterparty until that future date, but the obligation arising from the contract exists now if the counterparty has already paid for the work (see paragraphs 4.40–4.42).
- 4.39 An entity does not have a present obligation for the costs that will arise if it will receive benefits, or conduct activities, in the future (for example, the costs of future operations); the extent of the future transfer will not be determined by reference to benefits that the entity has received, or activities that it has conducted, in the past. If the entity has entered into a contract that is still executory, the entity may have a present right and obligation to exchange economic resources in the future (see paragraphs 4.40–4.42).

Executory contracts

- 4.40 An executory contract is a contract that is equally unperformed: neither party has fulfilled any of its obligations, or both parties have fulfilled their obligations partially and to an equal extent.
- 4.41 An executory contract establishes a right and an obligation to exchange economic resources. Entering into the contract is the activity that establishes the extent of the entity's right and obligation to exchange economic resources. That right, and the obligation to exchange economic resources, are interdependent and cannot be separated. Hence, the combined right and

obligation constitute a single asset or liability. The entity has an asset if the terms of the exchange are favourable; it has a liability if the terms of the exchange are unfavourable. Whether the asset or the liability is included in the financial statements depends on both the recognition criteria (see Chapter 5) and the measurement basis adopted for the contract (see Chapter 6), including, if applicable, any test for whether the contract is onerous.

- 4.42 To the extent that a party fulfils its obligations under the contract, the contract ceases to be executory. If the reporting entity performs first under the contract, that performance is the event that changes the reporting entity's right and obligation to exchange economic resources into a right to receive an economic resource (ie an asset). If the other party performs first, that performance is the event that changes the reporting entity's right and obligation to exchange economic resources into an obligation to transfer an economic resource (ie a liability).

Equity

- 4.43 Equity is the residual interest in the assets of the entity after deducting all its liabilities.
- 4.44 Equity claims are claims on the residual interest in the assets of the entity after deducting all its liabilities. In other words, they are claims against the entity that do not meet the definition of a liability. Such claims may be established by contract, legislation or similar means, and include (to the extent that they do not meet the definition of a liability):
- (a) shares of various types; and
 - (b) rights to receive an equity claim.
- 4.45 Different equity claims convey to their holders different rights to, for example, receive some or all of the following:
- (a) dividends;
 - (b) the repayment of contributed equity on liquidation; or
 - (c) other equity claims.
- 4.46 To provide useful information, it may be necessary to divide the total carrying amount of equity if, for example, there are:
- (a) more than one class of equity claim; or
 - (b) restrictions on particular components of equity; for example, the rights of particular equity claims may be affected by legal, regulatory or other restrictions on the ability of the entity to distribute its economic resources to the holders of those equity claims.
- 4.47 Business activities are often undertaken by means of entities such as sole proprietorships, partnerships and trusts and various types of government business undertakings. The legal and regulatory framework for such entities is often different from frameworks that apply to corporate entities. For example,

there may be few, if any, restrictions on the distribution to holders of equity claims. Nevertheless, the definition of equity in this [draft] *Conceptual Framework* applies to all entities.

Definitions of income and expenses

- 4.48 Income is increases in assets or decreases in liabilities that result in increases in equity, other than those relating to contributions from holders of equity claims.
- 4.49 Expenses are decreases in assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to holders of equity claims.
- 4.50 It follows from the definitions of income and expenses that transactions with holders of equity claims acting in that capacity do not give rise to income or expenses.
- 4.51 Income and expenses include amounts generated by transactions and other events, including changes in the carrying amount of assets and liabilities.
- 4.52 Income and expenses are the elements of an entity's financial performance. Users of financial statements need information about both an entity's financial position and its financial performance. Hence, although income and expenses are defined in terms of changes in assets and liabilities, information about income and expenses is just as important as the information provided by assets and liabilities.

Reporting the substance of contractual rights and contractual obligations

- 4.53 The terms of a contract create rights and obligations for the entity. To faithfully represent those rights and obligations, financial statements report their economic substance and not merely their legal form (see paragraph 2.14). In some cases, the substance of the rights and obligations is clear from the structure of the contract. In other cases, the terms of the contract, or a group or series of contracts, require detailed analysis to identify the substance of the rights and obligations.
- 4.54 All terms in a contract—whether explicit or implied—are taken into consideration unless they have no commercial substance. Implied terms could include, for example, obligations imposed by statute, such as statutory warranty obligations imposed on entities that enter into contracts for the sale of goods to customers.
- 4.55 Terms that have no commercial substance are disregarded. A term has no commercial substance if it has no discernible effect on the economics of the contracts. Terms that have no commercial substance could include, for example:
- (a) terms that bind neither party; or
 - (b) rights (including options) that the holder will not have the practical ability to exercise.

- 4.56 A group or series of contracts may achieve, or be designed to achieve, an overall commercial effect. In order to report the substance of such contracts, it may be necessary to treat the group or series of contracts as a whole. For example, if the rights or obligations in one contract entirely negate the rights or obligations in another contract entered into at the same time with the same counterparty, the combined effect is that no rights or obligations exist. Conversely, if a single contract creates two or more sets of rights and obligations that would have been identical if each set had been created through separate contracts, the entity may need to account for each set as if it arose from separate contracts in order to faithfully represent the rights and obligations (see paragraphs 4.57–4.63).

Unit of account

- 4.57 The unit of account is the group of rights, the group of obligations or the group of rights and obligations, to which recognition and measurement requirements are applied.
- 4.58 A unit of account is selected for an asset or a liability after considering how recognition and measurement will apply, not only to that asset or liability, but also to the related income and expenses. The selected unit of account may need to be aggregated or disaggregated for presentation or disclosure purposes.
- 4.59 In some circumstances, it may be appropriate to select one unit of account for recognition and a different unit of account for measurement (for example, contracts may sometimes be recognised individually but measured as part of a portfolio of contracts).
- 4.60 Sometimes, both rights and obligations arise from the same source. For example, contracts can establish both rights and obligations for each of the parties. If the rights and obligations are separable, then the rights may be combined separately from the obligations, resulting in the identification of one or more separate assets and liabilities. Alternatively, separable rights and obligations may be included in a single unit of account, ie a single asset or a single liability. The inclusion of rights and obligations in a single asset or a single liability is not the same as offsetting assets and liabilities (see paragraph 7.13). Offsetting occurs when an entity identifies, recognises and measures both an asset and a liability as two separate units of account, but presents them in the statement of financial position as a single net amount.
- 4.61 Possible units of account include:
- (a) all rights or all obligations (or all rights and obligations) arising from a single source, such as a contract;
 - (b) a subgroup of those rights and/or obligations—such as a subgroup of rights over an item of property, plant and equipment for which the useful life and depreciation method differ from those of the other rights over that item;
 - (c) the combined rights and/or obligations arising from a portfolio of similar sources;

- (d) the combined rights and/or obligations arising from a portfolio of dissimilar items—such as a portfolio of assets and liabilities to be disposed of in a single transaction; and
 - (e) a risk exposure within a portfolio of items—if a portfolio of items is subject to a common risk, some aspects of the accounting for that portfolio could focus on the aggregate exposure to that risk within the portfolio.
- 4.62 The objective in selecting a unit of account is to provide the most useful information that can be obtained at a cost that does not exceed the benefits. To meet this objective:
- (a) the information provided about the resulting asset, liability, income and expenses must be relevant. Treating a group of rights and obligations as a single unit of account may provide more relevant information if, for example, those rights and obligations:
 - (i) cannot (or are unlikely to) be the subject of separate transactions.
 - (ii) cannot (or are unlikely to) expire in different patterns.
 - (iii) are used together in the context of the business activities conducted by the entity to produce cash flows and are measured by reference to the estimates of their interdependent future cash flows.
 - (iv) have similar economic characteristics and risks. Rights and obligations with different characteristics and risks are likely to have different implications for the prospects for future net cash inflows to an entity and so may need to be separated.
 - (b) the asset, liability, income and expenses recognised must faithfully represent the substance of the transaction from which they have arisen. To achieve this, it may be necessary to treat the rights or obligations arising from different sources as a single unit of account or to separate the rights or obligations arising from a single source (see paragraphs 4.53–4.56). Moreover, to provide a faithful representation of unrelated rights and obligations, it may be necessary to recognise and measure them separately.
 - (c) as with other aspects of financial reporting, the costs of providing the information for that unit of account must not exceed the benefits. In general, the costs associated with recognising and measuring assets, liabilities, income and expenses increase as the size of the unit of account decreases. Hence, in general, rights or obligations arising from the same source are separated only if the resulting information is more useful and the benefits exceed the costs.
- 4.63 If an entity transfers part of an asset or part of a liability, the unit of account may change at that time so that the transferred component and the retained component become separate units of account (see paragraphs 5.25–5.32).

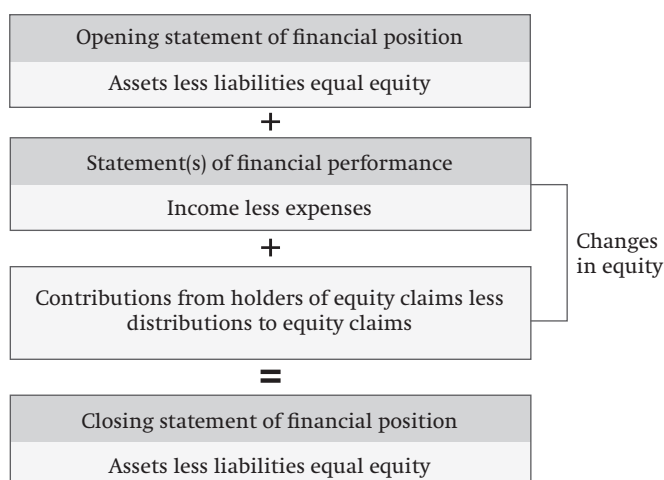
Chapter 5—Recognition and derecognition

Introduction

- 5.1 This chapter discusses:
- (a) the recognition process (paragraphs 5.2–5.8);
 - (b) recognition criteria (paragraphs 5.9–5.24); and
 - (c) derecognition (paragraphs 5.25–5.36).

