March 2018

IFRS® Conceptual Framework
Basis for Conclusions

Conceptual Framework for Financial Reporting

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Basis for Conclusions on the Conceptual Framework for Financial Reporting

This Basis for Conclusions accompanies the *Conceptual Framework for Financial Reporting* (issued March 2018; see separate booklet) and is issued by the International Accounting Standards Board (Board).

ISBN for this part: 978-1-911040-91-0

ISBN for complete publication (two parts): 978-1-911040-89-7

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Basis for Conclusions on the *Conceptual Framework for Financial Reporting*

This Basis for Conclusions accompanies, but is not part of the Conceptual Framework for Financial Reporting *(*Conceptual Framework*). It summarises the considerations of the International Accounting Standards Board (Board) in developing the* Conceptual Framework*. Individual Board members gave greater weight to some factors than to others.*

from paragraph

STATUS AND PURPOSE OF THE *CONCEPTUAL FRAMEWORK*

History of the project

BC0.1 In 1989, the Board's predecessor body, the International Accounting Standards Committee, issued the *Framework for the Preparation and Presentation of Financial Statements* (1989 *Framework*).

BC0.2 In 2004, the Board and the US national standard-setter, the Financial Accounting Standards Board (FASB), started a joint project to revise their conceptual frameworks.

BC0.3 The first phase of the project was to develop chapters that describe the objective of general purpose financial reporting and the qualitative characteristics of useful financial information. In developing these chapters, the Board and the FASB published a Discussion Paper in 2006 (2006 Discussion Paper) and an Exposure Draft in 2008 (2008 Exposure Draft).[1] After considering feedback on those documents and information gained from outreach, in 2010 the Board and the FASB issued two chapters of a revised *Conceptual Framework for Financial Reporting* (2010 *Conceptual Framework*). The chapters on the objective of general purpose financial reporting and qualitative characteristics of useful financial information came into effect as soon as they were issued. The remaining text of the 1989 *Framework* was carried forward to the 2010 *Conceptual Framework* unchanged.

BC0.4 In addition to finalising the chapters on the objective of general purpose financial reporting and qualitative characteristics of useful financial information, the Board and the FASB:

(a) published a Discussion Paper and then an Exposure Draft (2010 Exposure Draft) on the concept of a reporting entity;[2]

(b) discussed the definitions of the elements of financial statements; and

(c) discussed and held public round-table meetings about measurement.

BC0.5 This work did not lead to further revisions at that time because in 2010 the Board and the FASB suspended work on the *Conceptual Framework* to concentrate on other projects.

BC0.6 In 2011, the Board carried out a public consultation on its agenda. Most respondents to that consultation identified the Conceptual Framework as a priority project for the Board. Consequently, in 2012 the Board restarted its Conceptual Framework project.

BC0.7 Before 2010, the Board and the FASB had planned to complete the project in eight separate phases, but completed only one phase—on objectives and qualitative characteristics. On restarting the project in 2012, the Board decided to develop a complete set of proposals for a revised *Conceptual Framework* instead

1 See the Discussion Paper *Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information* published in 2006 and the Exposure Draft *An Improved Conceptual Framework for Financial Reporting: Chapters 1 and 2* published in 2008.

2 See the Discussion Paper *Preliminary Views on an Improved Conceptual Framework for Financial Reporting—The Reporting Entity* published in 2008 and the Exposure Draft *Conceptual Framework for Financial Reporting—The Reporting Entity* published in 2010.

of continuing with the phased approach. Developing the *Conceptual Framework* as a whole enabled the Board and stakeholders to see more clearly the links between different aspects of the *Conceptual Framework*.

BC0.8 In developing the revised *Conceptual Framework*, the Board published a Discussion Paper in 2013 (2013 Discussion Paper) and an Exposure Draft in 2015 (2015 Exposure Draft).[3] After considering feedback on these documents and information gained from outreach, in 2018 the Board completed its Conceptual Framework project when it issued the revised *Conceptual Framework for Financial Reporting* (2018 *Conceptual Framework*).

BC0.9 The work since restarting the project in 2012 was not conducted jointly with the FASB. The 2018 *Conceptual Framework* includes limited changes to the chapters on the objective of general purpose financial reporting and qualitative characteristics of useful financial information. The FASB did not make corresponding changes to its Statements of Financial Accounting Concepts.

Revision in 2018—approach and scope

BC0.10 Although the 2010 *Conceptual Framework* had helped the Board when developing IFRS Standards (Standards):

(a) some important areas were not covered;

(b) the guidance in some areas was unclear; and

(c) some aspects were out of date.

BC0.11 In developing the 2018 *Conceptual Framework*, the Board built on the 2010 *Conceptual Framework*—filling in gaps, as well as clarifying and updating it, but not fundamentally reconsidering all aspects of the 2010 *Conceptual Framework*. In particular, although the Board reconsidered some aspects of chapters on the objective of financial reporting and qualitative characteristics of useful financial information, it did not reconsider those chapters fundamentally. In selecting that approach, the Board noted that these chapters went through extensive due process during the development of the 2010 *Conceptual Framework*.

BC0.12 The Board normally establishes a consultative group for major projects. For the Conceptual Framework project, the Board used the Accounting Standards Advisory Forum (ASAF) as its consultative group. The ASAF is an advisory group to the Board. It comprises national accounting standard-setters and regional bodies with an interest in financial reporting. The Board discussed a range of topics with the ASAF during the development of the 2018 *Conceptual Framework*.

BC0.13 In developing the 2018 *Conceptual Framework*, the Board sought a balance between providing high-level concepts and providing enough detail for the 2018 *Conceptual Framework* to be useful to the Board and others. Some stakeholders stated that in some areas the Board's proposals merely described the factors that the Board would consider in making judgements when developing Standards. They expressed the view that, as a result, the proposals did not examine fundamental concepts and were not sufficiently aspirational. The Board did not

3 See the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* published in 2013 and the Exposure Draft *Conceptual Framework for Financial Reporting* published in 2015.

share that view. The Board viewed the *Conceptual Framework* as a practical tool to help it to develop Standards. The Board concluded that a *Conceptual Framework* would not fulfil this role if it described concepts without explaining the factors the Board needs to consider in making judgements when the application of concepts does not lead to a single answer, or leads to conflicting answers.

BC0.14 In developing the 2018 *Conceptual Framework*, the Board drew on some concepts developed in recent standard-setting projects. The Board's aim in doing so was to reflect the Board's most developed thinking on these matters, not to justify its standard-setting decisions or current practice.

BC0.15 The 2018 *Conceptual Framework* does not address classification of financial instruments with characteristics of both liabilities and equity because the Board did not want to delay other much-needed improvements to the *Conceptual Framework*. The Board is exploring how to distinguish liabilities from equity in its research project on Financial Instruments with Characteristics of Equity. If necessary, the *Conceptual Framework* will be updated as one possible outcome of that project (see paragraph BC4.45).

BC0.16 The discussion of capital and capital maintenance in the 2018 *Conceptual Framework* is unchanged from the 2010 *Conceptual Framework*. That discussion originally appeared in the 1989 *Framework* (see paragraphs BC8.1–BC8.4). The Board may consider revising that discussion in the future if it considers that necessary.

BC0.17 In developing the 2018 *Conceptual Framework*, the Board did not address the equity method of accounting, the translation of amounts denominated in foreign currency or the restatement of the measuring unit in hyperinflation. The Board concluded that these issues would best be dealt with if it were to carry out projects to consider revising Standards on these topics.

Purpose (paragraph SP1.1)

BC0.18 The 2010 *Conceptual Framework* included a long list of possible uses of the *Conceptual Framework*. In 2018, the Board streamlined the list, identifying three main uses of the *Conceptual Framework*: assisting the Board in developing Standards, assisting preparers in developing accounting policies when no Standard applies to a particular transaction or other event (or when a Standard allows a choice of accounting policy) and assisting all parties in understanding and interpreting Standards.

BC0.19 The Board considered whether to focus the stated purpose of the *Conceptual Framework* by stating that its primary purpose would be only to assist the Board in developing Standards. The Board rejected this approach because acknowledging the assistance the *Conceptual Framework* can give to other parties would not prevent the Board from developing focused and consistent concepts that will help it to develop Standards.

BC0.20 Although preparers apply the *Conceptual Framework* in developing accounting policies when no Standard applies to a particular transaction or other event or when a Standard allows a choice of accounting policy, a few aspects of the *Conceptual Framework* can only be applied by the Board. In such cases, the 2018

Conceptual Framework indicates that the Board may make particular decisions in developing Standards (for example, see paragraph 7.17).

Status (paragraphs SP1.2–SP1.3)

BC0.21 The 1989 *Framework* and the 2010 *Conceptual Framework* stated that the *Conceptual Framework* is not a Standard and does not override any specific Standards. In the 2018 *Conceptual Framework*, the Board reconfirmed this status.

