



HM Treasury

Review of the IASB Conceptual Framework

Current status and implications for public
sector financial reporting

Background

Purpose of Conceptual Frameworks

Conceptual Frameworks are used to develop or revise standards

They set out the underlying concepts for the preparation and presentation of financial statements and form the basis for specific recognition and measurement requirements of standards.

Allow standard setters to reach consistent conclusions on a variety of complex financial reporting matters and should also assist other parties when accounting for items not covered by a particular standard

IASB Conceptual Framework

Revised in 2010 to describe the objective of financial reporting and the characteristics of useful financial information.

Improvements wanted by IASB because:

- some important areas are not covered, e.g. provides very little guidance on measurement, presentation and disclosure.
- some areas deemed out of date and do not reflect current thinking or are otherwise unclear.

Discussion paper released in 2013 with Exposure Draft expected (Q4 2014) based on feedback to this paper. Areas of focus of the paper:

(a) definitions of assets and liabilities; (b) recognition and derecognition of assets and liabilities; (c) measurement; (d) equity; (e) profit or loss and other comprehensive income (OCI); and (f) presentation and disclosure.

IASB Discussion Paper

Definitions of assets and liabilities

Suggests revised definitions that:

- focus more clearly on the fact that an asset is a resource, and a liability is an obligation; and
- clarify the status of those resources and obligations that are not certain to result in inflows and outflows of economic benefits.

Assets – An asset of an entity is a present economic resource controlled by the entity as a result of past events.

Liabilities – A liability of an entity is a present obligation to transfer an economic resource as a result of past events.

IASB Discussion Paper

Recognition and derecognition of assets and liabilities

Recognition - an entity should recognise all its assets and liabilities, unless the IASB decides that:

- (a) recognising an asset or a liability would provide users of financial statements with information that is not relevant; or
- (b) no measure of an asset or a liability would result in a sufficiently faithful representation of both that asset or liability and the resulting income or expense.

Derecognition - existing *Conceptual Framework* does not address derecognition, although the derecognition of various assets or liabilities addressed in some recent IFRS. Suggested that an entity should derecognise an asset or a liability (or part of an asset or a liability) when it no longer meets the recognition criteria.

IASB Discussion Paper

Measurement

Existing *Conceptual Framework* provides little guidance on measurement and when a particular measurement basis should be used.

Suggested that the IASB should limit the number of measurement bases used in financial statements to enhance their understandability and comparability. Recognised that a single measurement basis for all assets and liabilities may not provide the most relevant information.

In selecting an appropriate measurement basis for a particular asset or liability, the IASB should consider: (a) how the asset contributes to future cash flows or how the entity will fulfil or settle the liability; and (b) what information that measurement basis will produce in the statement of financial position and the statement of comprehensive income.

IASB Discussion Paper

Equity

Financial statements do not typically provide enough information about the claims of different classes of equity investors, such as the effect of senior equity claims on subordinate equity claims. Suggested that entities should use an enhanced statement of changes in equity to provide more information about different classes of equity.

Also noted that existing IFRSs do not apply the definition of a liability consistently when distinguishing liabilities from equity instruments. The resulting requirements can be complex, difficult to understand and difficult to apply. Proposal is that to distinguish between equity instruments and liabilities, the IASB would use the existing definition of equity, and the definition of a liability, which focuses on whether the entity has an obligation to deliver economic resources.

IASB Discussion Paper

Profit or loss and other comprehensive income (OCI)

Currently no principle in IFRS to determine:

- (a) which items of income or expense should be presented in profit or loss and which should be presented in OCI; and (b) whether, and when, items previously recognised in OCI should be recycled from OCI into profit or loss.

Suggested that the *Conceptual Framework*:

- (a) should require a profit or loss total or subtotal that also results, or could result, in some items of income or expense being recycled; and (b) should limit the use of OCI to items of income or expense resulting from changes in current measures of assets and liabilities (remeasurements). However, not all such remeasurements would be eligible for recognition in OCI.

IASB Discussion Paper

Presentation and disclosure

The existing *Conceptual Framework* does not have a section on disclosure.

The IASB will aim to develop concepts that it will be able to use when developing future disclosure requirements in IFRSs. Suggested that:

(a) the objective of presenting information in the primary financial statements is to provide summarised information about recognised assets, liabilities, equity, income, expenses, changes in equity and cash flows, that has been classified and aggregated in a manner that is useful; and

(b) the objective of disclosing information in the notes to the financial statements is to supplement the primary financial statements by providing additional useful information about the items recognised in (a) and unrecognised assets and liabilities.

IASB Discussion Paper

Objectives of financial reporting and the qualitative characteristics of useful financial information

The IASB have noted that they do not intend to fundamentally reconsider the chapters of the existing *Conceptual Framework* that deal with the objective of financial reporting and the qualitative characteristics of useful financial information.

However the IASB will make changes to those chapters if it identifies areas that need clarification or improvement. Noted that concerns have been raised about how those chapters address stewardship, reliability and prudence. A summary of those concerns included in the Discussion Paper to seek respondents' views on these matters. The IASB will consider those views in determining whether, and the extent to which, amendments to those chapters are required.

Implications for public sector financial reporting

IASB position outlined in DP creates no insurmountable barriers to continued use of IFRS in UK public sector.

- Element of 'catching up' with the standards
- Keeps door open on differing measurement bases
- No fundamental change to asset and liability definitions
- Maintains current approach to objective of general purpose financial reporting & qualitative characteristics of financial information.

Implications for public sector financial reporting

Areas to watch to see how they evolve in the Exposure Draft:

- Guidance on the approach to selection of measurement base
- Treatment of uncertainty/expectation in asset/liability definitions
- Guidance supporting liability definition: including the meaning of ‘constructive obligation’ and the extent to which the conditionality of an entity’s future actions is relevant to recognition of a liability.

However, unsurprisingly, it does not assist in resolving issues of specific importance or unique to the public sector.