

## STAFF PAPER

April 2014

## REG IASB Meeting

<b>Project</b>	<b>Conceptual Framework</b>		
Paper topic	Purpose and status of the <i>Conceptual Framework</i>		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

**Purpose of paper**

1. The purpose of this paper is to consider the purpose and status of the *Conceptual Framework*.
2. This paper addresses the following questions:
  - (a) [Should there be a primary user for the \*Conceptual Framework\*?](#) (paragraphs 8-18)
  - (b) [Should the \*Conceptual Framework\* override Standards?](#) (paragraphs 19-25)
  - (c) [Should some parts of the \*Conceptual Framework\* be available for use by the IASB only?](#) (paragraphs 26-30)
  - (d) [Should the IASB be able to depart from the \*Conceptual Framework\*?](#) (paragraphs 31-42)
3. When discussing the purpose and status of the *Conceptual Framework*, some respondents also commented on the hierarchy in paragraph 11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Those comments will be discussed in later meetings.

## Summary of staff recommendations

4. We recommend that the purpose of the *Conceptual Framework* should be to identify concepts that:
  - (a) assist the IASB to develop and revise IFRSs.
  - (b) assist preparers to develop accounting policies when no IFRS applies to a particular transaction, event or condition.
  - (c) assist all parties to understand and interpret IFRS.
5. We recommend that the IASB retains the existing status of the *Conceptual Framework* – that is, the *Conceptual Framework* is not a Standard and does not override the requirements of specific Standards.
6. We recommend that preparers should not be restricted from applying particular aspects of the *Conceptual Framework*.
7. We recommend confirming that, in a limited number of cases, the IASB may depart from aspects of the *Conceptual Framework*. If the IASB does so, the IASB will explain that departure in the Basis for Conclusions on the Standard in question.

## Should there be a primary user for the *Conceptual Framework*?

### **Background**

8. The existing purpose of the *Conceptual Framework* is as follows:

The *Conceptual Framework* sets out the concepts that underlie the preparation and presentation of financial statements. Its purpose, as described in the existing *Conceptual Framework*, is:

- (a) to assist the IASB in the development of future IFRSs and in its review of existing IFRSs;
- (b) to assist the IASB in promoting harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a

basis for reducing the number of alternative accounting treatments permitted by IFRSs;

(c) to assist national standard-setting bodies in developing national standards;

(d) to assist preparers of financial statements in applying IFRSs and in dealing with topics that have yet to form the subject of an IFRS;

(e) to assist auditors in forming an opinion on whether financial statements comply with IFRSs;

(f) to assist users of financial statements in interpreting the information contained in financial statements prepared in compliance with IFRSs; and

(g) to provide those who are interested in the work of the IASB with information about its approach to the formulation of IFRSs.

#### *IASB's preliminary views in the Discussion Paper*

9. The IASB suggested that the primary purpose of the revised *Conceptual Framework* is to assist the IASB by identifying concepts that it will use consistently when developing and revising Standards. The Discussion Paper suggested that focusing on the needs of the IASB would help to provide better targeted concepts for the revised *Conceptual Framework*.

10. The IASB also suggested that:

1.28 ... the revised *Conceptual Framework* may also assist parties other than IASB:

(a) to understand and interpret existing Standards; and

(b) to develop accounting policies when no Standard or Interpretation specifically applies to a particular transaction or event.

*Feedback from respondents and outreach*

11. Some respondents (including a securities regulator and many accounting firms) agreed that the primary user of the *Conceptual Framework* should be the IASB. They cited the following reasons:
- (a) Because the IASB has developed more comprehensive guidance since the original *Framework*, there are fewer instances when parties other than the IASB will use the *Conceptual Framework* to interpret Standards.
  - (b) It reinforces the position that the *Conceptual Framework* is not a Standard and does not override Standards.
  - (c) It will ensure that the IASB focuses on conceptual issues when developing the *Conceptual Framework* and does not merely codify current practice.
12. However, many respondents thought that the suggestion in the Discussion Paper that the IASB is the primary user of the *Conceptual Framework* undermines or understates the fact that preparers may sometimes need to use the *Conceptual Framework* through the hierarchy of pronouncements listed in IAS 8 (copied in Appendix A).
13. Some respondents cited other reasons why the *Conceptual Framework* is important to parties other than the IASB:
- (a) The *Conceptual Framework* facilitates a common understanding of basic principles or concepts of financial reporting among all those who use the Standards.
  - (b) Focusing on the IASB as the primary user of the *Conceptual Framework* is likely to reduce the prominence or importance of this document to other parties. For example:
    - (i) auditors and regulators consider the *Conceptual Framework* when assessing the judgements made by preparers; and
    - (ii) the IFRS Interpretations Committee uses the *Conceptual Framework* when developing Interpretations.