BC0.22 The Board found that the status of the *Conceptual Framework* has worked well in practice. Also, an explicit statement that the *Conceptual Framework* does not override any requirements in a Standard prevents entities from attempting to override inappropriately Standards those entities might view as contradicting the *Conceptual Framework*.

BC0.23 In some stakeholders' view, the Board should never develop Standards that depart from the *Conceptual Framework*. The Board disagreed with this view. In some circumstances, the Board might need to depart from aspects of the *Conceptual Framework*. It is helpful for the *Conceptual Framework* to acknowledge this, and to specify that such departures are appropriate only if needed to meet the objective of general purpose financial reporting. That need might arise because conceptual thinking or the economic environment may change, and new or revised Standards might need to reflect these changes.

BC0.24 Some respondents to the 2015 Exposure Draft expressed concerns about the implications of the proposals for future Standards. In particular, they expressed concerns about proposed changes to the definitions of an asset and a liability. In response, the Board tested the revised definitions of an asset and a liability and the guidance supporting those definitions (see paragraphs BC4.19–BC4.22). One of the aims of this test was to enable both the Board and stakeholders to assess implications of the revised concepts for future Standards. In addition, the Board tested for inconsistencies between the revised concepts and existing Standards.

BC0.25 The aim of these tests was not to identify whether the Board should develop proposals to amend any Standards following the revision of the *Conceptual Framework*. Amending a Standard is not an automatic consequence of that revision. Changes to Standards are made to address deficiencies in financial reporting. Any changes to the *Conceptual Framework* that highlight inconsistencies in the Standards must be considered by the Board in the light of other priorities when developing its work plan.[4]

BC0.26 The *IFRS for SMEs®* Standard includes a section on the concepts and basic principles underlying the financial statements of small and medium-sized entities. That section is based on the 1989 *Framework*. The Board will consider whether it should amend this section of the *IFRS for SMEs* Standard when it next reviews that Standard.

4 See paragraph 4.23 of the IFRS Foundation *Due Process Handbook*.

Transition to the 2018 *Conceptual Framework*

BC0.27 The Board and the IFRS Interpretations Committee will start using the 2018 *Conceptual Framework* immediately once it is issued. If, when developing a draft IFRIC® Interpretation, the IFRS Interpretation Committee is faced with an inconsistency between a Standard (including any Standard developed on the basis of the 1989 *Framework* or the 2010 *Conceptual Framework*) and the concepts in the 2018 *Conceptual Framework*, it will refer the issue to the Board, as required by the IFRS Foundation *Due Process Handbook*.[5]

BC0.28 The revised concepts will guide the Board when it develops or revises Standards. However, changes to the *Conceptual Framework* will not automatically lead to changes in existing Standards (see paragraph BC0.25). Accordingly, changes to the *Conceptual Framework* will have no immediate effect on the financial statements of most reporting entities. Preparers of financial statements could be directly affected by the changes only if they need to use the *Conceptual Framework* to develop an accounting policy when no Standard applies to a particular transaction or other event or when a Standard allows a choice of accounting policy.[6] To achieve transition to the 2018 *Conceptual Framework* for such entities, the Board issued *Amendments to References to the Conceptual Framework in IFRS Standards* in 2018. Where appropriate, that document replaces references in Standards to the 1989 *Framework* with references to the 2018 *Conceptual Framework* and updates related quotations.

Business activities

BC0.29 In developing the 2018 *Conceptual Framework*, the Board concluded that the nature of an entity's business activities can affect the relevance of some types of financial information and that the Board may need to consider that factor when developing or revising Standards.

BC0.30 The Board disagreed with the view expressed by some stakeholders that considering the nature of an entity's business activities necessarily leads to subjectivity and impairs comparability of financial statements. An entity's business activities are a matter of fact that can in most cases be determined objectively. Hence, if entities conduct the same type of business activities, the Board expects that those activities would be reflected in a similar manner in the entities' financial statements.

BC0.31 The Board considered whether the nature of business activities should be considered in all areas of standard-setting and should be embedded in the *Conceptual Framework* as an overarching concept. The Board concluded that the

5 See paragraph 7.8 of the IFRS Foundation *Due Process Handbook*.

6 If no Standard specifically applies to a transaction, other event or condition, 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. If a Standard permits a choice of accounting policy, entities select an accounting policy subject to an overall requirement in IAS 1 *Presentation of Financial Statements* that financial statements must provide a fair presentation of the entity's financial position, financial performance and cash flows. The link between fair presentation and the concepts in the *Conceptual Framework* is described in paragraph 15 of IAS 1.

nature of an entity's business activities does not affect all areas of financial reporting in the same way and to the same extent and so it should not be included as an overarching concept. Accordingly, the 2018 *Conceptual Framework* does not include a general discussion of how an entity's business activities affect financial reporting decisions. Instead, the 2018 *Conceptual Framework* describes that factor in the context of:

(a) the selection of the unit of account (see paragraph 4.51(a)(iv)).

(b) the selection of a measurement basis for an asset or liability and for related income and expenses (see paragraphs 6.54–6.57). In some cases, this would lead to some items of income or expenses being included in other comprehensive income (see the discussion of more than one measurement basis in paragraphs 6.83–6.86).

(c) classification of assets, liabilities, equity, income or expenses (see paragraph 7.7).

BC0.32 The concept of business activities is discussed in the 2018 *Conceptual Framework* to assist the Board in developing Standards. In a particular Standard, the concept of business activities can be further explained and developed. The discussion of business model in IFRS 9 *Financial Instruments* is one example of how the Board has applied the concept of business activities.

BC0.33 The Board decided to use the term 'business activities' rather than the term 'business model' in the 2018 *Conceptual Framework*. The term 'business model' is used with a range of different meanings by various organisations, for example, the International Integrated Reporting Council, the Enhanced Disclosure Task Force of the Financial Stability Board and various regulators. Adopting the term 'business model' in the 2018 *Conceptual Framework* could have led to confusion with those definitions.

Implications of long-term investment

BC0.34 The subject of long-term investment has attracted a great deal of attention from governments and others. Governments have indicated that encouraging long-term investment is an important tool for promoting economic growth.

BC0.35 The Board considered the role of its Standards in promoting long-term investment and noted that:

(a) the Board makes an important contribution to the promotion of investment, including long-term investment, by producing Standards that require transparent financial reporting. This is a precondition for the healthy and efficient functioning of financial markets. Transparent financial reporting helps market participants to make more efficient and informed resource allocation and other economic decisions and thus makes investment more attractive to capital providers (investors and lenders). It also provides useful inputs for an assessment of stewardship.

(b) it is not, however, the role of the Standards to encourage or discourage any type of investments. Instead, standard-setting decisions are driven by the need for entities to provide useful information.

BC0.36 When developing the 2018 *Conceptual Framework*, the Board considered whether the *Conceptual Framework* will provide the Board with sufficient and appropriate tools to enable it, when developing Standards, to consider:

(a) the business activity of long-term investment (see paragraphs BC0.37–BC0.39); and

(b) the information needs of long-term investors (see paragraphs BC0.40–BC0.43).

Long-term investment as a business activity

BC0.37 The Board considered a suggestion made by some stakeholders that it should identify long-term investment as a particular type of business activity (or business model) and develop specific measurement and presentation and disclosure requirements for entities conducting that business activity. Some stakeholders expressing those views suggested that:

(a) entities should not use a current value measurement basis for their long-term investments and for their liabilities; or

(b) if a current value measurement basis is used for those investments and liabilities, income and expenses resulting from remeasurements should be included in other comprehensive income, not in the statement of profit or loss.

BC0.38 As discussed in paragraphs 6.54–6.57 of the 2018 *Conceptual Framework*, the nature of the business activities being conducted affects how an asset or liability contributes to future cash flows. Thus, the nature of an entity's business activities is considered in selecting a measurement basis for an asset or liability and for related income and expenses. Moreover, in some cases, considering the nature of an entity's activities may lead to some items of income and expenses being included in other comprehensive income (see paragraphs 6.85–6.86). The Board concluded that the discussion on this factor in the 2018 *Conceptual Framework* provides sufficient tools for the Board to make appropriate standard-setting decisions if future projects consider how to account for the long-term investments of entities whose business activities include long-term investment or for their liabilities.

BC0.39 For the following reasons, the Board decided that the 2018 *Conceptual Framework* should not refer explicitly to the business activity of long-term investment:

(a) referring explicitly to any particular business activity would, inappropriately, embed excessive detail in the *Conceptual Framework*; and

(b) the *Conceptual Framework* does not refer to any other business activity.

Information needs of long-term investors

BC0.40 Some stakeholders suggested that the *Conceptual Framework* should emphasise the information needs of long-term investors and that their information needs may differ from those of short-term investors. Views expressed by these stakeholders included the following:

(a) the Board focuses too much on the needs of short-term investors.