The recognition process

- 5.2 Recognition is the process of capturing, for inclusion in the statement of financial position or the statement(s) of financial performance, an item that meets the definition of an element. It involves depicting the item (either alone or as part of a line item) in words and by a monetary amount, and including that amount in totals in the relevant statement. (Chapter 7 discusses how recognised amounts are presented and disclosed in the financial statements.)
- 5.3 Recognising assets, liabilities, equity, income and expenses depicts economic resources and claims, and changes in those resources and claims, in a structured summary that is intended to be comparable and understandable. An important feature of that summary is that the amounts recognised in a statement are included in the totals and, if applicable, subtotals, that give structure to the statement.
- 5.4 Recognition links the elements, the statement of financial position and the statement(s) of financial performance as follows:
- (a) in the opening and closing statements of financial position, total assets less total liabilities equal total equity;
 - (b) recognised changes in equity during the period comprise:
 - (i) income less expenses recognised in the statement(s) of financial performance; plus
 - (ii) contributions from holders of equity claims, less distributions to holders of equity claims.
- 5.5 This linkage is illustrated in the following diagram:



5.6 The linkage between the statements arises because the recognition of one element (or a change in one element) requires the recognition of an equal amount in one or more other elements (or changes in one or more other elements). For example, income and expenses are recognised in the statement(s) of financial performance only if an increase or decrease in the carrying amount of an asset or a liability is also recognised. Hence, for example:

- (a) the recognition of income occurs simultaneously with:
 - (i) the initial recognition of an asset, or an increase in the carrying amount of an asset; or
 - (ii) the derecognition of a liability, or a decrease in the carrying amount of a liability.
- (b) the recognition of expenses occurs simultaneously with:
 - (i) the initial recognition of a liability, or an increase in the carrying amount of a liability; or
 - (ii) the derecognition of an asset, or a decrease in the carrying amount of an asset.

5.7 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 recognised in the statement(s) of financial performance. However, the purpose of financial statements is not to show the value of the entity and, therefore, not all assets and liabilities are recognised. The criteria for recognising assets and liabilities are discussed in paragraphs 5.9–5.24. The need for disclosures about unrecognised assets and liabilities is discussed in paragraphs 7.2–7.3.

5.8 The recognition of assets or liabilities arising from transactions or other events sometimes results in the simultaneous recognition of both income and related expenses. For example, the sale of goods for cash results in the recognition of both income (from the recognition of an asset for the customer consideration)

and expenses (from the derecognition of the asset comprising the goods that were sold). The simultaneous recognition of income and related expenses is sometimes referred to as the matching of costs with income. The concepts in this [draft] *Conceptual Framework* lead to such matching when it arises from the recognition of changes in assets and liabilities. However, these concepts do not allow the recognition in the statement of financial position of items that do not meet the definition of assets or liabilities.

Recognition criteria

- 5.9 Failure to recognise items that meet the definition of an element makes the statement of financial position and the statement(s) of financial performance less complete and can exclude useful information from financial statements. On the other hand, in some circumstances, the recognition of some items that meet the definition of an element can provide information that is not useful. An entity recognises an asset or a liability (and any related income, expenses or changes in equity) if such recognition provides users of financial statements with:
- (a) relevant information about the asset or the liability and about any income, expenses or changes in equity (see paragraphs 5.13–5.21);
 - (b) a faithful representation of the asset or the liability and of any income, expenses or changes in equity (see paragraphs 5.22–5.23); and
 - (c) information that results in benefits exceeding the cost of providing that information (see paragraph 5.24).
- 5.10 It is not possible to define precisely when recognition of an item that meets the definition of an element will provide useful information to the users of financial statements. What is useful to users depends on the item and the specific facts and circumstances. Consequently, judgement is required when deciding whether to recognise an item and recognition requirements may need to vary between Standards.
- 5.11 If an item meeting the definition of an element is not recognised, disclosures may be needed. It is important to consider how to make such disclosures sufficiently visible to compensate for the absence of the item from the summary provided by the statement of financial position or the statement(s) of financial performance.
- 5.12 It is important when making decisions about recognition to consider the information that would be given by not recognising an asset. For example, if no asset is recognised when expenditure is incurred, an expense is recognised. Over time, recognising those expenses may, in some cases, provide useful information, such as information about trends, at a lower cost than recognising an asset.

Relevance

- 5.13 Information about assets, liabilities, equity, income and expenses is relevant to users of financial statements. However, if one or more of the following factors applies, recognition may not provide relevant information:

- (a) if it is uncertain whether an asset exists, or is separable from goodwill, or whether a liability exists (see paragraphs 5.15–5.16);
- (b) if an asset or a liability exists, but there is only a low probability that an inflow or outflow of economic benefits will result (see paragraphs 5.17–5.19); or
- (c) if a measurement of an asset or a liability is available (or can be obtained), but the level of measurement uncertainty is so high that the resulting information has little relevance and no other relevant measure is available or can be obtained (see paragraphs 5.20–5.21).

5.14 Deciding whether recognition will provide relevant information requires the exercise of judgement. It will often be a combination of the factors described in paragraph 5.13, instead of any single factor, that causes information to lack relevance. Moreover, other factors may also cause information to lack relevance.

Existence uncertainty and separability

5.15 Some assets, for example, rights to benefit from items such as know-how and customer or supplier relationships, are not contractual or other legal rights. It may therefore be uncertain whether there is an asset or whether it is separable from the business as a whole (that is, it may be unclear whether there is an asset distinct from goodwill). In some such cases, uncertainty about the existence of an asset combined with the difficulty of separately identifying the asset may mean that recognition may not provide relevant information.

5.16 For some liabilities, it may be unclear whether a past event causing an obligation has occurred. For example, if another party claims that the entity has committed an act of wrongdoing and should compensate the other party for that act, it may be uncertain whether the act occurred or whether the entity committed it. In some such cases, the uncertainty about the existence of an obligation, possibly combined with a low probability of outflows of economic benefits and a high level of measurement uncertainty, may mean that the recognition of a single amount would not provide relevant information. Whether or not the liability is recognised, disclosures about the uncertainties associated with the liability may be needed.

Low probability of a flow of economic benefits

5.17 An asset or a liability can exist even if there is a low probability that there will be an inflow or outflow of economic benefits (see paragraphs 4.13 and 4.27).

5.18 Even if the probability of an inflow or outflow of economic benefits is low, recognition of the asset or the liability may provide relevant information, especially if the measurement of the asset or the liability reflects the low probability and is accompanied by explanatory disclosures. For example, if an asset is acquired, or a liability is incurred, in an exchange transaction for an observable price, its cost reflects the low probability that economic benefits will flow and that cost may be relevant information.

5.19 However, users of financial statements may, in some cases, not find it useful for an entity to recognise assets and liabilities with very low probabilities of inflows and outflows of economic benefits.

Measurement uncertainty

- 5.20 To be recognised, an asset or a liability must be measured. In many cases, measurements must be estimated and are subject to uncertainty. The use of reasonable estimates is an essential part of the preparation of financial statements and does not necessarily undermine their usefulness. A faithful representation is achieved if amounts that are estimates are described as such, and the nature and level of uncertainties, if material, are disclosed in the notes to the financial statements.
- 5.21 As noted in paragraph 2.13, for some estimates, a high level of measurement uncertainty may contribute to the resulting information having little relevance, even if the estimate is properly described and disclosed. For example, a measurement may not provide relevant information if:
- (a) the range of possible outcomes is extremely wide and the likelihood of each outcome is exceptionally difficult to estimate. In such cases, the most relevant information for users of financial statements may relate to the range of outcomes and the factors affecting their likelihoods. When that information is relevant (and can be provided at a cost that does not exceed the benefits), disclosure of that information in the notes to the financial statements may be appropriate, regardless of whether the entity also recognises the asset or the liability. However, in some cases, trying to capture that information in a single number may not provide any further relevant information. In such cases, if no relevant measure is available, or can be obtained, recognition would not provide relevant information.
 - (b) measuring the resource or obligation requires unusually difficult or exceptionally subjective allocations of cash flows that do not relate solely to the item being measured.

Faithful representation

- 5.22 Faithful representation of assets, liabilities, equity, income and expenses involves not only recognition, but also the measurement, presentation and disclosure of information about the items recognised (see Chapters 6–7).
- 5.23 Hence, when assessing whether the recognition of an asset or a liability can provide a faithful representation of the asset or the liability, it is necessary to consider not merely its description and measurement on the face of the statement of financial position, but also:
- (a) the depiction of resulting income, expenses or equity; for example, if an entity acquires an asset in exchange for consideration, the failure to recognise the asset would result in an expense and reduce the entity's profit and equity. In some cases, for example, if the entity does not consume the asset immediately, that result could provide a misleading representation that the entity's financial position has deteriorated.
 - (b) whether related assets and liabilities are recognised. If related assets and liabilities are not recognised, recognition may lead to an 'accounting mismatch', which may not provide an understandable or faithful representation of the overall effect of the transaction or other event

giving rise to the asset or the liability, even if explanatory disclosure is provided in the notes to the financial statements.

- (c) related disclosures: a complete depiction includes all information necessary for a user of financial statements to understand the phenomenon being depicted, including all necessary descriptions and explanations. Hence, related disclosures can enable a recognised amount to form part of a faithful representation of an asset, liability, equity claim, income or expenses.

Cost

- 5.24 As with all other areas of financial reporting, cost constrains recognition decisions. There is a cost to recognising an asset or a liability. Preparers of financial statements incur costs in obtaining a relevant measure. Users of financial statements also incur costs in analysing and interpreting information. In some cases, the cost of recognition may outweigh the benefits.