- (c) A *Conceptual Framework* should contain high-level principles that stakeholders can understand to fulfil the IFRS Foundation’s objective of promoting and facilitating the adoption of IFRS.
- (d) The *Conceptual Framework* is a ‘behavioural code’ that all parties should follow.

14. At the March 2013 Global Preparers Forum (GPF) meeting, the staff asked GPF members how often preparers use the *Conceptual Framework* to develop accounting policies. GPF members made the following comments:

- (a) Some members agreed that the primary purpose of the *Conceptual Framework* should be to help the IASB develop Standards. They thought that preparers referred to it infrequently.
- (b) Some members said that even though they may not use the *Conceptual Framework* often, they use it as a point of reference. Examples of using the *Conceptual Framework* included:
  - (i) referring to the definitions and recognition criteria when an issue is unclear.
  - (ii) using the *Conceptual Framework* to help them interpret Standards when they are unclear or the answer implied by a Standard appears counter-intuitive. (They do not use the *Conceptual Framework* to override the requirements in Standards because the IAS 8 hierarchy does not permit this).
  - (iii) when there is a choice in accounting, using the guidance in the *Conceptual Framework* to help them decide on the most appropriate approach.
  - (iv) when writing comment letters.
  - (v) when preparing the company’s internal implementation guidance on accounting standards (for example how to apply IFRS 3 *Business Combinations* to identify assets and liabilities acquired in a business combination).
- (c) Most GPF members stated that it is difficult to base a decision solely on the *Conceptual Framework*. They prefer using other sources such as

national accounting requirements or accounting manuals produced by the accounting firms.

- (d) Some members thought that if the *Conceptual Framework* was more developed, they may use it more often.

### **Staff analysis and recommendation**

15. In developing the Discussion Paper, we suggested introducing the term ‘primary purpose’ of the *Conceptual Framework* to focus on the IASB’s needs when it develops Standards. It was not the intention to downplay the importance of the *Conceptual Framework* to other parties.
16. The response discussed in paragraphs 11-14 demonstrates that the *Conceptual Framework* is important:
  - (a) to preparers who use it to develop accounting policies, particularly when there is no applicable IFRS for a transaction, event or condition; and
  - (b) to all parties in a principles-based environment in which Standards do not deal with all types of transactions, events or conditions.
17. Therefore we recommend that the purpose of the *Conceptual Framework* should be to identify the concepts that:
  - (a) assist the IASB to develop and revise IFRSs;
  - (b) assist preparers to develop accounting policies when no IFRS applies to a particular transaction, event or condition.
  - (c) assist all parties to understand and interpret IFRS.
18. In addition, we think our recommendation:
  - (a) removes outdated information, such as the previous reference to assisting national standard-setting bodies in developing national standards, a task that is not part of the IASB’s mandate.
  - (b) is consistent with the purpose and authority of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector*

*Entities*<sup>1</sup> of the International Public Sector Accounting Standards Board (IPSASB). Please refer to Appendix B for the relevant text of the purpose and status of the IPSASB's Conceptual Framework.

#### Question 1

We recommend that the purpose of the *Conceptual Framework* should be to identify concepts that:

- (a) assist the IASB to develop and revise IFRSs;
- (b) assist preparers to develop accounting policies when no IFRS applies to a particular transaction, event or condition.
- (c) assist all parties to understand and interpret IFRS.

Do you agree?

## Should the *Conceptual Framework* override Standards?

### Background

19. Currently, the *Conceptual Framework* is not a Standard, and does not override Standards. This position is stated in the Purpose and Status section of the existing *Conceptual Framework*.
20. In the Discussion Paper, the IASB suggested retaining the idea that the *Conceptual Framework* is not a Standard and does not override specific Standards.

### Feedback from respondents

21. Many respondents agreed with the IASB's preliminary views. Reasons given were:

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<sup>1</sup> The IPSASB is currently developing a Conceptual Framework for financial reporting by public sector entities. The first four chapters addressing the purpose and status, objective of financial reporting and qualitative characteristics of useful information can be found here. <http://www.ifac.org/sites/default/files/publications/files/Public%20Sector%20Conceptual%20Framework%20Ch%20%201-4%20Jan%20%2011%202013%20FINAL.pdf>

- (a) If the *Conceptual Framework* were mandatory, preparers could override the requirements in the Standards if they viewed the requirements as being inconsistent with the *Conceptual Framework*.
  - (b) They think that the *Conceptual Framework* is only intended to provide conceptual guidance and not to define specific requirements.
  - (c) Conceptual thinking or the economic environment may change, and the IASB may need to develop or revise Standards that reflect that new thinking. The *Conceptual Framework* may not be updated to keep pace with those changes.
  - (d) The guidance in Standards that is developed to address specific transactions, events or conditions should take precedence over the higher-level concepts that are in the *Conceptual Framework*.
22. However, some respondents disagreed with the IASB's preliminary views because they think that the *Conceptual Framework* should be considered akin to a constitution within a system of laws – in other words, the Standards should be consistent with the *Conceptual Framework* and if this is not the case preparers should have the power to override the requirements in Standards.