(b) the Board gives too much weight to the needs of potential investors and not enough weight to the needs of existing long-term investors. Existing long-term investors own the reporting entity and bear the residual risks of ownership. Hence, these stakeholders argue that long-term investors need information that helps them to assess management's stewardship of the entity's economic resources.

(c) the Board makes excessive use of current value measurement bases, particularly those reflecting market-participant assumptions, such as fair value, and those measurement bases provide information more relevant to short-term investors than to investors who are interested in long-term value creation.

(d) excessive use of current value measurement bases (especially for long-term investments) and recognition of unrealised gains in the statement of profit or loss may:

  (i) lead to excessive and volatile dividend distributions that are not in the best interest of long-term investors;

  (ii) lead to inflated management remuneration (including bonuses); and

  (iii) encourage short-termism and financial engineering and discourage long-term investment.

BC0.41 For the following reasons, the Board disagreed with the views expressed in paragraph BC0.40:

(a) the Board does not place more emphasis on the needs of short-term investors than on the needs of long-term investors. The Board considers both long-term investors and short-term investors to be primary users of financial statements. Moreover, the Board believes that there is no reason why short-term investors would need information that is not also needed by long-term investors.

(b) the *Conceptual Framework* identifies both existing and potential investors as primary users of financial statements. The Board's discussions with users in its project on the *Conceptual Framework* and in many other projects have identified no reasons why existing investors would need information that differs from the information needed by potential investors. Furthermore, the changes made by the 2018 *Conceptual Framework* to the discussion of the objective of general purpose financial reporting highlight the importance of providing information to help investors to assess management's stewardship of the entity's economic resources. The 2018 *Conceptual Framework* states explicitly that decisions relating to providing resources to the entity include decisions about exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources. Thus, the 2018 *Conceptual Framework* clarifies that the needs of existing investors (including long-term investors) are considered when making decisions about the usefulness of financial information (see paragraphs BC1.36–BC1.37).

(c) when the Board has decided to require or permit current value measurement bases, that has not been because of a belief that those measurement bases would be particularly useful to short-term investors. Instead, the Board's decisions have been driven by an assessment of what information is most likely to be useful to the primary users of financial statements, including both long-term and short-term investors. Under the concepts in Chapter 6—*Measurement* of the 2018 *Conceptual Framework*, this will continue to be the case.

(d) in the Board's view, accounting information (such as reported profit) is not, and should not be, the sole determinant of distributions of dividends and bonuses. Distribution policy is affected by many other factors, for example, the entity's financing needs, current and projected liquidity, the risks faced by the entity, legal constraints and (in the case of bonus decisions) remuneration policy and incentive arrangements. These factors differ by entity, by country and over time. It would be neither desirable nor feasible for the Board to consider them in standard-setting decisions.

BC0.42 For these reasons, the Board concluded that the 2018 *Conceptual Framework* contains sufficient and appropriate discussion of primary users and their information needs, and of the objective of general purpose financial reporting, to address appropriately the needs of long-term investors.

BC0.43 Conceivably, long-term investors may need entities to provide some information that is not also needed by short-term investors; for example, long-term investors may have more extensive needs for information to support decisions to vote on, or otherwise influence, management's actions. However, the Board concluded that to help it to identify what information particular Standards should require entities to provide, there is no need for the *Conceptual Framework* to contain a specific reference to the needs of long-term investors. When the Board develops Standards, it routinely seeks input and feedback from investors, including long-term investors, to help ensure that it understands what information they need.

from paragraph

CHAPTER 1—THE OBJECTIVE OF GENERAL PURPOSE FINANCIAL REPORTING

In 2018, the Board made limited changes to Chapter 1 of the Conceptual Framework. *A description of the Board's considerations in developing those changes was added to the original Basis for Conclusions on this chapter. The Board added a date to the heading of each section of the Basis for Conclusions to indicate when that section was developed. Sections of the Basis for Conclusions that reflect the Board's considerations at the time of developing the chapter in 2010 were not updated in 2018 except to add and update cross-references and to make minor necessary editorial changes.*

Introduction

BC1.1 The first version of Chapter 1 was developed jointly with the FASB and issued in 2010 (see paragraph BC0.3). Consequently, this Basis for Conclusions includes some references to the FASB's literature.

Revision in 2018

BC1.2 When the Board restarted its work on the Conceptual Framework project in 2012, it did not reconsider Chapter 1 fundamentally (see paragraph BC0.11). Although some respondents to the 2013 Discussion Paper agreed with this approach, many stated that the Board should reconsider one or more aspects of Chapter 1. In the light of these comments, the Board considered whether to make changes in the following areas:

(a) primary users (see paragraphs BC1.18–BC1.20); and

(b) stewardship (see paragraphs BC1.32–BC1.41).

BC1.3 The FASB has not made any changes to its Concepts Statement No. 8 *Conceptual Framework for Financial Reporting—Chapter 1*, The Objective of General Purpose Financial Reporting corresponding to the limited changes made by the Board in 2018. The Board concluded that the clarity achieved by its improvements to Chapter 1 outweighs the disadvantages of divergence in those respects from the FASB's version.

General purpose financial reporting (2010)

BC1.4 Consistently with the Board's responsibilities, the *Conceptual Framework* establishes an objective of financial reporting and not just of financial statements. Financial statements are a central part of financial reporting, and most of the issues that the Board addresses involve financial statements. Although the scope of FASB Concepts Statement No. 1 *Objectives of Financial Reporting by Business Enterprises* was financial reporting, the other FASB concepts statements focused on financial statements. The scope of the Board's *Framework for the Preparation and Presentation of Financial Statements*, which was published by the Board's predecessor body in 1989 (1989 *Framework*), dealt with financial statements only. Therefore, for both boards the scope of the 2010 *Conceptual Framework* is broader than the scopes of their previous frameworks.[7]

BC1.5 Some stakeholders suggested that advances in technology may make general purpose financial reporting obsolete. New technologies, for example the use of

7 With the exception of Chapters 1 and 2, the 2018 *Conceptual Framework* focuses on (general purpose) financial statements rather than on (general purpose) financial reports (see paragraph 3.1).

eXtensible Business Reporting Language (XBRL), may make it practicable in the future for reporting entities either to prepare or to make available the information necessary for different users to assemble different financial reports to meet their individual information needs.

BC1.6 To provide different reports for different users, or to make available all of the information that users would need to assemble their own custom-designed reports, would be expensive. Requiring users of financial information to assemble their own reports might also be unreasonable, because many users would need to have a greater understanding of accounting than they have now. Therefore, the Board concluded that for now a general purpose financial report is still the most efficient and effective way to meet the information needs of a variety of users.

BC1.7 In the 2006 Discussion Paper, the Board used the term 'general purpose external financial reporting'. External was intended to convey that internal users such as management were not the intended beneficiaries for general purpose financial reporting as established by the Board. During redeliberations, the Board concluded that this term was redundant. Therefore, Chapter 1 uses 'general purpose financial reporting'.

Financial reporting of the reporting entity (2010)

BC1.8 Some respondents to the 2008 Exposure Draft said that the reporting entity is not separate from its equity investors or a subset of those equity investors. This view has its roots in the days when most businesses were sole proprietorships and partnerships that were managed by their owners who had unlimited liability for the debts incurred in the course of the business. Over time, the separation between businesses and their owners has grown. The vast majority of today's businesses have legal substance separate from their owners by virtue of their legal form of organisation, numerous investors with limited legal liability and professional managers separate from the owners. Consequently, the Board concluded that financial reports should reflect that separation by accounting for the entity (and its economic resources and claims) rather than its primary users and their interests in the reporting entity.[8]

Primary users (paragraphs 1.5, 1.8–1.10)

Primary users (2010)

BC1.9 The objective of financial reporting in paragraph 1.2 refers to existing and potential investors, lenders and other creditors. The description of the primary users in paragraph 1.5 refers to existing and potential investors, lenders and other creditors who cannot require reporting entities to provide information directly to them. Paragraph 1.10 states that 'regulators and members of the public other than investors, lenders and other creditors' may find information in general purpose financial reports useful but states that those are not the parties to whom general purpose financial reports are primarily directed.

8 See also paragraph 3.8 of the 2018 *Conceptual Framework* and paragraphs BC3.9–BC3.10.

BC1.10 Paragraph 9 of the 1989 *Framework* stated that users included ‘present and potential investors, employees, lenders, suppliers and other trade creditors’ (and later added advisers in the discussion of investors’ needs), all of which are intended to be encompassed by the phrase in paragraph 1.2. Paragraph 9 of the 1989 *Framework* also included a list of other potential users such as customers, governments and their agencies, and the public, which is similar to the list in paragraph 1.10 of those who may be interested in financial reports but are not primary users.