Derecognition

- 5.25 Derecognition is the removal of all or part of a previously recognised asset or liability from an entity's statement of financial position. For an asset, this normally occurs when the entity loses control of all or part of the previously recognised asset; for a liability this normally occurs when the entity no longer has a present obligation for all or part of the previously recognised liability.
- 5.26 Accounting requirements for derecognition aim to represent faithfully both:
- (a) the assets and liabilities retained after the 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
 - (b) the change in the entity's assets and liabilities as a result of that transaction or other event.
- 5.27 Those aims are normally achieved by:
- (a) derecognising any assets or liabilities that have been transferred, consumed, collected or fulfilled, or have expired and recognising any resulting income or expense.
 - (b) continuing to recognise the assets or liabilities retained, if any (the retained component), which become a separate unit of account. Accordingly, no income or expenses are recognised on the retained component as a result of the derecognition of the transferred component.
- 5.28 If an entity transfers a previously recognised asset or liability to another party that is acting as its agent (see paragraph 4.23), then the asset is still controlled by the transferor (the liability is still an obligation of the transferor) and derecognition would not faithfully represent the transferor's assets, liabilities, income and expenses.

- 5.29 If an entity retains exposure to positive or negative variations in the amount of economic benefits produced by an economic resource, this may indicate that the entity retains control of that economic resource, in which case, derecognition is not appropriate.
- 5.30 It may sometimes be difficult to achieve both aims mentioned in paragraph 5.26, for example:
- (a) if the retained component contains a disproportionate exposure to variations in economic benefits, derecognition may faithfully represent the fact that the entity no longer has the components that have been transferred, but may not faithfully represent the extent of the change in the entity's assets or liabilities as a result of the transaction.
 - (b) sometimes, at the same time as transferring an asset, the entity enters into another transaction (for example, a forward contract, a written put option, or a purchased call option) under which the entity must or may reacquire the asset. Because the component that has been transferred must or may be reacquired, derecognising it may misrepresent the extent of the change in the entity's financial position.
- 5.31 In some of the circumstances described in paragraph 5.30, derecognition may achieve the two aims described in paragraph 5.26 if supported by separate presentation, or explanatory disclosure, in the notes to the financial statements; for example, to highlight any greater concentration of risk in the retained component.
- 5.32 However, if derecognition supported by separate presentation, or explanatory disclosure, is not sufficient to achieve those two aims, there may be a need to continue to recognise not only the retained component, but also the transferred component. In applying this approach:
- (a) no income or expenses are recognised on either component as a result of the transaction;
 - (b) a liability (or asset) is recognised and measured initially at the amount of any proceeds received (or paid) upon transfer of the asset (or liability); and
 - (c) separate presentation, or explanatory disclosure, is needed to depict the fact that the entity no longer has any rights or obligations under the transferred component.

Modification of contracts

- 5.33 One case in which questions about derecognition arise is when a contract is modified. Modifications of contracts may do one or both of the following:
- (a) reduce or eliminate existing rights and obligations. The discussion in paragraphs 5.25–5.32 is relevant in deciding whether to derecognise those rights or obligations.
 - (b) add new rights or new obligations.

- 5.34 If a modification to a contract adds rights and obligations that are distinct from those created by the original terms of the contract, it may be appropriate to treat the additions as new assets or liabilities.
- 5.35 If the rights and obligations added to a contract by a modification are not distinct from those arising under the original terms of the contract, it may be appropriate to treat the new rights and obligations as part of the same unit of account as the existing rights and obligations.
- 5.36 Some modifications of contracts both reduce or eliminate existing rights and obligations and add new rights and obligations. To provide the most relevant information about such modifications in the way that most faithfully represents their effect, it is necessary to consider their combined effect and not merely consider them separately.

Chapter 6—Measurement

Introduction

- 6.1 This chapter discusses:
- (a) measurement bases and the information that they provide (paragraphs 6.4–6.47);
 - (b) factors to consider when selecting a measurement basis (paragraphs 6.48–6.73).
 - (c) situations when more than one measurement basis provides relevant information (paragraphs 6.74–6.77); and
 - (d) measurement of equity (paragraphs 6.78–6.80).
- 6.2 Measurement is the process of quantifying, in monetary terms, information about an entity's assets, liabilities, equity, income and expenses. A measure is the result of measuring an asset, a liability, equity or an item of income or expense on a specified measurement basis. A measurement basis is an identified feature of an item being measured (for example, historical cost, fair value or fulfilment value). Applying a measurement basis to an asset or a liability creates a measure for that asset or liability and for any related income or expense. Paragraphs 6.78–6.80 discuss the measurement of equity.
- 6.3 Consideration of the objective of financial reporting, the qualitative characteristics of useful financial information and the cost constraint is likely to result in the selection of different measurement bases for different assets, liabilities and items of income and expense.

Measurement bases and the information that they provide

- 6.4 Measurement bases can be categorised as:
- (a) historical cost (paragraphs 6.6–6.18); or
 - (b) current value (paragraphs 6.19–6.46).
- 6.5 Paragraphs A1–A10 discuss cash-flow-based measurement techniques. These techniques are often used to estimate a measure on a particular measurement basis.

Historical cost

- 6.6 Measures based on historical cost provide monetary information about assets, liabilities, income and expenses using information derived from the transaction or event that created them. The historical cost measures of assets or liabilities do not reflect changes in prices. However, the measures do reflect changes such as the consumption or impairment of assets and the fulfilment of liabilities.
- 6.7 The historical cost of a non-financial asset at the time of the asset's acquisition or construction is the value of all the costs incurred in acquiring or constructing the asset, including both the consideration given and the transaction costs incurred. That amount is adjusted over time to depict, if and when applicable:

- (a) the consumption of the economic resource that constitutes the asset (depreciation or amortisation); and
 - (b) the fact that part of the historical cost of the asset is no longer recoverable (impairment).
- 6.8 The historical cost of a non-financial liability at the time it is incurred is the value of the consideration received, comprising the consideration less the transaction costs incurred in taking it on. That amount is adjusted over time to depict, if and when applicable:
- (a) accrual of interest;
 - (b) fulfilment of the liability; and
 - (c) any excess in the estimated cash outflows over the net consideration received (onerous liabilities). As a result, the carrying amount of a liability is increased when it becomes so onerous that the historical consideration is no longer sufficient to depict the requirement to fulfil the liability.
- 6.9 The historical cost of a financial asset (sometimes referred to as amortised cost) is initially the value of the consideration given to acquire the asset plus the transaction costs relating to the acquisition. The historical cost of a financial liability (again, sometimes referred to as amortised cost) is initially the value of the consideration received to take on the liability less the transaction costs incurred in taking it on. The subsequent carrying amount of financial assets and financial liabilities measured using amortised cost reflects subsequent changes such as the accrual of interest, changes in the estimates of cash flows (including the impairment of financial assets) and payments or receipts, but does not reflect subsequent changes in prices caused by other factors.
- 6.10 The derecognition of assets (liabilities) measured at historical cost results in the recognition as income or expenses of any difference between the carrying amount of the asset (liability) and any consideration received (paid) for that asset (liability).
- 6.11 The assets acquired and the liabilities incurred in transactions that involve no exchange do not have a readily identifiable initial cost. In such cases, current values are sometimes used as a proxy for cost (deemed cost) on initial measurement and that deemed cost is then used as a starting point for subsequent measurement.
- 6.12 The information provided by historical cost measures of assets, liabilities, income and expenses in both the statement of financial position and the statement(s) of financial performance is summarised in Table 6.1, following paragraph 6.47. Paragraphs 6.13–6.17 summarise the main advantages and disadvantages of historical cost.
- 6.13 Income and expenses measured at historical cost may have predictive value. For example, for non-financial assets, information about the consideration received from supplying goods and services in the past, and about the past consumption of assets (including services received), can be used as some of the inputs needed in assessing an entity's prospects for future cash flows from the future supply of

goods and services and from the future consumption of existing and future assets (including services to be received). Information about past margins can be used as one input in predicting future margins.

- 6.14 Income and expenses measured at historical cost may also have confirmatory value by providing feedback about previous estimates of cash flows or margins.
- 6.15 In many situations, it is simpler and less expensive to provide information about historical cost than information using current value measurement bases. In addition, measures prepared using the historical cost measurement basis are generally well understood and, in many cases, verifiable.
- 6.16 As noted in paragraph 6.11, historical cost can be difficult to determine when there is no observable transaction price for the asset or the liability being measured. In addition, estimating consumption and identifying impairment losses or onerous liabilities can be subjective. Hence, the historical cost of an asset or a liability can sometimes be as difficult to estimate as a current value.
- 6.17 On the historical cost measurement basis, similar assets or liabilities that are acquired or incurred at different times can be reported in the financial statements at very different amounts. This can reduce comparability both between reporting entities and within the same reporting entity.
- 6.18 The current cost of an asset (liability) is the cost of (proceeds from) an equivalent asset (liability) at the measurement date. Current cost and historical cost are both entry values (ie they reflect values in the market in which the entity acquires the asset or incurs the liability). Hence, they are different from the current value measurement bases described in paragraphs 6.19–6.46. Information about the current cost of assets or liabilities may sometimes be more relevant than information about their historical cost, particularly when price changes are significant. For example, reporting income and expenses based on current costs:
- (a) may sometimes be more useful for predicting future margins than information based on historical costs.
 - (b) may be necessary if a physical capital maintenance concept is used in financial statements. Chapter 8 discusses capital maintenance.

Current value

- 6.19 Measures based on current value provide monetary information about assets, liabilities, income and expenses using information that is updated to reflect conditions at the measurement date. Because of the updating, current values capture any positive or negative changes, since the previous measurement date, in estimates of cash flows and other factors included in those current values (see paragraph 6.23).
- 6.20 Current value measurement bases include:
- (a) fair value (see paragraphs 6.21–6.33); and
 - (b) value in use for assets and fulfilment value for liabilities (see paragraphs 6.34–6.46).

