THE IASB CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

THE PURPOSE OF THE FRAMEWORK

Overview: The framework was issued in September 2010 and subsequently revised in March 2018 effective for annual reporting periods beginning on or after 1 January 2020.

The purpose of the conceptual framework broadly includes all the following;

- To assist the International Accounting Standards Boards (IASB) in developing and revising IFRSs that are based on consistent concepts.
- To assist preparers of financial statements in making a choice of consistent accounting policies where there are options provided by a particular standard; and to develop consistent accounting policies for areas that are not covered by a standard.
- To assist all parties to understand and interpret IFRS.

Note: The conceptual framework is not a standard and therefore does not override any specific IFRS. In the event that the IASB issues a pronouncement or standard (whether new or revised) that conflicts with the framework, then the IASB must highlight the fact and explain the reasons for the departure.

THE FRAMEWORK (IT'S SCOPE)

The framework sets out the following;

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

THE OBJECTIVE OF GENERAL PURPOSE FR

The objective forms the back born of the framework with all the remaining chapters flowing logically from the objective.

The Objective: to provide ***financial information*** about the ***reporting entity*** that is useful to existing and potential investors, lenders and other creditors in making ***decisions*** relating to providing resources to the entity.

Financial information includes 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, as well as information about the effects of transactions and other events that *change a reporting entity's economic resources and claims* against it.

Knowledge about the entity's economic resources and claims helps users to identify the reporting entity's financial strengths and weaknesses, hence assessing its liquidity & solvency, it's need for additional financing and management's stewardship of its economic resources.

Changes in a reporting entity's economic resources and claims result from that entity's financial performance and from other events or transactions such as issuing debt or equity instruments

Decisions include buying, selling or holding equity and debt instruments; providing or settling loans and other forms of credit; exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.

QUALITATIVE X-TICS OF USEFUL FINANCIAL INFORMATION

The qualitative characteristics of useful financial information apply to financial information provided in financial statements, as well as to financial information provided in other ways.

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***. Hence these characteristics can be broadly divided into fundamental and enhancing.

The fundamental qualitative characteristics

Relevance: Relevant financial information is capable of making a difference in the decisions made by users. Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value, or both (i.e. revenue forecasts made basing on current revenue figures).

- ***Materiality:*** 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.

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports.

QUALITATIVE X-TICS OF USEFUL FINANCIAL INFORMATION

Faithful representation: Financial information must not only be relevant, but also represent faithfully the phenomena it purports to represent. If the substance of an economic phenomenon and its legal form are not the same, providing information only about the legal form would not faithfully represent the economic phenomenon.

For a perfectly faithful representation, financial information should be complete, neutral and free from error.

The enhancing qualitative characteristics

Comparability: Information about a reporting entity is more useful if it can be compared with a similar information about other entities and with similar information about the same entity for another period.

Verifiability: This means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. It helps assure users that information faithfully represents the economic phenomena it purports to represent.

QUALITATIVE X-TICS OF USEFUL FINANCIAL INFORMATION

Timeliness: This means that information is available to decision-makers in time to be capable of influencing their decisions.

Understandability: Classifying, characterizing and presenting information clearly and concisely makes it understandable.

Note: *Enhancing qualitative characteristics (either individually or collectively) cannot render financial information useful if that information is irrelevant or not represented faithfully. However, enhancing qualitative characteristics need to be maximized as much as possible to enhance the usefulness of financial information.*

FINANCIAL STATEMENTS AND THE REPORTING ENTITY

Objective and scope of financial statements

The objective of financial statements is to provide information about an entity's assets, liabilities, equity, income and expenses that is useful to financial statements users in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources.

Financial statements

- A statement of financial position
- A statement of profit or loss and other comprehensive income or a statement of profit or loss and a separate statement of comprehensive income.
- A statement of changes in equity
- A statement of cash flows
- Notes to the financial statements

The underlaying assumption of preparation of financial statements

Going concern: Financial statements are normally prepared on the assumption that the reporting entity is a going concern and will continue in operation for the foreseeable future.