BC1.11 Paragraph 10 of the 1989 *Framework* stated that ‘as investors are providers of risk capital to the entity, the provision of financial statements that meet their needs will also meet most of the needs of other users that financial statements can satisfy’, which might have been read to narrow the focus to investors only. However, paragraph 12 explicitly stated that the objective of financial statements is to provide information ‘that is useful to a wide range of users in making economic decisions.’ Thus, the 1989 *Framework* focused on investors’ needs as representative of the needs of a wide range of users but did not explicitly identify a group of primary users.

BC1.12 FASB Concepts Statement 1 referred to ‘present and potential investors and creditors and other users in making rational investment, credit, and similar decisions’ (paragraph 34). It also stated that ‘major groups of investors are equity securityholders and debt securityholders’ and ‘major groups of creditors are suppliers of goods and services who extend credit, customers and employees with claims, lending institutions, individual lenders, and debt securityholders’ (paragraph 35). One difference in emphasis from the 1989 *Framework*, which emphasised providers of risk capital, is that Concepts Statement 1 referred to ‘both those who desire safety of investment and those who are willing to accept risk to obtain high rates of return’ (paragraph 35). However, like the 1989 *Framework*, Concepts Statement 1 stated that the terms investors and creditors ‘also may comprehend security analysts and advisors, brokers, lawyers, regulatory agencies, and others who advise or represent the interests of investors and creditors or who otherwise are interested in how investors and creditors are faring’ (paragraph 35).

BC1.13 Paragraphs 1.3, 1.5 and 1.10 differ from the 1989 *Framework* and Concepts Statement 1 for two reasons—to eliminate differences between the 1989 *Framework* and Concepts Statement 1 and to be more direct by focusing on users making decisions relating to providing resources (but not to exclude advisers). The reasons are discussed in paragraphs BC1.15–BC1.17 and BC1.21–BC1.26.

Should there be a primary user group? (2010)

BC1.14 The 2006 Discussion Paper and the 2008 Exposure Draft proposed identifying a group of primary users of financial reports. Some respondents to the 2008 Exposure Draft said that other users who have not provided, and are not considering providing, resources to the entity, use financial reports for a variety of reasons. The Board sympathised with their information needs but concluded that without a defined group of primary users, the *Conceptual Framework* would risk becoming unduly abstract or vague.

Why are existing and potential investors, lenders and other creditors considered the primary users? (2010)

BC1.15 Some respondents to the 2006 Discussion Paper and the 2008 Exposure Draft suggested that the primary user group should be limited to existing shareholders or the controlling entity's majority shareholders. Others said that the primary users should be existing shareholders and creditors, and that financial reports should focus on their needs.

BC1.16 The reasons why the Board concluded that the primary user group should be the existing and potential investors, lenders and other creditors of a reporting entity are:

(a) Existing and potential investors, lenders and other creditors have the most critical and immediate need for the information in financial reports and many cannot require the entity to provide the information to them directly.

(b) The Board's and the FASB's responsibilities require them to focus on the needs of participants in capital markets, which include not only existing investors but also potential investors and existing and potential lenders and other creditors.

(c) Information that meets the needs of the specified primary users is likely to meet the needs of users both in jurisdictions with a corporate governance model defined in the context of shareholders and those with a corporate governance model defined in the context of all types of stakeholders.

BC1.17 Some respondents expressed the view that the specified primary user group was too broad and that it would result in too much information in the financial reports. However, too much is a subjective judgement. In developing financial reporting requirements that meet the objective of financial reporting, the boards will rely on the qualitative characteristics of, and the cost constraint on, useful financial information to provide discipline to avoid providing too much information.

Primary user group (2018)

BC1.18 Views expressed by respondents to the 2013 Discussion Paper and to the 2015 Exposure Draft about the description of the primary user group were similar to those expressed by stakeholders and considered by the Board when it originally developed Chapter 1:

(a) some respondents commented that the primary user group is defined too narrowly. They argued that it should be expanded to include, for example, employees, customers, suppliers, regulators and others.

(b) in contrast, others said that the primary user group is defined too broadly. These respondents stated that the Board should describe primary users as holders of equity claims against the entity (or perhaps as the holders of the most residual equity claims against the entity). The respondents argued that holders of equity claims have different (and perhaps more extensive) information needs than other capital providers because they are exposed to more extensive risks.

BC1.19 In the light of views expressed by respondents, the Board reconsidered the description of the primary user group. Nevertheless, it concluded that its reasons for describing the primary user group as the existing and potential investors, lenders and other creditors of a reporting entity were still valid (see paragraph BC1.16). In addition, as explained in paragraph 1.8 of the 2018 *Conceptual Framework*, focusing on the common information needs of the primary users does not prevent a reporting entity from including additional information that is most useful to a particular subset of primary users. Consequently, the Board concluded that no changes to the description of the primary user group were needed.

BC1.20 In addition, the Board decided that there was no need for the 2018 *Conceptual Framework* to identify long-term investors as a particular subset of primary users with specific information needs (see paragraphs BC0.40–BC0.41).

Should there be a hierarchy of users? (2010)

BC1.21 Some respondents to the 2008 Exposure Draft who supported the composition of the primary user group also recommended that the Board should establish a hierarchy of primary users because investors, lenders and other creditors have different information needs. However, the Board observed that individual users may have information needs and desires that are different from, and possibly conflict with, those of other users with the same type of interest in the reporting entity. General purpose financial reports are intended to provide common information to users and cannot accommodate every request for information. The Board will seek the information set that is intended to meet the needs of the maximum number of users in cost-beneficial ways.

Information needs of other users who are not within the primary user group (2010)

Management's information needs (2010)

BC1.22 Some stakeholders questioned the interaction between general purpose financial reporting and management's needs. The Board stated that some of the information directed to the primary users is likely to meet some of management's needs but not all of them. However, management has the ability to access additional financial information, and consequently, general purpose financial reporting need not be explicitly directed to management.

Regulators' information needs (2010)

BC1.23 Some stakeholders said that maintaining financial stability in capital markets (the stability of a country's or region's economy or financial systems) should be an objective of financial reporting. They stated that financial reporting should focus on the needs of regulators and fiscal policy decision-makers who are responsible for maintaining financial stability.

BC1.24 Other stakeholders opposed establishing an objective to maintain financial stability. They said that financial statements should present the economic reality of the reporting entity with as little bias as possible, but that such a presentation is not necessarily inconsistent with a financial stability objective. By presenting economic reality, financial statements could lead to more informed decision-making and thereby support financial stability even if that is not the primary aim.[9]

BC1.25 However, advocates of a financial stability objective had a different outcome in mind. They did not encourage the Board to require reporting entities to provide information for use by regulators and fiscal policy decision-makers. Instead, they recommended that the Board consider the consequences of new Standards for the stability of the world's economies and financial systems and, at least at times, assign greater weight to that objective than to the information needs of investors, lenders and other creditors.

BC1.26 The Board acknowledged that the interests of investors, lenders and other creditors often overlap with those of regulators. However, expanding the objective of financial reporting to include maintaining financial stability could at times create conflicts between the objectives that the Board is not well-equipped to resolve. For example, some may take the view that the best way to maintain financial stability is to require entities not to report, or to delay reporting, some changes in asset or liability values. That requirement would almost certainly result in depriving investors, lenders and other creditors of information that they need. The only way to avoid conflicts would be to eliminate or de-emphasise the existing objective of providing information to investors, lenders and other creditors. The Board concluded that eliminating that objective would be inconsistent with its basic mission, which is to serve the information needs of participants in capital markets. The Board also noted that providing financial information that is relevant and faithfully represents what it purports to represent can improve users' confidence in the information, and thus contribute to promoting financial stability.[10]

Usefulness for making decisions (paragraphs 1.2–1.4)

Usefulness for making decisions (2010)

BC1.27 Both the Board's and the FASB's previous frameworks focused on providing information that is useful in making economic decisions as the fundamental objective of financial reporting. Those frameworks also stated that financial information that is useful in making economic decisions would also be helpful in assessing how management has fulfilled its stewardship responsibility.

9 One group expressing that view was the Financial Crisis Advisory Group (FCAG). The FCAG comprised approximately 20 senior leaders with broad experience in international financial markets and an interest in the transparency of financial reporting information. The FCAG was formed in 2009 to advise the Board and the FASB about the standard-setting implications of the financial crisis and of potential changes in the global regulatory environment.

10 See also paragraphs BC0.34–BC0.43 for the Board's 2018 discussion on the role of Standards in promoting long-term investment and paragraph SP1.5 of the 2018 *Conceptual Framework* for an explanation of the *Conceptual Framework*'s contribution to the mission of the IFRS Foundation and of the Board, which is to develop Standards that bring transparency, accountability and efficiency to financial markets.