Fair value

- 6.21 Fair value is 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.
- 6.22 Fair value reflects the perspective of market participants. That is, the asset or the liability is measured using the same assumptions that market participants would use when pricing the asset or the liability if those market participants act in their economic best interest.
- 6.23 Fair value reflects the following factors:
- (a) estimates of future cash flows.
 - (b) possible variations in the estimated amount and timing of future cash flows for the asset or the liability being measured, caused by the uncertainty inherent in the cash flows.
 - (c) the time value of money.
 - (d) the price for bearing the uncertainty inherent in the cash flows (ie a risk premium or risk discount). The price for bearing that uncertainty depends on the extent of that uncertainty. It also reflects the fact that investors would generally pay less for an asset (generally expect to receive more for taking on a liability) that has uncertain cash flows than for an asset (liability) whose cash flows are certain.
 - (e) other factors, such as liquidity, that market participants would take into account in the circumstances.
- 6.24 For a liability, the factors mentioned in paragraph 6.23(b) and 6.23(d) include the possibility that the entity may fail to fulfil the liability (own credit risk).
- 6.25 As noted in paragraph 6.23(d), the fair value of an asset or a liability reflects a risk premium. Thus, when an entity takes on a liability in a transaction that involves no exchange and measures it on initial recognition at fair value, the expense recognised at that date includes the risk premium. As the entity is subsequently released from risk, the liability is reduced and income is recognised. Including the risk premium in the measure of the liability depicts the full burden of the liability. However, users may sometimes find it counterintuitive to recognise an initial expense including the risk premium, and then subsequently to recognise the same amount as income.
- 6.26 The fair value of:
- (a) an asset is not increased by the transaction costs incurred when acquiring the asset. Nor is it decreased by the transaction costs that would be incurred on selling the asset.
 - (b) a liability is not decreased by the transaction costs arising when the liability is incurred. Nor is it increased by the transaction costs that would be incurred on transferring or settling the liability.
- 6.27 The information provided by the fair value measures of assets, liabilities, income and expenses in both the statement of financial position and the statement(s) of

financial performance is summarised in Table 6.1 following paragraph 6.47. Paragraphs 6.28–6.33 summarise the main advantages and disadvantages of fair value.

- 6.28 Information given about assets and liabilities when they are measured at fair value has predictive value, because fair value reflects expectations about the amount, timing and uncertainty of the cash flows (reflecting market participants' expectations and priced in a manner that reflects their risk preferences). It may also have confirmatory value by providing feedback about previous estimates.
- 6.29 Income and expenses measured at fair value could be split in various ways to provide information with predictive and confirmatory value. For example, they could be split into:
- (a) the return that market participants would have expected from holding the asset during the period;
 - (b) the difference between that return and the return generated by the entity's actual use of the asset during the period (providing information about the efficiency with which the entity has used the asset); and
 - (c) the effect of changes in estimates of market participants' expectations about the amount, timing and uncertainty of future returns, combined with changes in estimates of market participants' risk preferences.
- 6.30 However, depending on the item that is being measured and the nature of the business activities conducted by the entity, users may not always find information about estimates of changes in expectations of market participants relevant. Hence, they may not always find income and expenses measured at fair value relevant. In particular, this may be the case when the business activities conducted by the entity do not involve selling the asset or transferring the liability; for example, if assets are held solely for use or to collect contractual cash flows, or if liabilities are to be fulfilled by the reporting entity itself.
- 6.31 Because fair value is determined from the perspective of market participants, instead of the perspective of the entity, and is independent of when the asset or the liability was acquired or incurred, identical assets will (subject to estimation error) be measured at the same amount. This can enhance comparability both between reporting entities and within the same reporting entity.
- 6.32 If the fair value of an asset or a liability can be observed in an active market, the process of fair value measurement is simple and easy to understand, and the fair value is verifiable. If fair value cannot be observed, valuation techniques (sometimes including the use of cash-flow-based measurements) may be needed to estimate that fair value. Depending on the techniques used:
- (a) the estimation process may be costly and complex.
 - (b) the inputs into the process may be subjective and it may be difficult to verify both the inputs and the validity of the process itself. As a consequence, entities may measure identical assets or liabilities at different amounts, which reduces comparability.

- 6.33 If an entity is estimating the fair value of a specialised item, there may sometimes be little reason for the entity to assume that market participants would use assumptions different from those that the entity itself uses. In that case, measurement from a market participant perspective and measurement from the entity's perspective are likely to produce similar measures.

Value in use and fulfilment value

- 6.34 Value in use and fulfilment value are entity-specific values. Value in use is the present value of the cash flows that an entity expects to derive from the continuing use of an asset and from its ultimate disposal. Fulfilment value is the present value of the cash flows that an entity expects to incur as it fulfils a liability.
- 6.35 Value in use and fulfilment value cannot be directly observed and are determined using cash-flow-based measurement techniques. In principle, value in use and fulfilment value reflect the same factors as described for fair value in paragraph 6.23, but are based on entity-specific assumptions instead of assumptions by market participants. In practice, to provide the most useful information, value in use and fulfilment value may sometimes need to be customised, for example, it may sometimes be appropriate:
- (a) to use market participant assumptions about the time value of money or the risk premium; or
 - (b) to exclude from the fulfilment value the effect of the possibility of non-performance by the entity.
- 6.36 When an entity incurs a liability in a transaction that involves no exchange and measures it on initial recognition at the fulfilment value, the expense recognised at that date includes a risk premium. As the entity is subsequently released from risk, the liability is reduced and income is recognised. Users may sometimes find that effect counterintuitive (see paragraph 6.25).
- 6.37 Value in use reflects the present value of the transaction costs that the entity expects to incur on the ultimate disposal of the asset.
- 6.38 Fulfilment value not only includes the present value of the amounts to be transferred to the liability counterparty, but also the present value of the amounts that the entity expects to transfer to other parties to enable it to fulfil the liability. Thus, it also includes the present value of transaction costs (if any) that the entity expects to incur in undertaking transactions that enable it to fulfil the liability.
- 6.39 The information provided by value in use measures of assets, income and expenses and fulfilment value measures of liabilities, income and expenses in both the statement of financial position and the statement(s) of financial performance is summarised in Table 6.1, following paragraph 6.47. Paragraphs 6.40–6.46 summarise the main advantages and disadvantages of value in use and fulfilment value.
- 6.40 Value in use provides information about the present value of the estimated cash flows from the continued use of an asset and from its disposal at the end of its

useful life. This information has predictive value and can be used in assessing the prospects for future cash flows, particularly if the asset will contribute to future cash flows by being used.

- 6.41 Fulfilment value provides information about the present value of the estimated cash flows to fulfil a liability. That information has predictive value; particularly if the liability will be fulfilled instead of transferred or settled by negotiation.
- 6.42 Updated estimates of value in use and fulfilment value, combined with information about actual cash flows, have confirmatory value because they provide feedback about previous estimates of value in use and fulfilment value.
- 6.43 Value in use and fulfilment value are determined using cash-flow-based measurement techniques. As noted in paragraph 6.32, depending on the techniques used:
- (a) the estimation process can be costly and complex; and
 - (b) the inputs into the process may be subjective and it may be difficult to verify both the inputs and the validity of the process. As a consequence, entities may measure identical assets or liabilities at different amounts, which reduces comparability.
- 6.44 Because value in use and fulfilment value are determined from the perspective of the reporting entity, those measures could differ for identical assets and liabilities in different entities, arguably reducing comparability. In contrast, because fair value uses market participant assumptions, in theory, different entities should arrive at identical estimates of fair value for identical items.
- 6.45 For many assets that are used in combination with other assets, the value in use cannot be determined meaningfully for individual assets. Instead, the value in use is determined for a group of assets and the result is then allocated to individual assets. Hence, determining the value in use of an asset used in combination with other assets can be a costly and complex process and value in use may not be a practical measurement basis for periodic remeasurements of such assets. However, it may be useful for occasional remeasurements of assets (for example, when it is used in an impairment test to determine whether a historical cost measure is fully recoverable).
- 6.46 In addition, estimates of value in use and fulfilment value may inadvertently reflect synergies with other assets and liabilities and so may not measure only the item that they purport to measure.

Summary of information provided by different measurement bases

- 6.47 Table 6.1 summarises the information provided in the statement of financial position and the statement(s) of financial performance by the measurement bases described in paragraphs 6.6–6.46.

Table 6.1—Information provided by various measurement bases
Assets

	Historical cost measures	Current value measures	
		Fair value (market participant assumptions)	Value in use (entity-specific assumptions)
Statement of financial position	Recoverable cost of the unconsumed (or uncollected) part of an asset (includes transaction costs incurred on acquisition).	Price that would be received to transfer the asset.	Present value of cash flows estimated to arise from the continuing use of the asset and from its disposal at the end of its useful life (includes present value of future costs of transfer).
Statement(s) of financial performance^{(a),(b)}	Income or expenses on initial recognition of exchanges of unequal value.	Income or expenses on initial recognition of exchanges of unequal value.	Income or expenses on initial recognition of exchanges of unequal value.
	–	Transaction costs on acquiring the asset.	Transaction costs on acquiring the asset.
	Historical cost of the economic resources consumed in the period (through cost of sales, depreciation or amortisation, etc).	Fair value, at the time of consumption, of economic resources consumed during the period.	Value in use, at the time of performance, of economic resources consumed during the period.
	Interest income (financial assets only).	Interest income (if identified separately).	Interest income (if identified separately).
	Impairment losses (compared with previous historical cost).	Impairment losses (if identified separately).	Impairment losses (if identified separately).
	Income or expenses on sales of assets during the period (includes transaction costs incurred then, which may or may not be identified separately).	Transaction costs incurred on disposal. Also, net income (or net expense) if consideration received exceeds (or is less than) the fair value at the date of disposal.	Transaction costs incurred on disposal. Also, net income (or net expense) if consideration received exceeds (or is less than) the value in use at the date of disposal.
	–	Remeasurement caused by: (a) changes in estimates of cash flows; (b) changes in interest rates; and (c) changes in the amount of risk or in its price.	Remeasurement caused by: (a) changes in estimates of cash flows; (b) changes in interest rates; and (c) changes in the amount of risk or in its price.