### **Staff analysis and recommendation**

23. The IASB could decide to change the status of the *Conceptual Framework* so that its requirements override the requirements in Standards. However, we think that this would cause the following problems:
- (a) It would allow preparers to override the requirements of specific Standards if they think that those Standards do not comply with the *Conceptual Framework*.
  - (b) Preparers would not be able to apply any exemptions or exceptions specified in individual Standards that conflict with the principles in the *Conceptual Framework*.
  - (c) This would not allow the IASB the flexibility to develop interim Standards that potentially conflict with aspects of the *Conceptual*



*Framework*, as it did, for example, in issuing IFRS 4 *Insurance Contracts* or IFRS 14 *Regulatory Deferral Accounts*.

24. We recommend retaining the position that the *Conceptual Framework* is not a Standard because:
- (a) We think that the existing status of the *Conceptual Framework* works and has not caused problems. We also observe that the status of the *Conceptual Framework* is consistent with the status of most of the conceptual frameworks used by national standard-setters.
  - (b) Changing the status of the *Conceptual Framework* would impose significant costs on users, preparers and others – for example, preparers who currently apply the exceptions or exemptions in IFRSs (many of which were introduced for costs-benefit reasons) will have to change their systems to comply with the overriding ‘requirements’ in the *Conceptual Framework*.
25. We also think it is useful to add to IAS 1 that the *Conceptual Framework* is not authoritative. Confirming the status of the *Conceptual Framework* in a Standard will minimise any confusion.

#### Question 2

We recommend that the IASB retains the existing status of the *Conceptual Framework* - that is, the *Conceptual Framework* is not a Standard and does not override the requirements of specific Standards. Do you agree?

### Should some parts of the *Conceptual Framework* be available for use by the IASB only?

#### **Background**

26. The Discussion Paper suggested that some aspects of the *Conceptual Framework* should be only for the use of the IASB as it develops new or revised Standards. For example, determining whether an item of income or expense can be included

in other comprehensive income (OCI)<sup>2</sup> and deciding that an asset or liability does not need to be recognised<sup>3</sup>.

27. Some respondents agreed that preparers should not use some aspects of the *Conceptual Framework* (other than to help them understand standard-setting decisions).
28. Some respondents disagreed with the IASB's suggestion, and especially with the example given in the Discussion Paper that only the IASB should determine what should be included in OCI. They saw no conceptual reason why the guidance in the *Conceptual Framework* should not be applicable to all parties.
29. A few respondents suggested that if the IASB intended to restrict the use of some guidance in the *Conceptual Framework*, that restriction should appear within Standards rather than in the *Conceptual Framework* (as is the case with the use of OCI in IAS 1).

### **Staff analysis and recommendation**

30. We think that the suggestion in the Discussion Paper that some parts of the *Conceptual Framework* should only be applied by the IASB was based on a fear that preparers might use the *Conceptual Framework* to override a Standard. That fear should be addressed by a clear statement that the *Conceptual Framework* does not override Standards. If the IASB wants to restrict preparers from applying particular concepts, that should be done within the Standards and not via the *Conceptual Framework*.

#### **Question 3**

We recommend that preparers should not be restricted from applying particular aspects of the *Conceptual Framework*. Do you agree?

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<sup>2</sup> Paragraph 1.29 in the Discussion Paper

<sup>3</sup> Paragraph 4.25 in the Discussion Paper

## Should the IASB be able to depart from the *Conceptual Framework*?

### **Background**

31. Currently, the *Conceptual Framework* acknowledges that in a limited number of cases, the requirements in IFRSs may differ from those of the *Conceptual Framework*.
32. The Discussion Paper suggested that there may be rare cases when applying some aspect of the *Conceptual Framework* produces financial information about the reporting entity that is not useful.
33. About half of the respondents commented on this issue. Many of these respondents thought that the IASB should never develop Standards that conflict with the *Conceptual Framework*. They gave the following reasons:
  - (a) departure from the *Conceptual Framework* raises questions about the validity of the concepts in the *Conceptual Framework*.
  - (b) the *Conceptual Framework* should outline the normative thinking or the foundation of financial reporting. The *Conceptual Framework* should be akin to a constitution for developing laws.
  - (c) departing from agreed concepts would undermine the consistency of the IASB's Standards.
34. Many of these respondents agreed with the IASB's preliminary view that in rare cases, a new or revised Standard may need to conflict with *some aspects* of the *Conceptual Framework*, in order to meet the overall objective of financial reporting. Their reasons are:
  - (a) conceptual thinking or the economic environment may change, and the IASB would need to develop new or revised Standards to reflect that new thinking. The *Conceptual Framework* may need to be updated later to keep pace with those changes.
  - (b) when developing or revising Standards, the IASB may need to balance different qualitative characteristics to meet the overall needs of users.