BC1.28 The 2006 Discussion Paper that led to Chapter 1 stated that the objective of financial reporting should focus on resource allocation decisions. Although most respondents to the 2006 Discussion Paper agreed that providing useful information for decision-making was the appropriate objective, they said that investors, lenders and other creditors make other decisions that are aided by financial reporting information in addition to resource allocation decisions. For example, shareholders who vote on whether to retain directors or replace them, and on how members of management should be remunerated for their services, need information on which to base their decisions. Shareholders' decision-making process may include evaluating how management of the entity performed against management in competing entities in similar circumstances.

BC1.29 The Board agreed with these respondents and noted that, in most cases, information designed for resource allocation decisions would also be useful for assessing management's performance. Therefore, in the 2008 Exposure Draft leading to Chapter 1, the Board proposed that the objective of financial reporting is to provide financial information about the reporting entity that is useful to present and potential investors, lenders and other creditors in making decisions in their capacity as capital providers. The 2008 Exposure Draft also described the role financial statements can have in supporting decisions related to the stewardship of an entity's resources.

BC1.30 The 2008 Exposure Draft discussed the *Objective of Financial Reporting and Decision-usefulness* in separate sections. The Board combined those two sections in Chapter 1 because usefulness in making decisions is the objective of financial reporting. Consequently, both sections addressed the same points and provided more detail than was necessary. Combining those two sections resulted in eliminating the separate subsections on usefulness in assessing cash flow prospects and usefulness in assessing stewardship. The Board did not intend to imply that assessing prospects for future cash flow or assessing the quality of management's stewardship is more important than the other. Both are important for making decisions about providing resources to an entity, and information about stewardship is also important for resource providers who have the ability to vote on, or otherwise influence, management's actions.

BC1.31 The Board decided not to use the term 'stewardship' in the 2010 *Conceptual Framework* because there would be difficulties in translating it into other languages. Instead, the Board described what stewardship encapsulates. Accordingly, the objective of financial reporting in the 2010 *Conceptual Framework* acknowledged that users make resource allocation decisions as well as decisions as to whether management has made efficient and effective use of the resources provided.

Stewardship (2018)

BC1.32 After Chapter 1 was issued in 2010, some stakeholders interpreted the chapter, and in particular the removal from it of the term 'stewardship', as neglecting the fact that users of financial statements need information to help them to assess management's stewardship. As mentioned in paragraph BC1.30, the

Board had not intended to neglect that need. Nevertheless, the Board concluded subsequently that the wording in the 2010 *Conceptual Framework* was not clear enough.

BC1.33 Thus, in the 2018 *Conceptual Framework* the Board improved the wording to clarify its original intention. The Board reintroduced the term 'stewardship' and, in describing the objective of general purpose financial reporting, gave more prominence to the importance of providing information needed to assess management's stewardship of the entity's economic resources. That extra prominence contributes to highlighting management's accountability to users for economic resources entrusted to their care.

BC1.34 To provide that greater prominence, the 2018 *Conceptual Framework* identifies information needed to assess management's stewardship as possibly partly separate from the information needed to help users to assess the prospects for future net cash inflows to the entity. Both types of information are needed to meet the overall objective of financial reporting—that is to provide information that is useful for making decisions relating to providing resources to the entity (resource allocation decisions).

BC1.35 The Board also considered other approaches suggested by some stakeholders. Those approaches would have identified the provision of information to help to assess management's stewardship as part of the objective of financial reporting or as an additional and equally prominent objective. The Board rejected those approaches because:

(a) assessing management's stewardship is not an end in itself; it is an input needed in making resource allocation decisions. For example, a conclusion that management's stewardship is unsatisfactory may lead to a decision to replace management with the aim of increasing future returns.

(b) introducing an additional objective of financial reporting could be confusing.

BC1.36 Further, in the 2018 *Conceptual Framework* the Board clarified how the assessment of management's stewardship contributed to resource allocation decisions. The Board did this by expanding the explanation of resource allocation decisions. The feedback on the 2015 Exposure Draft indicated that some respondents interpreted resource allocation decisions as referring solely to buying, selling or holding decisions. Thus, in their view, resource allocation decisions excluded decisions made while holding an investment, for example, decisions to reappoint or replace management, to assess the adequacy of management's remuneration or to approve a business strategy proposed by management.

BC1.37 The Board did not intend resource allocation decisions to be interpreted narrowly as referring solely to buying, selling or holding decisions. Consequently, the 2018 *Conceptual Framework* states explicitly that resource allocation decisions involve decisions about:

(a) buying, selling or holding equity and debt instruments;

(b) providing or settling loans and other forms of credit; or

(c) exercising rights to vote on, or otherwise influence, management's[11] actions that affect the use of the entity's economic resources.

Users of financial statements need to assess both the amount, timing and uncertainty of future net cash inflows and management's stewardship of the entity's economic resources to make any of these decisions.

BC1.38 Paragraph BC1.37(c) refers to management's actions that affect the use of the entity's economic resources. One example of a decision about such actions is a decision in voting on the membership of the Board of directors. That vote will ultimately influence the Board of directors' subsequent actions affecting the use of the entity's economic resources. However, financial reporting is not designed to provide information that will help the primary users of that information to exercise their rights to vote on other actions by management, such as developing a statement on an issue of a public policy that does not directly affect the use of the entity's economic resources.

BC1.39 Some respondents to the 2015 Exposure Draft suggested that in some cases the information needed to assess management's stewardship differs from the information needed to assess prospects for future net cash inflows to the entity. In particular, these respondents focused on the selection of a measurement basis:

(a) some respondents suggested that, in some cases, historical cost measures are more useful than current value measures for assessing stewardship because, in their opinion, historical cost measures are more verifiable and provide a more direct link to the transactions actually undertaken by management; and

(b) in contrast, other respondents argued that, in some cases, current value measures may be more useful for assessing stewardship because, in their opinion, such measures can provide information about how well management has performed in comparison with other courses of action currently available.

BC1.40 In giving more prominence to stewardship within the description of the objective of financial reporting in the 2018 *Conceptual Framework*, the Board did not intend to imply a preference for any particular measurement basis. Factors to be considered in the selection of a measurement basis are discussed in Chapter 6—*Measurement* of the 2018 *Conceptual Framework*.

The term 'stewardship' (2018)

BC1.41 The revised Chapter 1 reintroduces the term 'stewardship' and explains that the assessment of management's stewardship involves assessing how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's economic resources (see paragraphs 1.4 and 1.22–1.23). That assessment enables users of financial statements to hold management to account for its actions. The Board's use of the term 'stewardship' is consistent with the general understanding of that term: the

11 The term 'management' refers to management and the governing board of an entity (see paragraph 1.4(b) of the 2018 *Conceptual Framework*).

careful and responsible management of something entrusted to one's care.[12] These improvements to Chapter 1 provide increased clarity and the Board concluded that this outweighs the translation difficulties identified in 2010.

The objective of financial reporting for different types of entities (2010)

BC1.42 The Board considered whether the objective of general purpose financial reporting should differ for different types of entities. Possibilities include:

(a) smaller entities versus larger entities;

(b) entities with listed (publicly traded) debt or equity financial instruments versus those without such instruments; and

(c) closely held entities versus those with widely dispersed ownership.

BC1.43 External users of financial reporting have similar objectives, irrespective of the type of entities in which they invest. Therefore, the Board concluded that the objective of general purpose financial reports is the same for all entities. However, cost constraints and differences in activities among entities may sometimes lead the Board to permit or require differences in reporting for different types of entities.

Information about a reporting entity's economic resources, claims against the entity and changes in resources and claims (paragraphs 1.12–1.21)

The significance of information about financial performance (2010)

BC1.44 A long-standing assertion by many stakeholders is that a reporting entity's financial performance as represented by comprehensive income and its components is the most important information.[13] Concepts Statement 1 (paragraph 43) stated:

> The primary focus of financial reporting is information about an enterprise's performance provided by measures of comprehensive income and its components. Investors, creditors, and others who are concerned with assessing the prospects for enterprise net cash inflows are especially interested in that information.

In contrast, the 1989 *Framework* considered information on the reporting entity's financial position and financial performance of equal importance.

BC1.45 To be useful for decision-making, financial reports must provide information about a reporting entity's economic resources and claims, and the change during a period in economic resources and claims. A reporting entity cannot provide reasonably complete information about its financial performance (as represented by comprehensive income, profit or loss or other similar terms) without identifying and measuring its economic resources and the claims.

12 This definition of stewardship is provided in the Merriam-Webster online dictionary (https://www.merriam-webster.com/dictionary/stewardship).

13 Concepts Statement 1 referred to 'earnings and its components'. However, FASB Concepts Statement No. 6 *Elements of Financial Statements* substituted the term 'comprehensive income' for the term 'earnings'. The latter term is reserved for a component of comprehensive income.

Consequently, the Board concluded that to designate one type of information as the primary focus of financial reporting would be inappropriate.