(a) Not all items will arise in every period.
 (b) Chapter 7 discusses the presentation and disclosure of items of income or expense in the statement(s) of financial performance.

Table 6.1 *continued***Liabilities**

	Historical cost measures	Current value measures	
		Fair value (market participant assumptions)	Fulfilment value (entity-specific assumptions)
Statement of financial position	Net consideration for taking on the unfulfilled part of a liability, plus any excess of the present value of the estimated cash flows over that net consideration (consideration is net of the transaction costs).	Price that would be paid to transfer the liability.	Present value of cash flows estimated to arise in fulfilling the liability.
Statement(s) of financial performance^{(a),(b)}	Income or expenses on initial recognition of exchanges of unequal value.	Income or expenses on initial recognition of exchanges of unequal value.	Income or expenses on initial recognition of exchanges of unequal value.
	–	Transaction costs on incurring the liability.	Transaction costs on incurring the liability.
	Consideration provided by customers (or others) for obligations fulfilled by the entity during the period.	Fair value, at the time of performance, of performance obligations fulfilled by the entity during the period.	Fulfilment value, at the time of performance, of performance obligations fulfilled by the entity during the period.
	Interest expenses.	Interest expenses (if identified separately).	Interest expenses.
	Losses on liabilities that have become (more) onerous during the period.	Losses on liabilities that have become (more) onerous during the period (if identified separately).	Losses on liabilities that have become (more) onerous during the period (if identified separately).
	Income and expenses on settlement or transfers of liabilities in the period (includes transaction costs incurred then, which may or may not be identified separately).	Transaction costs incurred on settlement or transfer. Also, net expense (or net income) if consideration paid exceeds (or is less than) the fair value at the date of settlement or transfer.	Transaction costs incurred on settlement or transfer. Also, net expense (or net income) if consideration paid exceeds (or is less than) the fulfilment value at the date of settlement or transfer.
	–	Remeasurement caused by: (a) changes in estimates of cash flows; (b) changes in interest rates; and (c) changes in the amount of risk or in its price.	Remeasurement caused by: (a) changes in estimates of cash flows; (b) changes in interest rates; and (c) changes in the amount of risk or in its price.

(a) Not all items will arise in every period.
(b) Chapter 7 discusses the presentation and disclosure of items of income and expense in the statement(s) of financial performance.

Factors to consider when selecting a measurement basis

- 6.48 The discussion in paragraphs 6.4–6.47 describes, for each measurement basis, the information it provides and its advantages and disadvantages. The following paragraphs discuss factors to be considered in selecting a measurement basis for an asset or a liability and the related income and expenses. The relative importance of each of the factors will depend upon facts and circumstances.
- 6.49 For information provided by a particular measurement basis to be useful to the users of financial statements, it must be relevant and it must faithfully represent what it purports to represent. In addition, the information provided should, as far as possible, be comparable, verifiable, timely and understandable.
- 6.50 As with all other areas of financial reporting, cost constrains the selection of a measurement basis. Hence, the benefits of the information provided to the users of financial statements by a particular measurement basis must be sufficient to justify the cost of providing that information.
- 6.51 Measures of assets, liabilities, income and expenses are used in the measurement of recognised items, and in presentation and disclosure. The following discussion on the factors to be considered in selecting a measurement basis focuses on the selection for recognised items. Nevertheless, some of that discussion may also apply to the disclosure in the notes to the financial statements of measures of unrecognised assets and unrecognised liabilities.
- 6.52 Paragraphs 6.53–6.63 discuss the factors to be considered in selecting a measurement basis by reference to the qualitative characteristics of useful financial information. Paragraphs 6.64–6.73 discuss additional factors to consider in selecting a measurement basis on initial recognition. Initial measurement and subsequent measurement cannot be considered separately. If the initial measurement basis and subsequent measurement basis are not consistent, income and expenses will be recognised solely because of the change in measurement basis. Recognising such income or expenses might appear to depict a transaction or other event when, in fact, no such transaction or event has occurred. Hence, the choice of measurement basis for an asset or a liability and the related income or expenses is determined by considering both the initial measurement and the subsequent measurement.

Relevance

- 6.53 When selecting a measurement basis, it is important to consider what information that measurement basis will produce in both the statement of financial position and the statement(s) of financial performance.
- 6.54 To produce relevant information, it is important to consider the following factors when selecting a measurement basis for an asset or a liability and the related income and expenses:
- (a) how that asset or liability contributes to future cash flows. This will depend in part on the nature of the business activities conducted by the entity. For example, if a property is realised by sale, it will produce cash

flows from that sale, but if a property is used in combination with other assets to produce goods and services, it will help produce cash flows from the sale of those goods and services.

- (b) the characteristics of the asset or the liability (for example, the nature or extent of the variability in the item's cash flows, or the sensitivity of the value of the item to changes in market factors or to other risks inherent in the item).

6.55 One factor affecting the relevance of the information provided by a measurement basis is the level of measurement uncertainty in estimates of that information (see paragraphs 2.12–2.13). A high level of measurement uncertainty does not prevent the use of an estimate that provides the most relevant information. However, in some cases, the level of measurement uncertainty is so high that a different measurement basis may provide more relevant information. Moreover, if no measurement basis for an asset or a liability would provide relevant information, it is not appropriate to recognise the asset or the liability (see paragraph 5.13).

6.56 Measurement uncertainty is not the same thing as outcome uncertainty. For example, if the fair value of an asset is observable in an active market, no uncertainty is associated with the measurement of that fair value, even though it is uncertain how much cash the asset will ultimately produce. Nevertheless, outcome uncertainty may sometimes contribute to measurement uncertainty. For example, there may be a high level of uncertainty about the cash flows that a unique asset will produce (outcome uncertainty) and estimating a current value of that asset may depend on a model whose validity is untested and that requires inputs that are difficult to verify.

Faithful representation

6.57 As noted in paragraphs 2.15 and 2.19, a perfectly faithful representation is free from error, but this does not mean that measures must be perfectly accurate in all respects. For example, an estimate of an unobservable price can be faithfully represented if it is described as being an estimate, if the nature and limitations of the estimating process are explained and if no errors have been made in selecting and applying the process for developing the estimate.

6.58 When assets and liabilities are related in some way, using different measurement bases for those assets and liabilities can create a measurement inconsistency (an 'accounting mismatch'). Measurement inconsistencies can result in financial statements that do not faithfully represent the entity's financial position and financial performance. Consequently, in some circumstances, using a similar measurement basis for related assets or liabilities may provide more useful information for users of financial statements than using dissimilar measurement bases. This may be particularly likely when the cash flows from one item are contractually linked to the cash flows from another item.

Enhancing qualitative characteristics

- 6.59 The enhancing qualitative characteristics of comparability, verifiability and understandability also have implications for the selection of a measurement basis. However, the enhancing qualitative characteristic of timeliness has no specific implications for measurement.
- 6.60 Comparability implies using measurement bases that are the same between periods and between entities. Reducing the number of measurement bases used contributes to comparability.
- 6.61 Verifiability implies using measurement bases that result in measures that can be independently corroborated either directly (such as by observing prices) or indirectly (such as by checking inputs to a model). If a particular measure cannot be verified, disclosures may be needed in the notes to the financial statements to enable users of financial statements to understand the assumptions used. In some such cases, it may be necessary to select a different measurement basis.
- 6.62 Understandability depends partly on the number of different measurement bases used and on whether they change over time. In general, if the number of measurement bases used in a set of financial statements increases, the resulting information becomes more complex (and, hence, less understandable), and the totals or subtotals in the statement of financial position and the statement(s) of financial performance become less meaningful. However, it could be appropriate to increase the number of measurement bases used if that is necessary to provide more relevant information.
- 6.63 A change in measurement basis can make financial statements less understandable. However a change may be justified if other factors outweigh the reduction in understandability; for example, if the change results in more relevant information. In such cases, disclosures may be needed in the notes to the financial statements to enable users to understand any income or expenses recognised as a result of the change in measurement basis.

Factors specific to initial measurement

- 6.64 Paragraphs 6.48–6.63 discuss factors to consider when selecting a measurement basis, whether at initial recognition or subsequently. The following paragraphs discuss some additional factors to consider solely at initial recognition.
- 6.65 Assets and liabilities may be recognised initially as a result of:
- (a) exchanges of items of similar value (see paragraphs 6.66–6.68);
 - (b) transactions with holders of equity claims (see paragraph 6.69);
 - (c) exchanges of items of different value (see paragraphs 6.70–6.71); or
 - (d) internal construction of an asset (see paragraphs 6.72–6.73).

Exchanges of items of similar value

- 6.66 An exchange of items of similar value might occur:
- (a) when an entity acquires an asset in exchange for incurring a liability. The asset and the liability are normally measured initially at the same amount. Thus, no income or expenses are recognised as a result of that transaction, except when the transaction costs are not included in the initial measure of the asset or the liability.
 - (b) when an entity acquires an asset, or incurs a liability, in exchange for transferring another asset or liability. The initial measure of the asset acquired (or the liability incurred) determines whether any income or expenses arise on the transfer of the other asset or the liability.
- 6.67 At initial recognition, the cost of an asset or a liability is normally similar to its fair value at that date, except if transaction costs are material. Nevertheless, even if those two amounts are similar, it is necessary to describe what measurement basis is used at initial recognition. If historical cost will be used subsequently, that basis is also normally appropriate at initial recognition. Similarly, if a current value will be used subsequently, it is also normally appropriate at initial measurement, thus avoiding an unnecessary change at the first subsequent measurement (see paragraph 6.63).
- 6.68 In some cases, the initial measure of one of the items exchanged may need to be used as the deemed cost of the other item. Paragraph 6.11 discusses deemed cost.