35. Respondents also agreed that any departure from aspects of the *Conceptual Framework* should be explained in the Basis for Conclusions on the Standard in question.
36. Some respondents thought that the idea that the IASB would need to depart from the *Conceptual Framework* was redundant. This is because they thought that, although the IASB might need to balance the qualitative characteristics and the cost constraint to meet the overall objective of financial reporting, the result of that exercise could never constitute a departure.
37. A few respondents thought that departure from the *Conceptual Framework* should only be made for cost-benefit reasons (which would not, in fact, be a departure).

### **Staff analysis and recommendation**

38. It is important to distinguish between:
- (a) doing something that is inconsistent with the objective of financial reporting – which many respondents deem as departing from the *Conceptual Framework as a whole*; and
  - (b) departing from *an aspect* of the *Conceptual Framework*, eg the definition of an asset, in order to meet the overall objective of financial reporting.
39. We think that, in developing or revising Standards, the IASB will always strive to meet the objective of financial reporting. As part of that consideration, the IASB will always consider the qualitative characteristics and weigh whether the benefit of providing information justifies the cost. Therefore, we think it is unlikely that the IASB will ever depart from the objective of financial reporting or depart from the *Conceptual Framework as a whole*.
40. However, in meeting the overall objective of financial reporting, the IASB may conclude that it needs to depart from *some aspect* of the *Conceptual Framework*. We, therefore, recommend that the IASB should continue to have the right to depart from some aspects of the *Conceptual Framework*, if this is necessary to meet the objective of financial reporting. Our staff recommendation is:
- (a) consistent with the view that conceptual thinking may evolve over time.

- (b) consistent with the existing approach to the *Conceptual Framework* that has not caused problems in practice.
41. We also think that the IASB should indicate that departure from the *Conceptual Framework* occurs only in limited circumstances. Frequent departures would defeat the purpose of the *Conceptual Framework*.
42. We also recommend that the IASB confirms the suggestion in the Discussion Paper that if the IASB departs from some aspects of the *Conceptual Framework*, the IASB should explain the departure.

**Question 4**

We recommend confirming that, in a limited number of cases, the IASB may depart from some aspects of the *Conceptual Framework*. If the IASB does so, the IASB will explain that departure in the Basis for Conclusions on the Standard in question. Do you agree?

## Appendix A IAS 8 Hierarchy

A1. IAS 8 states the following:

- 10 In the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:
- (a) relevant to the economic decision-making needs of users; and
  - (b) reliable, in that the financial statements:
    - (i) represent faithfully the financial position, financial performance and cash flows of the entity;
    - (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
    - (iii) are neutral, ie free from bias;
    - (iv) are prudent; and
    - (v) are complete in all material respects.
- 11 In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:
- (a) the requirements in IFRSs dealing with similar and related issues; and
  - (b) the definitions, recognition criteria measurement concepts for assets, liabilities, income and expenses in the *Framework*.<sup>4</sup>
- 12 In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.

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<sup>4</sup> In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

## Appendix B IPSASB's Role and Authority of its Conceptual Framework

B1. The IPSASB's Conceptual Framework states the following:

### **Role of the Conceptual Framework**

1.1 The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (the Conceptual Framework) establishes the concepts that underpin general purpose financial reporting (financial reporting) by public sector entities that adopt the accrual basis of accounting. The International Public Sector Accounting Standards Board (IPSASB) will apply these concepts in developing International Public Sector Accounting Standards (IPSASs) and Recommended Practice Guidelines (RPGs) applicable to the preparation and presentation of general purpose financial reports (GPFRs) of public sector entities.

### **Authority of the Conceptual Framework**

1.2 The Conceptual Framework does not establish authoritative requirements for financial reporting by public sector entities that adopt IPSASs, nor does it override the requirements of IPSASs or RPGs. Authoritative requirements relating to the recognition, measurement and presentation of transactions and other events and activities that are reported in GPFRs are specified in IPSASs.

1.3 The Conceptual Framework can provide guidance in dealing with financial reporting issues not dealt with by IPSASs or RPGs. In these circumstances, preparers and others can refer to and consider the applicability of the definitions, recognition criteria, measurement principles, and other concepts identified in the Conceptual Framework.