BC1.46 In discussing the financial position of an entity, the 2008 Exposure Draft referred to 'economic resources and claims on them'. The chapter uses the phrase 'the entity's economic resources and the claims against the reporting entity' (see paragraph 1.12). The reason for the change is that in many cases, claims against an entity are not claims on specific resources. In addition, many claims will be satisfied using resources that will result from future net cash inflows. Thus, while all claims are claims against the entity, not all are claims against the entity's existing resources.

Financial position and solvency (2010)

BC1.47 Some stakeholders have suggested that the main purpose of the statement of financial position should be to provide information that helps assess the reporting entity's solvency. The question is not whether information provided in the financial reports should be helpful in assessing solvency; clearly, it should. Assessing solvency is of interest to investors, lenders and other creditors, and the objective of general purpose financial reporting is to provide information that is useful to them for making decisions.

BC1.48 However, some have suggested that the statement of financial position should be directed towards the information needs of lenders, other creditors and regulators, possibly to the detriment of investors and other users. To do so would be inconsistent with the objective of serving the common information needs of the primary user group. Therefore, the Board rejected the notion of directing the statement of financial position (or any other particular financial statement) towards the needs of a particular subset of users.

from paragraph

CHAPTER 2—QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION

In 2018, the Board made limited changes to Chapter 2 of the Conceptual Framework*. A description of the Board's considerations in developing those changes was added to the original Basis for Conclusions on this chapter. The Board added a date to the heading of each section of the Basis for Conclusions to indicate when that section was developed. Sections of the Basis for Conclusions that reflect the Board's considerations at the time of developing the chapter in 2010 were not updated in 2018 except to add and update cross-references and to make minor necessary editorial changes.*

Introduction

BC2.1 The first version of this chapter was developed jointly with the FASB and issued in 2010 as Chapter 3 of the 2010 *Conceptual Framework* (see paragraph BC0.3). Consequently, this Basis for Conclusions includes some references to the FASB's literature.

Revision in 2018

BC2.2 When the Board restarted its work on the *Conceptual Framework* project in 2012, it did not reconsider fundamentally the chapter on the qualitative characteristics of useful financial information (see paragraph BC0.11). Although some respondents to the 2013 Discussion Paper agreed with this approach, many stated that the Board should reconsider one or more aspects of this chapter. In the light of these comments, the Board considered whether to make changes in the following areas:

(a) materiality (see paragraph BC2.20);

(b) reliability and measurement uncertainty (see paragraphs BC2.28–BC2.31 and BC2.46–BC2.49);

(c) substance over form (see paragraph BC2.33);

(d) prudence (see paragraphs BC2.37–BC2.45); and

(e) applying the fundamental qualitative characteristics (see paragraphs BC2.52–BC2.57).

BC2.3 In addition, the Board renumbered the chapter on qualitative characteristics of useful financial information as Chapter 2. The Board also made some editorial changes to Chapter 2, mainly to use the term 'faithful representation' more precisely by discussing whether financial information faithfully represents what it purports to represent (for example, an economic phenomenon), rather than by discussing whether financial information itself is faithfully represented.

BC2.4 The FASB has not made any changes to its Concepts Statement No. 8 *Conceptual Framework for Financial Reporting—Chapter 3*, Qualitative Characteristics of Useful Financial Information corresponding to the limited changes made by the Board in 2018. The Board concluded that the clarity achieved by its improvements to Chapter 2 outweigh the disadvantages of divergence in those respects from the FASB's version.

The objective of financial reporting and the qualitative characteristics of useful financial information (2010)

BC2.5 Alternatives are available for all aspects of financial reporting, including recognition, derecognition, measurement, classification, presentation and disclosure. When developing Standards, the Board will choose the alternative that goes furthest towards achieving the objective of financial reporting. Preparers of financial information will also have to choose among the alternatives in a way that achieves the objective of financial reporting if no Standards apply or if application of a particular Standard requires judgements or provides options.

BC2.6 Chapter 1 specifies that the objective of general purpose financial reporting 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. The decision-makers on which this *Conceptual Framework* focuses are existing and potential investors, lenders and other creditors.

BC2.7 That objective by itself leaves a great deal to judgement and provides little guidance on how to exercise that judgement. Chapter 2 describes the first step in making the judgements needed to apply that objective. It identifies and describes the qualitative characteristics that financial information should have if it is to meet the objective of financial reporting. It also discusses cost, which is a pervasive constraint on financial reporting.

BC2.8 Subsequent chapters use the qualitative characteristics to help guide choices about recognition, measurement and the other aspects of financial reporting.

Fundamental and enhancing qualitative characteristics (2010) (paragraph 2.4)

BC2.9 Chapter 2 distinguishes between the fundamental qualitative characteristics that are the most critical and the enhancing qualitative characteristics that are less critical but still highly desirable. The 2006 Discussion Paper did not explicitly distinguish between those qualitative characteristics. The Board made the distinction later because of confusion among respondents to the 2006 Discussion Paper about how the qualitative characteristics relate to each other.

BC2.10 Some respondents to the 2008 Exposure Draft stated that all of the qualitative characteristics should be considered equal, and that the distinction between fundamental and enhancing qualitative characteristics was arbitrary. Others said that the most important qualitative characteristic differs depending on the circumstances; therefore, differentiating qualitative characteristics was not appropriate.

BC2.11 The Board does not agree that the distinction is arbitrary. Financial information without the two fundamental qualitative characteristics of relevance and faithful representation is not useful, and it cannot be made useful by being more comparable, verifiable, timely or understandable. However, financial information that is relevant and faithfully represents what it purports to represent may still be useful even if it does not have any of the enhancing qualitative characteristics.

Fundamental qualitative characteristics (paragraphs 2.5–2.22)

Relevance (paragraphs 2.6–2.11)

BC2.12 It is self-evident that financial information is useful for making a decision only if it is capable of making a difference in that decision. 'Relevance' is the term used in the *Conceptual Framework* to describe that capability. It is a fundamental qualitative characteristic of useful financial information.

BC2.13 The definition of relevance in the *Conceptual Framework* is consistent with the definition in FASB Concepts Statement No. 2 *Qualitative Characteristics of Accounting Information*. The 1989 *Framework* definition of relevance was that information is relevant only if it actually makes a difference in users' decisions. However, users consider a variety of information from many sources, and the extent to which a decision is affected by information about a particular economic phenomenon is difficult, if not impossible, to determine, even after the fact.

BC2.14 In contrast, whether information is capable of making a difference in a decision (relevance as defined in the 2010 *Conceptual Framework*) can be determined. One of the primary purposes of publishing exposure drafts and other due process documents is to seek the views of users on whether information that would be required by proposed Standards is capable of making a difference in their decisions. The Board also assesses relevance by meeting users to discuss proposed Standards, potential agenda decisions, effects on reported information of applying recently implemented Standards and other matters.

Predictive and confirmatory value (2010) (paragraphs 2.7–2.10)

BC2.15 Many decisions by investors, lenders and other creditors are based on implicit or explicit predictions about the amount and timing of the return on an equity investment, loan or other debt instrument. Consequently, information is capable of making a difference in one of those decisions only if it will help users to make new predictions, confirm or correct prior predictions or both (which is the definition of predictive or confirmatory value).

BC2.16 The 1989 *Framework* identified predictive value and confirmatory value as components of relevance, and Concepts Statement 2 referred to predictive value and feedback value. The Board concluded that confirmatory value and feedback value were intended to have the same meaning. The Board and the FASB agreed that both boards would use the same term (confirmatory value) to avoid giving the impression that the two frameworks were intended to be different.

The difference between predictive value and related statistical terms (2010)

BC2.17 Predictive value, as used in the *Conceptual Framework*, is not the same as predictability and persistence as used in statistics. Information has predictive value if it can be used in making predictions about the eventual outcomes of past or current events. In contrast, statisticians use predictability to refer to the accuracy with which it is possible to foretell the next number in a series and persistence to refer to the tendency of a series of numbers to continue to change as it has changed in the past.

Materiality (2010) (paragraph 2.11)

BC2.18 Concepts Statement 2 and the 1989 *Framework* discussed materiality and defined it similarly. Concepts Statement 2 described materiality as a constraint on financial reporting that can be considered only together with the qualitative characteristics, especially relevance and faithful representation. The 1989 *Framework*, on the other hand, discussed materiality as an aspect of relevance and did not indicate that materiality has a role in relation to the other qualitative characteristics.

BC2.19 The 2006 Discussion Paper and the 2008 Exposure Draft proposed that materiality is a pervasive constraint in financial reporting because it is pertinent to all of the qualitative characteristics. However, some respondents to the 2008 Exposure Draft agreed that although materiality is pervasive, it is not a constraint on a reporting entity's ability to report information. Rather, materiality is an aspect of relevance, because immaterial information does not affect a user's decision. Furthermore, a standard-setter does not consider materiality when developing standards because it is an entity-specific consideration. The boards agreed with those views and concluded that materiality is an aspect of relevance that applies at the individual entity level.