Transactions with holders of equity claims

- 6.69 If an entity receives an asset from a holder of an existing or new equity claim, it would normally be appropriate:
- (a) to measure the asset initially at a current value. If the asset will be measured subsequently at historical cost, the current value would form the deemed cost of the asset at that date.
 - (b) to recognise a contribution from the holders of equity claims, after deducting the current value of consideration provided to them, if any.

Exchanges of items of different values

- 6.70 Sometimes, two items of different value are exchanged; for example, because the transaction price is affected by relationships between the parties or by financial distress or other duress of one of the parties. In such cases, measuring the asset acquired, or the liability incurred, at historical cost may not faithfully represent income or expenses (for example, a loss arising from an overpayment or a gain arising from a bargain purchase).
- 6.71 On other occasions, an asset is acquired, or a liability is incurred, for no consideration; for example, when an asset is acquired as a gift or when a liability to pay compensation or penalties arises from an act of wrongdoing. In such cases, measuring the asset acquired, or the liability incurred, at its historical cost of zero would be unlikely to provide a faithful representation of the assets

and liabilities of the entity. Hence, it may be appropriate to measure such assets and liabilities at a current value and recognise the difference as income or expense.

Internally constructed assets

- 6.72 Unnecessary changes in measurement bases can be avoided by measuring assets constructed by the entity on the same basis as the basis that would be used subsequently (for example, at historical cost if the subsequent measurement of the asset will be historical cost and at current value if the subsequent measurement of the asset will be a current value).
- 6.73 Measuring the asset on its completion date at a fair value could provide relevant information about the cost-effectiveness of the construction through the recognition of income or expenses on completion. Hence, a change in the measurement basis from historical cost to fair value may be justified. However, determining fair value may not be easy for unique or custom-made assets. Consequently, the cost of doing so may outweigh the benefits for many internally constructed assets.

More than one relevant measurement basis

- 6.74 Sometimes, more than one measurement basis is needed to provide relevant information about an asset, liability, income or expense.
- 6.75 In most cases, the most understandable way to provide that information is:
- (a) to use a single measurement basis for the asset or the liability both in the statement of financial position and for related income and expenses in the statement(s) of financial performance; and
 - (b) to disclose in the notes to the financial statements additional information using the other measurement basis.
- 6.76 However, in some cases, because of the way in which an asset or a liability contributes to future cash flows (which depends in part on the nature of the business activities conducted by the entity) or because of the characteristics of the asset or the liability, the information provided in the statement of financial position and the statement(s) of financial performance is made more relevant by using:
- (a) a current value measurement basis for the asset or the liability in the statement of financial position; and
 - (b) a different measurement basis to determine the related income or expenses in the statement of profit or loss (see paragraph 7.25).
- 6.77 In such cases, the total income or total expenses arising from the change in the current value in the statement of financial position is split into two components:
- (a) in the statement of profit or loss: the income or expenses measured using the measurement basis selected for that statement; and

- (b) in other comprehensive income (see paragraph 7.19): the remaining income or expenses. The cumulative income or expenses included in other comprehensive income equals the difference between the carrying amount determined by the measurement basis selected for the statement of financial position and the carrying amount determined by the measurement basis selected in determining profit or loss.

Measurement of equity

- 6.78 The total amount at which equity is shown in the statement of financial position (total equity) is not measured directly; instead, it equals the total of the carrying amounts of all recognised assets less the total of the carrying amounts of all recognised liabilities.
- 6.79 Because general purpose financial statements are not designed to show an entity's value, total equity will not generally equal:
- (a) the aggregate market value of the entity's shares;
 - (b) the sum that could be raised by selling the entity as a whole on a going concern basis; or
 - (c) the sum that could be raised by selling all its assets after settling all its liabilities.
- 6.80 Although total equity is not measured directly, some individual classes or categories of equity may be measured directly. The total amount attributed to individual classes or categories of equity may be positive or, in some circumstances, negative. Similarly, although total equity is generally positive, it can also be negative, depending on which assets and liabilities are recognised and on how they are measured.

Chapter 7—Presentation and disclosure

Introduction

- 7.1 This chapter discusses:
- (a) the objective and scope of financial statements (paragraphs 7.2–7.7);
 - (b) presentation and disclosure as communication tools (paragraphs 7.8–7.18); and
 - (c) information about financial performance (paragraphs 7.19–7.27).

The objective and scope of financial statements

- 7.2 The scope of financial statements is determined by their objective, which is to provide information about an entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources (see paragraph 3.4). That information is provided:
- (a) in the statement of financial position and the statement(s) of financial performance, by recognising items that meet the definition of an element;
 - (b) in other parts of the financial statements, including the notes to the financial statements, by providing information about:
 - (i) recognised items that meet the definition of an element;
 - (ii) items that meet the definition of an element but that have not been recognised;
 - (iii) cash flows; and
 - (iv) contributions from, or distributions to, holders of equity claims.
- 7.3 The information provided in the notes to the financial statements includes:
- (a) information about the nature of both recognised and unrecognised elements and about the risks arising from them; and
 - (b) the methods, assumptions and judgements, and changes in those methods, assumptions and judgements, that affect the amounts presented or disclosed.
- 7.4 Forward-looking information about likely or possible future transactions and events is included in the financial statements only if it provides relevant information about an entity's assets, liabilities and equity that existed at the end of, or during, the period (even if they are unrecognised) or income and expenses for the period. For example, if an asset or a liability is measured by estimating future cash flows, information about the estimates of those future cash flows may be needed in order to understand the reported measures.
- 7.5 Other types of forward-looking information are sometimes provided outside the financial statements, for example, in management commentary.

- 7.6 Information about transactions or events that have occurred after the end of the reporting period is included in the financial statements if such information is necessary to meet the objective of financial statements.
- 7.7 Financial statements include comparative information about preceding periods. Such information is relevant because it helps users to identify and assess changes and trends.

Presentation and disclosure as communication tools

- 7.8 Financial statements present, in the statement of financial position and the statement(s) of financial performance, information about recognised assets, liabilities, equity, income and expenses. They also disclose additional information about those recognised elements and other information that is relevant to users. Efficient and effective communication of that information improves its relevance and contributes to a faithful representation of the assets, liabilities, equity, income and expenses. Such communication also enhances the understandability and comparability of information in financial statements. Efficient and effective communication includes:
- (a) classifying information in a structured manner that reports similar items together and reports dissimilar items separately;
 - (b) aggregating information so that it is not obscured by unnecessary detail; and
 - (c) using presentation and disclosure objectives and principles instead of rules that could lead to purely mechanistic compliance.
- 7.9 As with all other areas of financial reporting, cost constrains decisions about presentation and disclosure. Hence, the benefits of the information provided by presentation and disclosure must be sufficient to justify the cost of providing that information.

Classification

- 7.10 Classification is the sorting of assets, liabilities, equity, income and expenses on the basis of shared characteristics. Such characteristics include, but are not limited to, the nature of the item, its role (function) within the business activities conducted by the entity and how it is measured.
- 7.11 Classification is applied to the unit of account selected for assets, liabilities and equity (see paragraphs 4.57–4.63). However, for income and expenses, it may sometimes be appropriate to split the total income or expenses arising from a change in the carrying amount of an asset or a liability into components and to classify those components separately. That would be appropriate when the components have such different characteristics that classifying them separately would enhance the relevance and understandability of financial information.
- 7.12 Classifying dissimilar items together obscures relevant information and reduces understandability. Hence, classifying dissimilar items together generally does not result in the most useful information.

- 7.13 Offsetting occurs when an entity recognises and measures both an asset and a liability as separate units of account, but presents them in the statement of financial position as a single net amount. Offsetting classifies dissimilar items together and therefore is generally not appropriate. Offsetting assets and liabilities differs from treating a set of rights and obligations as a single unit of account (see paragraph 4.60).

Aggregation

- 7.14 Aggregation is the adding together of individual items that share characteristics and are classified together. Different levels of aggregation may be needed in different parts of the financial statements. For example:
- (a) a higher level of aggregation is used in the statement of financial position and the statement(s) of financial performance; and
 - (b) a lower level of aggregation is often needed in the notes to the financial statements.
- 7.15 Aggregation makes information more useful by summarising a large volume of detail. However, aggregation conceals some of that detail. Hence, a balance needs to be found so that relevant information is not obscured by a large amount of insignificant detail or by excessive aggregation.

Presentation and disclosure objectives and principles

- 7.16 Including specific presentation and disclosure objectives in a Standard enables an entity to identify relevant information and decide how to communicate that information in the most efficient and effective manner.
- 7.17 In setting presentation and disclosure requirements, an appropriate balance is needed between:
- (a) giving entities the flexibility to provide relevant information that faithfully represents the entity's assets and liabilities, and the transactions and other events of the period; and
 - (b) requiring information that is comparable among entities and across reporting periods.
- 7.18 Efficient and effective communication of information also requires consideration of the following principles:
- (a) entity-specific information is more useful than 'boilerplate' language and is more useful than information that is readily available outside the financial statements; and
 - (b) duplication of information in different parts of the financial statements is usually unnecessary and makes financial statements less understandable.