FINANCIAL STATEMENTS AND THE REPORTING ENTITY

The reporting entity

A reporting entity is an entity that is required, or chooses, to prepare financial statements. It can be a single entity or a portion of an entity or can comprise more than one entity. If a reporting entity comprises both the parent and its subsidiaries, then its financial statements are referred to as ***consolidated financial statements***.

Note: *A reporting entity may not necessarily be a legal entity.*

ELEMENTS OF FINANCIAL STATEMENTS

Element	Definition	Key aspects
Asset	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.	❑ Right ❑ Potential to produce economic benefits ❑ Control
Liability	A present obligation of the entity to transfer an economic resource as a result of past events.	❑ The entity has an obligation ❑ The obligation is to transfer an economic resource ❑ The obligation is a present obligation that exists as a result of past Events
Equity	The residual interest in the assets of the entity after deducting all its liabilities.	
Income	Increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.	
Expenses	Decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.	

RECOGNITION AND DERECOGNITION

❑ Recognition

Recognition is the process of capturing for inclusion in the financial statements an item that meets the definition of one of the elements of financial statements.

Recognition criteria

- It is probable that any future economic benefit associated with the item will flow to or from the entity.
- The item's cost or value can be measured with reliability.

Hence;

Assets and **liabilities** are recognized following the recognition criteria whilst incomes and expenses are recognized basing on movements of assets and liabilities.

Incomes: Recognized in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably.

Expenses: Recognized when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

RECOGNITION AND DERECOGNITION

- **Derecognition**

Derecognition is the removal of all or part of a recognized asset or liability from an entity's statement of financial position. Broadly, an item of assets or liabilities is derecognized when the item no longer meets the definition of an asset or of a liability.

Asset: Derecognized when the entity loses control of all or part of the recognized asset.

Liability: Derecognized when the entity no longer has a present obligation for all or part of the recognized liability.

MEASUREMENT OF ELEMENTS OF FINANCIAL STATEMENTS

Since all elements recognized in the financial statements need to be quantified in monetary terms, there arises a need to select a measurement base to best ascertain the monetary value.

Measurement involves assigning monetary amounts at which the elements of the financial statements are to be recognized and reported.

Measurement bases

Historical cost: Measuring an item using the price of the transaction or other event that gave rise to such an item.

Current value: Measuring an item using information updated to reflect conditions at the measurement date. It includes fair value, value in use and current cost.

- Fair value refers to 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.
- Value in use refers to the present value of the cash flows, or other economic benefits, that an entity expects to derive from the use of an asset and from its ultimate disposal.
- Current cost refers to the cost of an equivalent asset at the measurement date.

Net realizable value: Cash flows that would be received from sale of an asset after deducting costs to sell.

Present value: Measuring an item as the present value of future cash flows expected to be derived or paid.

Note: A Standard may need to describe how to implement the measurement basis selected in that Standard.

PRESENTATION AND DISCLOSURE

Classification of assets and liabilities: It may sometimes be appropriate to separate an asset or liability into components that have different characteristics and to classify those components separately. Such as separating assets or liabilities into current and non-current components.

Offsetting: This occurs when an entity recognizes and measures both an asset and liability as separate units of account, but groups them into a single net amount in the statement of financial position. This is not appropriate.

Aggregation: Refers to adding together of assets, liabilities, equity, income or expenses that have shared characteristics and are included in the same classification. However, excessive aggregation could conceal some details hence not facilitating relevance and faithful representation. Hence, a balance needs to be struck so that relevant information is not obscured by aggregation.

CAPITAL AND CAPITAL MAINTENANCE

Concepts of capital

Financial concept of capital: This looks at capital in terms of invested money or invested purchasing power. Under this concept, capital is synonymous with the net assets or equity of the entity.

Physical concept of capital: This looks at capital in terms of operating capability. Under this concept, capital is regarded as the productive capacity of the entity such as units of out put per day.

A choice of an appropriate concept of capital depends on the users' priority between maintenance of nominal invested capital/ the purchasing power of invested capital or the operating capability of the entity.

Concepts of capital maintenance and determination of profit

Financial capital maintenance: A profit is earned only if the financial (monetary) amount of the net assets at the end of the period exceeds the financial (monetary) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

Physical capital maintenance: A profit is earned only if the physical productive capacity (or operating capability) of the entity 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 during the period