Materiality (2018)

BC2.20 In revising the *Conceptual Framework* in 2018, the Board concluded that the concept of materiality is described clearly in the 2010 *Conceptual Framework*. Hence, the Board did not amend that description of materiality, except to clarify that the users mentioned in the description are the primary users of general purpose financial reports, as described in paragraph 1.5 of the *Conceptual Framework*. This clarification emphasises that decisions about materiality are intended to reflect the needs of the primary users, not the needs of any other group.

Faithful representation (paragraphs 2.12–2.19)

BC2.21 The discussion of faithful representation in Chapter 3 of the 2010 *Conceptual Framework* differed from that in the previous frameworks in two significant ways. First, it used the term 'faithful representation' instead of the term 'reliability'. Second, substance over form, prudence (conservatism) and verifiability, which had been aspects of reliability in Concepts Statement 2 and the 1989 *Framework*, were not considered aspects of faithful representation in the 2010 *Conceptual Framework*. References to substance over form and prudence were removed in 2010 for the reasons described in paragraphs BC2.32 and BC2.34, but they were reinstated, with clarifications, in the 2018 *Conceptual Framework*. Since 2010, verifiability has been described as an enhancing qualitative characteristic rather than as part of this fundamental qualitative characteristic (see paragraphs 2.30–2.32).

Replacement of the term 'reliability' (2010)

BC2.22 Concepts Statement 2 and the 1989 *Framework* used the term 'reliability' to describe what is now called faithful representation.

BC2.23 Concepts Statement 2 listed representational faithfulness, verifiability and neutrality as aspects of reliability and discussed completeness as part of representational faithfulness.

BC2.24 The 1989 *Framework* said:

> Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.

The 1989 *Framework* also discussed substance over form, neutrality, prudence and completeness as aspects of faithful representation.

BC2.25 Unfortunately, neither framework clearly conveyed the meaning of reliability. The comments of respondents to numerous proposed standards indicated a lack of a common understanding of the term 'reliability'. Some focused on verifiability or free from material error to the virtual exclusion of faithful representation. Others focused more on faithful representation, perhaps combined with neutrality. Some apparently think that reliability refers primarily to precision.

BC2.26 Because attempts to explain what reliability was intended to mean in this context have proved unsuccessful, the Board sought a different term that would more clearly convey the intended meaning. The term 'faithful representation', the faithful depiction in financial reports of economic phenomena, was the result of that search. That term encompasses the main characteristics that the previous frameworks included as aspects of reliability.

BC2.27 Many respondents to the 2006 Discussion Paper and the 2008 Exposure Draft opposed the Board's preliminary decision to replace 'reliability' with 'faithful representation'. Some said that the Board could have better explained what reliable means rather than replacing the term. However, many respondents who made those comments assigned a different meaning to reliability from what the Board meant. In particular, many respondents' descriptions of reliability more closely resembled the Board's notion of verifiability than its notion of reliability. Those comments led the Board to affirm its decision to replace the term 'reliability' with 'faithful representation'.

Retention of the term 'faithful representation' (2018)

BC2.28 In developing the 2018 *Conceptual Framework*, the Board considered whether to reinstate the term 'reliability' as a label for the qualitative characteristic now called 'faithful representation'. Arguments given for such a reinstatement by some stakeholders included:

(a) the term 'reliability' is clearer and better understood than the term 'faithful representation'.

(b) the 2010 *Conceptual Framework* implies that anything can be faithfully represented if sufficient explanatory information is given. This interpretation of faithful representation would allow the recognition of items that cannot be measured reliably. Consequently, the qualitative characteristic of faithful representation does not act as an effective filter when identifying the types of information to be included in financial statements.

(c) the 1989 *Framework* acknowledged a trade-off between the qualitative characteristics of relevance and reliability. More relevant information may lack reliability and more reliable information may lack relevance. Some respondents expressed the view that this trade-off was missing in the 2010 *Conceptual Framework* (see paragraphs BC2.52–BC2.57).

(d) the idea that financial statements should be credible, that is, that users need assurance that they can depend on financial statements to faithfully represent what they purport to represent, is a key concept that should be acknowledged in the *Conceptual Framework*. Treating that concept solely as an enhancing qualitative characteristic (verifiability, see paragraphs BC2.60–BC2.62) gives it too little weight.

BC2.29 The Board noted that the notion of reliability was used in two different ways in Standards:

(a) to mean that the level of measurement uncertainty is tolerable. This use of the word reflects the recognition criteria included in the 1989 *Framework* (and not reviewed in amending the 1989 *Framework* in 2010)—an item that meets the definition of an element is recognised only if it is probable there will be a flow of economic benefits and it has a cost or value that can be measured with reliability.

(b) to refer to a qualitative characteristic of useful financial information—the characteristic previously called 'reliability' and now called 'faithful representation'. This use of reliability is much less frequent in Standards.

BC2.30 The decision to change from the term 'reliability' to the term 'faithful representation' was made to avoid confusion between the two uses of the word 'reliability' described in paragraph BC2.29. The responses both to the 2013 Discussion Paper and the 2015 Exposure Draft seemed to confirm that many respondents continue to equate the word 'reliability' with a tolerable level of measurement uncertainty, not with the qualitative characteristic described in the 1989 *Framework*. Hence, the Board retained the term 'faithful representation' as the label for the qualitative characteristic previously called 'reliability'. However, to address concerns that the 2010 *Conceptual Framework* did not adequately discuss the role of measurement uncertainty in financial reporting, the Board included in the 2018 *Conceptual Framework* a discussion of how measurement uncertainty affects the usefulness of financial information (see paragraphs 2.19, 2.22 and BC2.46–BC2.49). Furthermore, the 2018 *Conceptual Framework* discusses the role of measurement uncertainty in decisions about recognition and measurement (see paragraphs 5.19–5.23 and 6.60).

BC2.31 Following the 2018 amendments to the discussion of prudence and substance over form (see paragraphs BC2.37–BC2.45 and BC2.33), the description of the qualitative characteristic of reliability in the 1989 *Framework* and the description of the qualitative characteristic of faithful representation in the 2018 *Conceptual Framework* are substantially aligned. Table 2.1 compares those descriptions.

Table 2.1—Reliability in the 1989 *Framework* and faithful representation in the 2018 *Conceptual Framework*

1989 *Framework* **Reliability**	**2018 *Conceptual Framework*** **Faithful representation**
Can be depended on by users to faithfully represent what it purports to represent	Faithfully represents the phenomena that it purports to represent (see paragraph 2.12)
Complete	Complete (see paragraph 2.14)
Neutral	Neutral (see paragraph 2.15)
Free from material error or bias	Free from error and neutral (see paragraphs 2.18 and 2.15)
Substance over form	Substance over form (see paragraph 2.12)
Prudence	Prudence (see paragraphs 2.16–2.17)

Substance over form (2010) (paragraph 2.12)

BC2.32 In the 2010 *Conceptual Framework*, substance over form was not considered a separate component of faithful representation because the Board concluded that it would be redundant. Faithful representation means that financial information represents the substance of an economic phenomenon rather than merely representing its legal form. Representing a legal form that differs from the economic substance of the underlying economic phenomenon could not result in a faithful representation.

Substance over form (2018)

BC2.33 In developing the 2018 *Conceptual Framework*, the Board noted that some stakeholders had inferred that the 2010 deletion of the reference to substance over form meant that the Board was no longer committed to depicting the substance of an economic phenomenon. The Board did not intend to imply such a change. Accordingly, to avoid any further misunderstandings and to highlight the Board's intention, the Board reinstated in paragraph 2.12 of the 2018 *Conceptual Framework* an explicit reference to the need to faithfully represent the substance of an economic phenomenon. The Board explained further how to provide a faithful representation of the substance of contractual rights and contractual obligations in paragraphs 4.59–4.62 of the 2018 *Conceptual Framework*.

Prudence and neutrality (2010) (paragraph 2.15)

BC2.34 Chapter 2 of the 2010 *Conceptual Framework* did not include prudence or conservatism as an aspect of faithful representation because the Board concluded then that including either would be inconsistent with neutrality. Some respondents to the 2006 Discussion Paper and the 2008 Exposure Draft disagreed with that view. They said that the framework should include conservatism, prudence or both. They said that bias should not always be assumed to be undesirable, especially in circumstances when bias, in their view, produces information that is more relevant to some users.

BC2.35 Deliberately reflecting conservative estimates of assets, liabilities, income or equity has sometimes been considered desirable to counteract the effects of some management estimates that have been perceived as excessively optimistic. However, even with the prohibitions against deliberate misstatement that appeared in the 1989 *Framework*, an admonition to be prudent is likely to lead to a bias. Understating assets or overstating liabilities in one period frequently leads to overstating financial performance in later periods—a result that cannot be described as prudent or neutral.