Information about financial performance

- 7.19 In order to communicate information about financial performance more efficiently and effectively, income and expenses in the statement(s) of financial performance are classified into either:

- (a) the statement of profit or loss, which includes a total or subtotal for profit or loss;¹⁴ or
 - (b) other comprehensive income.
- 7.20 The purpose of the statement of profit or loss is to:
- (a) depict the return that an entity has made on its economic resources during the period; and
 - (b) provide information that is helpful in assessing prospects for future cash flows and in assessing management's stewardship of the entity's resources.
- 7.21 Hence, income and expenses included in the statement of profit or loss are the primary source of information about an entity's financial performance for the period.
- 7.22 The total or subtotal for profit or loss provides a highly summarised depiction of the entity's financial performance for the period. Many users incorporate that total or subtotal in their analysis of the entity's financial performance for the period and in their analysis of management's stewardship of the entity's resources, using it either as a starting point for further analysis or as the main indicator of the entity's financial performance for the period. Nevertheless, understanding an entity's financial performance for the period requires an analysis of all recognised income and expenses (including income and expenses included in other comprehensive income), as well as an analysis of other information included in the financial statements.
- 7.23 Because the statement of profit or loss is the primary source of information about an entity's financial performance for the period, there is a presumption that all income and all expenses will be included in the statement of profit or loss. That presumption cannot be rebutted for:
- (a) income or expenses related to assets and liabilities measured at historical cost; and
 - (b) components of income or expenses related to assets and liabilities measured at current values if the components are separately identified and are of the type that would arise if the related assets and liabilities were measured at historical cost. For example, if an interest-bearing asset is measured at a current value and if interest income is identified as one component of the change in the carrying amount of the asset, that interest income would need to be included in the statement of profit or loss.
- 7.24 The presumption that all income and all expenses will be included in the statement of profit or loss can only be rebutted if:

14 This [draft] *Conceptual Framework* does not specify whether the statement(s) of financial performance comprise a single statement or two statements. For brevity, this [draft] *Conceptual Framework* uses the term 'statement of profit or loss' to refer both to a separate statement (showing a total for profit or loss) and to a separate section (showing a subtotal for profit or loss) within a single statement.

- (a) the income or expenses (or components of them) relate to assets or liabilities measured at current values and are not of the type described in paragraph 7.23(b); and
- (b) excluding those income or expenses (or components of them) from the statement of profit or loss would enhance the relevance of the information in that statement for the period.

When this is the case, those income or expenses (or components of them) are included in other comprehensive income.

- 7.25 One example of when income and expenses will be included in other comprehensive income is when a current value measurement basis is selected for an asset or a liability for the statement of financial position and a different measurement basis is selected for determining the related income and expenses in the statement of profit or loss (see paragraphs 6.74–6.77).
- 7.26 If income or expenses are included in other comprehensive income in one period, there is a presumption that it will be reclassified into the statement of profit or loss in some future period. That reclassification occurs when it will enhance the relevance of the information included in the statement of profit or loss for that future period.
- 7.27 The presumption that such a reclassification will occur could be rebutted, for example, if there is no clear basis for identifying the period in which reclassification would enhance the relevance of the information in the statement of profit or loss. If no such basis can be identified, this may indicate that the income or expenses should not be included in other comprehensive income.

Chapter 8—Concepts of capital and capital maintenance

This chapter comprises material carried forward from Chapter 4 of the existing *Conceptual Framework* with minor changes for consistency of terminology. To highlight the changes, they are shown in mark-up. Deleted text is struck through and new text is underlined. The format of the numbering has also been changed (for example, from '4.1' to '8.1'), but is not shown as a mark-up.

Concepts of capital

- 8.1 A financial concept of capital is adopted by most entities in preparing their financial statements. Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the entity. Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of the entity based on, for example, units of output per day.
- 8.2 The selection of the appropriate concept of capital by an entity should be based on the needs of the users of its financial statements. Thus, a financial concept of capital should be adopted if the users of financial statements are primarily concerned with the maintenance of nominal invested capital or the purchasing power of invested capital. If, however, the main concern of users is with the operating capability of the entity, a physical concept of capital should be used. The concept chosen indicates the goal to be attained in determining profit, even though there may be some measurement difficulties in making the concept operational.

Concepts of capital maintenance and the determination of profit

- 8.3 The concepts of capital in paragraph 8.1 give rise to the following concepts of capital maintenance:
- (a) *Financial capital maintenance.* Under this concept a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, ~~owners~~ holders of equity claims during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.
 - (b) *Physical capital maintenance.* Under this concept a profit is earned only if the physical productive capacity (or operating capability) of the entity (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, ~~owners~~ holders of equity claims during the period.
- 8.4 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.

- 8.5 The physical capital maintenance concept requires the adoption of the current cost basis of measurement. The financial capital maintenance concept, however, does not require the use of a particular basis of measurement. Selection of the basis under this concept is dependent on the type of financial capital that the entity is seeking to maintain.
- 8.6 The principal difference between the two concepts of capital maintenance is the treatment of the effects of changes in the prices of assets and liabilities of the entity. In general terms, an entity has maintained its capital if it has as much capital at the end of the period as it had at the beginning of the period. Any amount over and above that required to maintain the capital at the beginning of the period is profit.
- 8.7 Under the concept of financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period. Thus, increases in the prices of assets held over the period, conventionally referred to as holding gains, are, conceptually, profits. They may not be recognised as such, however, until the assets are disposed of in an exchange transaction. When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit. The rest of the increase is treated as a capital maintenance adjustment and, hence, as part of equity.
- 8.8 Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the entity are viewed as changes in the measurement of the physical productive capacity of the entity; hence, they are treated as capital maintenance adjustments that are part of equity and not as profit.
- 8.9 The selection of the measurement bases and concept of capital maintenance will determine the accounting model used in the preparation of the financial statements. ~~Different accounting models exhibit different degrees of relevance and reliability and, as in other areas, management must seek a balance between relevance and reliability.~~ This *Conceptual Framework* is applicable to a range of accounting models and provides guidance on preparing and presenting the financial statements constructed under the chosen model. At the present time, it is not the intention of the Board IASB to prescribe a particular model other than in exceptional circumstances, such as for those entities reporting in the currency of a hyperinflationary economy. This intention will, however, be reviewed in the light of world developments.

Capital maintenance adjustments

- 8.10 The revaluation or restatement of assets and liabilities gives rise to increases or decreases in equity. While these increases or decreases meet the definition of income and expenses, they are not included in the income statement under certain concepts of capital maintenance. Instead these items are included in equity as capital maintenance adjustments or revaluation reserves. ~~These concepts of capital maintenance are discussed in paragraphs 4.57–4.65 of this *Conceptual Framework*.~~

The IASB proposes new appendices. Because they are new, no mark-up has been used.

Appendix A Cash-flow-based measurement techniques

This appendix is an integral part of the [draft] Conceptual Framework for Financial Reporting.

- A1 Sometimes, a measure determined using a measurement basis described in Chapter 6 cannot be observed. In some such cases, it can be estimated using cash-flow-based measurement techniques. In particular:
- (a) the value in use of an asset and the fulfilment value of a liability can only be determined using such a technique; and
 - (b) if fair value cannot be observed, it would need to be estimated using a cash-flow-based measurement technique or another technique.
- A2 Cash-flow-based measurement techniques are not measurement bases; they are a means of estimating a measure. Hence, when using such a technique, it is necessary to identify the objective of using that technique (ie which measurement basis is being used) and, in the light of that objective, whether the technique includes using the following factors:
- (a) estimates of future cash flows.
 - (b) possible variations in the estimated amount and timing of future cash flows for the asset or the liability being measured, caused by the uncertainty inherent in the cash flows (see paragraphs A6–A10).
 - (c) the time value of money.
 - (d) the price for bearing the uncertainty inherent in the cash flows (ie a risk premium or risk discount). That price is not captured by the techniques used to measure a single amount within the central part of the range of possible cash flows (see paragraphs A6–A10). That price depends on the extent of the uncertainty. It also reflects the fact that investors would generally pay less for an asset (or expect to receive more for taking on a liability) that has uncertain cash flows than for an asset (or liability) whose cash flows are certain.
 - (e) other factors, such as liquidity, that market participants would take into account in the circumstances.
- A3 For a liability, the factors mentioned in paragraph A2(b) and A2(d) include the possibility that the entity may fail to fulfil the liability (own credit risk).
- A4 Not all of the factors listed in paragraph A2 are considered in every cash-flow-based measurement. However, if such a technique is used to estimate fair value, it will need to capture all of the factors and adopt the perspective of market participants. Estimates of fulfilment value or value in use adopt the perspective of the entity.
- A5 Cash-flow-based measurement techniques can be used to customise measurement bases (for example, departing from fair value by choosing to

update only some of the factors listed in paragraph A2). Customising measurement bases may sometimes result in information that is more relevant to the users of financial statements. However, they may also be more difficult for users of financial statements to understand. Hence, the reasons for customisation in a Standard will need to be explained in the Basis for Conclusions on that Standard.

Possible variations in the estimated amount and timing of cash flows

A6 Uncertainties about the amount of any cash flows are important characteristics of assets and liabilities. When measuring an asset or a liability by reference to uncertain future cash flows, it is necessary to represent the range of possible cash flows by selecting a single amount. The most relevant amount is usually one from within the central part of the range (a central estimate).

A7 Different central estimates provide different information. For example:

- (a) the expected value (the probability-weighted average, also known as the statistical mean) reflects the entire range of outcomes and gives more weight to the outcomes that are more likely. It is not intended to predict the ultimate inflow or outflow of cash (or other economic benefits) arising from that asset or liability.
- (b) the maximum amount that is more likely than not to occur (similar to the statistical median) indicates that the probability of a subsequent loss is no more than 50 per cent and that the probability of a subsequent gain is no more than 50 per cent.
- (c) the most likely outcome (the statistical mode) predicts the ultimate inflow or outflow arising from an asset or a liability.

A8 Each of these central estimates is illustrated in the following example:

Example

Probability (%)	Cash flow (CU) ^(a)
40	100
30	200
30	500

(a) In this [draft] *Conceptual Framework*, monetary amounts are denominated in 'currency units' (CU).

In this example:

- (a) The expected value (the mean) is CU250 ($40\% \times \text{CU}100 + 30\% \times \text{CU}200 + 30\% \times \text{CU}500$).
- (b) The maximum amount that is more likely than not to occur (the median) is CU200. (The probability that the cash flow will be more than CU200 is less than 50 per cent and the probability that the cash flow will be less than CU200 is less than 50 per cent.)

- (c) The most likely outcome (the mode) is CU100. It is the outcome with the highest probability.
- A9 As noted in paragraph A2, a central estimate does not capture the price for bearing the uncertainty that the ultimate outcome may differ from that central estimate.
- A10 No one central estimate gives complete information about the range of possible outcomes. To provide complete information, disclosure may be needed.

Appendix B Glossary

This glossary is extracted from the [draft] *Conceptual Framework for Financial Reporting*.

agent	A party that is primarily engaged to act on behalf of, and for the benefit of, another party (the principal).	CF 4.23
aggregation	The adding together of individual items that share characteristics and are classified together.	CF 7.14
asset	A present economic resource controlled by the entity as a result of past events.	CF 4.4
classification	The sorting of assets, liabilities, equity, income and expenses on the basis of shared characteristics.	CF 7.10
combined financial statements	Financial statements prepared for two or more entities that do not have a parent-subsidiary relationship with each other.	CF 3.17
commercial substance	A discernible effect on the economics of a contract or transaction.	CF 4.53, 4.55
comparability	An enhancing qualitative characteristic that enables users to identify and understand similarities in, and differences among, items.	CF 2.24
complete depiction	A depiction that includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations. Completeness is one component of a faithful representation.	CF 2.16
consolidated financial statements	Financial statements of a reporting entity whose boundary is based on both direct and indirect control.	CF 3.15(b)
constructive obligation	A term often used to describe an obligation that arises when an entity has no practical ability to act in a manner that is inconsistent with its customary practices, or published policies or specific statements, that require the transfer of an economic resource.	CF 4.34
control	The present ability to direct the use of an economic resource and obtain the economic benefits that flow from it.	CF 4.18
cost constraint	A pervasive constraint that prevents financial reports from providing information if the costs of reporting exceed the benefits of doing so.	CF 2.38

continued...

...continued

current value measure	A measure that provides monetary information about assets, liabilities, income and expenses using information that is updated to reflect conditions at the measurement date.	CF 6.19
derecognition	The removal of all or a part of a previously recognised asset or liability from an entity's statement of financial position.	CF 5.25
economic resource	A right that has the potential to produce economic benefits.	CF 4.4
enhancing qualitative characteristic	A qualitative characteristic that makes financial information more useful if the information both is relevant and provides a faithful representation.	CF 2.4, 2.22
equity	The residual interest in the assets of the entity after deducting all its liabilities.	CF 4.4
equity claim	A claim on the residual interest in the assets of the entity after deducting all its liabilities.	CF 4.44
executory contract	A contract that is equally unperformed: neither party has fulfilled any of its obligations, or both parties have fulfilled their obligations partially and to an equal extent.	CF 4.40
existence uncertainty	Uncertainty about whether an asset or a liability exists.	CF 5.15–5.16
expenses	Decreases in assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to holders of equity claims.	CF 4.4
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.	CF 6.21
faithful representation	Financial information that faithfully represents the phenomena that it purports to represent. A faithful representation provides information about the substance of an economic phenomenon instead of merely providing information about its legal form. A perfectly faithful representation would be complete, neutral and free from error. Providing a faithful representation is one of the two fundamental characteristics of useful financial information.	CF 2.14–2.15

continued...

...continued

free from error	Without errors or omissions in the description of the phenomenon and produced using a process that has been selected and applied with no errors. Freedom from error is one component of a faithful representation.	CF 2.19
fulfilment value	The present value of the cash flows that an entity expects to incur as it fulfils a liability.	CF 6.34
fundamental qualitative characteristics	Qualitative characteristics that financial information must possess to make it useful to the primary users of general purpose financial reports. They are relevance and faithful representation.	CF 2.4
general purpose financial report	A report that provides the reporting entity's existing and potential investors, creditors and other lenders with information about the reporting entity's economic resources, claims against the entity and changes in those economic resources and claims.	CF 3.2
general purpose financial statements	A particular form of general purpose financial report that provides information (about the reporting entity's assets, liabilities, equity, income and expenses) that is useful to the primary users of those statements in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources.	CF 3.2, 3.4
going concern assumption	The assumption that the reporting entity is a going concern and will continue in operation for the foreseeable future.	CF 3.10
historical cost measure	A measure that provides monetary information about assets, liabilities, income and expenses using information derived from the transaction or event that created them. The historical cost measures of assets or liabilities do not reflect changes in prices. However, they do reflect changes such as consumption or impairment of assets and fulfilment of liabilities.	CF 6.6
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.	CF 4.4
liability	A present obligation of the entity to transfer an economic resource as a result of past events.	CF 4.4

continued...

...continued

material information	Information whose omission or misstatement could influence decisions that the primary users of general purpose financial reports make on the basis of financial information about a specific reporting entity.	CF 2.11
measure	The result of measuring an asset, a liability or equity, or an item of income or expense, on a specified measurement basis.	CF 6.2
measurement	The process of quantifying, in monetary terms, information about an entity's assets, liabilities, equity, income and expenses.	CF 6.2
measurement basis	An identified feature of an item being measured (for example, historical cost, fair value or fulfilment value).	CF 6.2
measurement uncertainty	Uncertainty that arises when the result of applying a measurement basis is imprecise and can be determined only with a range.	CF 2.12–2.13, 5.20–5.21, 6.55–6.56
neutral	Without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users. Neutrality is one component of a faithful representation.	CF 2.17
objective of general purpose financial reporting	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.	CF 1.2
objective of general purpose financial statements	To provide information about an entity's assets, liabilities, equity, income and expenses that is useful to users of the financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources.	CF 3.4
obligation to transfer an economic resource	An obligation that already exists and has the potential to require an entity to transfer an economic resource to another party in at least one circumstance.	CF 4.27

continued...

...continued

offsetting	Identifying, recognising and measuring both an asset and a liability as separate units of account, but presenting them in the statement of financial position as a single net amount.	CF 7.13
outcome uncertainty	Uncertainty about the amount or timing of any inflow or outflow of economic benefits that will ultimately result from an asset or liability.	CF 5.17, 6.56
potential to produce economic benefits	Within an economic resource, a feature that already exists and will produce economic benefits in at least one circumstance.	CF 4.13
present obligation to transfer an economic resource	An obligation of an entity to transfer an economic resource: (a) for which the entity has no practical ability to avoid the transfer; and (b) that has arisen from past events; in other words, the entity has received the economic benefits, or conducted the activities, that establish the extent of its obligation.	CF 4.31
presentation and disclosure	The terms used to describe how information about assets, liabilities, equity, income and expenses is provided in financial statements.	CF 7.8
primary users of general purpose financial reports	Those existing and potential investors, lenders and other creditors who cannot require the reporting entity to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need.	CF 1.5
principal	See agent.	CF 4.23
prudence	The exercise of caution when making judgements under conditions of uncertainty.	CF 2.18
qualitative characteristic (of useful financial information)	A characteristic that makes financial information useful to the primary users of general purpose financial reports.	CF 2.1

continued...

...continued

recognition	The process of capturing, for inclusion in the statement of financial position or the statement(s) of financial performance, an item that meets the definition of an element. It involves depicting the item (either alone or as part of a line item) in words and by a monetary amount, and including that amount in totals in the relevant statement.	CF 5.2
relevant financial information	Financial information that is capable of making a difference in the decisions made by users. Relevance is one of the two fundamental qualitative characteristics of useful financial information.	CF 2.6
reporting entity	An entity that chooses, or is required, to prepare general purpose financial statements.	CF 3.11
timeliness	An enhancing qualitative characteristic possessed by information that is available to decision-makers in time to be capable of influencing their decisions.	CF 2.32
unconsolidated financial statements	Financial statements of a reporting entity whose boundary is based on direct control only.	CF 3.15(a)
understandability	An enhancing qualitative characteristic possessed by financial information that is classified, characterised and presented clearly and concisely.	CF 2.33
unit of account	The group of rights, the group of obligations or the group of rights and obligations, to which recognition and measurement requirements are applied.	CF 4.57
users (of general purpose financial statements)	See primary users of general purpose financial reports.	-
value in use	The present value of the cash flows that an entity expects to derive from the continuing use of an asset and from its ultimate disposal.	CF 6.34
verifiability	An enhancing qualitative characteristic that enables different knowledgeable and independent observers to reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation.	CF 2.29

Approval by the Board of the Exposure Draft *Conceptual Framework for Financial Reporting* published in May 2015

The Exposure Draft *Conceptual Framework for Financial Reporting* was approved for publication by eleven of the fourteen members of the International Accounting Standards Board. Mr Cooper, Mr Finnegan and Ms Lloyd voted against its publication. Their alternative views are set out after the Basis for Conclusions on the Exposure Draft.

Hans Hoogervorst	Chairman
Ian Mackintosh	Vice-Chairman
Stephen Cooper	
Philippe Danjou	
Amaro Luiz De Oliveira Gomes	
Martin Edelmann	
Patrick Finnegan	
Gary Kabureck	
Suzanne Lloyd	
Takatsugu Ochi	
Darrel Scott	
Chungwoo Suh	
Mary Tokar	
Wei-Guo Zhang	

SET ISBN 978-1-909704-81-7



9 781909 704817 ▷

EXPOSURE DRAFT ISBN 978-1-909704-82-4

International Accounting Standards Board® (IASB®)

The IASB is the independent standard-setting body of the IFRS Foundation®

30 Cannon Street | London EC4M 6XH | United Kingdom

Telephone: +44 (0)20 7246 6410 | Fax: +44 (0)20 7246 6411

Email: info@ifrs.org | Web: www.ifrs.org

Publications Department

Telephone: +44 (0)20 7332 2730 | Fax: +44 (0)20 7332 2749

Email: publications@ifrs.org

IAS®