BC2.36 Other respondents to the 2008 Exposure Draft said that neutrality is impossible to achieve. In their view, relevant information must have purpose, and information with a purpose is not neutral. In other words, because financial reporting is a tool to influence decision-making, it cannot be neutral. Obviously, reported financial information is expected to influence the actions of users of that information, and the mere fact that many users take similar actions on the basis of reported information does not demonstrate a lack of neutrality. The Board does not attempt to encourage or predict specific actions of users. If financial information is biased in a way that encourages users to take or avoid predetermined actions, that information is not neutral.

Prudence (2018) (paragraphs 2.16–2.17)

BC2.37 In developing the 2018 *Conceptual Framework*, the Board noted that different stakeholders apply the term ‘prudence’ to mean different things. In particular:

(a) some use it to refer to being cautious when making judgements under conditions of uncertainty, but without employing more caution in judgements relating to income or assets than in those relating to expenses or liabilities (‘cautious prudence’—see paragraphs BC2.39–BC2.40).

(b) others use it to refer to applying systematic asymmetry—expenses are recognised at an earlier stage than is income (‘asymmetric prudence’—see paragraphs BC2.41–BC2.45). Stakeholders expressed a range of views on how to achieve such asymmetry and to what extent it should be achieved. For example, some advocate a concept of prudence that would:

  (i) require more persuasive evidence to support the recognition of income or assets than the recognition of expenses or liabilities; or

  (ii) require the selection of measurement bases that recognise losses at an earlier stage than gains.

BC2.38 An understanding of prudence is linked to an understanding of the term 'neutrality'. The Board has identified two aspects of neutrality:

(a) the neutral application of accounting policies—applying the selected accounting policies in a neutral (ie unbiased) manner (see paragraph BC2.39); and

(b) the selection of neutral accounting policies—selecting accounting policies in order to provide relevant information that faithfully represents the items that it purports to represent (see paragraph BC2.44). A faithful representation requires that the depiction is neutral.

Financial information is neutral if it is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that the information will be received favourably or unfavourably by users.[14]

BC2.39 The Board was persuaded by the arguments made by some stakeholders that applying prudence (defined as the exercise of caution when making judgements under conditions of uncertainty) can help to achieve neutrality in applying accounting policies. Thus, 'cautious prudence' (see paragraph BC2.37(a)) can help to achieve a faithful representation of assets, liabilities, equity, income and expenses. Setting out that message clearly is expected to:

(a) help preparers, auditors and regulators to counter a natural bias that management may have towards optimism; for example, the message underlines the need to exercise care in selecting the inputs used in estimating a measure that cannot be observed directly; and

(b) help the Board to develop rigorous Standards that would reduce the risk of management bias in applying the reporting entity's accounting policies.

BC2.40 The Board found that the removal of the term 'prudence' in the 2010 revisions had led to confusion and had perhaps exacerbated the diversity in use of this term. People continued to use the term, but did not always say clearly what they meant by it. In addition, some stakeholders said that, because the term had been removed, financial information prepared using IFRS Standards was not neutral but was, in fact, imprudent. The Board concluded that it would reduce the confusion by reintroducing the term with a clear explanation that caution works both ways, so that assets and liabilities are neither overstated nor understated. Therefore, the Board reintroduced the term 'prudence', defined as the exercise of caution when making judgements under conditions of uncertainty, in the 2018 *Conceptual Framework*.

BC2.41 Some respondents to the 2015 Exposure Draft suggested that the Board should go further and identify 'asymmetric prudence' (see paragraph BC2.37(b)) as a necessary qualitative characteristic of useful financial information for these reasons:

(a) asymmetric prudence reflects the view that investors are more interested in downside risk than upside potential;

14 See paragraph 2.15 of the 2018 *Conceptual Framework*.

(b) asymmetric prudence is inherent in many Standards and the *Conceptual Framework* should acknowledge this fact so that asymmetric prudence could be applied consistently when developing Standards;

(c) by limiting distributions to shareholders, asymmetric prudence minimises the risk that today's shareholders would benefit at the expense of future shareholders; and

(d) by limiting management remuneration, asymmetric prudence would reduce management's opportunism and encourage long-term growth.

BC2.42 The Board did not include asymmetric prudence in the 2018 *Conceptual Framework* because a systematic requirement for asymmetry in the accounting treatment of assets and liabilities or of income and expenses could sometimes conflict with the need for financial information to be relevant and provide a faithful representation. The Board noted that, depending on its exact nature, the requirement to apply asymmetric prudence in all circumstances might:

(a) prohibit the recognition of all unrealised gains. In some circumstances, for example, in the measurement of many financial instruments, recognising unrealised gains is necessary to provide relevant information to users of financial reports.

(b) prohibit the recognition of all unrealised gains not supported by observable market prices. In some circumstances, measuring an asset or liability at a current value (which may require the recognition of unrealised gains) provides relevant information to users of financial reports even if the current value cannot be determined directly by observing prices in an active market.

(c) permit an entity to measure an asset at an amount lower than an unbiased estimate using the measurement basis selected for that asset or to measure a liability at an amount higher than such an estimate. Such an approach cannot result in relevant information and cannot provide a faithful representation.

BC2.43 Further, the Board noted that information in financial reports may be used as an input in determining distributions to shareholders and management remuneration, but such information is only one of the factors to be considered (see paragraph BC0.41(d)).

BC2.44 However, although the Board rejected a requirement for systematic asymmetry, the Board also concluded that not all asymmetry is inconsistent with neutrality. The selection of neutral accounting policies means selecting accounting policies in a manner that is not intended to increase the probability that financial information will be received favourably or unfavourably by users. The selection of neutral accounting policies:

(a) does not require an entity to recognise the value of the entity in the statement of financial position. Paragraph 1.7 of the 2018 *Conceptual Framework* states that general purpose financial reports are not designed to show the value of a reporting entity.

(b) does not require the recognition of all assets and liabilities. Chapter 5—*Recognition and derecognition* of the 2018 *Conceptual Framework* discusses recognition criteria for assets and liabilities.

(c) does not require the measurement of all assets and liabilities at a current value. Chapter 6—*Measurement* of the 2018 *Conceptual Framework* discusses factors to consider when selecting a measurement basis. Considering those factors would not lead to such a requirement.

(d) does not prohibit impairment tests on assets measured at historical cost. Measurement at historical cost, including an impairment test, is consistent with neutrality if that measurement basis is selected without bias. The absence of bias means that the measurement basis is selected without slanting, weighting, emphasising, de-emphasising or otherwise manipulating information to increase the probability that it will be received favourably or unfavourably by users.

BC2.45 Hence, the 2018 *Conceptual Framework* acknowledges that Standards may contain asymmetric requirements. This would be the consequence of the Board taking decisions that it believes require entities to produce the most relevant information that faithfully represents what it purports to represent, rather than a consequence of applying asymmetric prudence. Such decisions are reflected in several Standards developed before the 2018 *Conceptual Framework*. For example, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires one recognition threshold for contingent liabilities and a different recognition threshold for contingent assets.

Measurement uncertainty (2018) (paragraph 2.19)

BC2.46 As mentioned in paragraph BC2.28(b), some respondents to the 2013 Discussion Paper expressed concern that the qualitative characteristic of faithful representation did not act as an effective filter when identifying the types of information to be included in financial statements. These respondents said that the 2010 *Conceptual Framework* did not convey the idea that a high level of measurement uncertainty can make financial information less useful.

BC2.47 Paragraph QC16 of the 2010 *Conceptual Framework* already set out the idea that an estimate might not provide useful information if the level of uncertainty in the estimate is too large:

> 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.

BC2.48 Nevertheless, it was apparent that the link between the level of uncertainty in an estimate and its usefulness was not very visible and many readers of the 2010 *Conceptual Framework* seemed to overlook it. Consequently, the 2015 Exposure Draft discussed how measurement uncertainty could affect the relevance of financial information. Respondents to the 2015 Exposure Draft welcomed the discussion of measurement uncertainty. However, some argued that measurement uncertainty is an aspect of the fundamental qualitative characteristic of faithful representation rather than an aspect of relevance. The Board agreed with these arguments noting that:

(a) measurement uncertainty makes information less verifiable. As explained in paragraph 2.30 of the 2018 *Conceptual Framework*, verifiability helps to assure users of financial statements that information faithfully represents what it purports to represent. The higher the level of measurement uncertainty, the less assurance users have that a particular estimate provides a faithful representation of the phenomenon. Thus, measurement uncertainty affects whether economic phenomena can be faithfully represented.

(b) paragraphs 2.20–2.21 of the 2018 *Conceptual Framework* describe the most efficient and effective process of applying the fundamental qualitative characteristics. In line with that description, the qualitative characteristic of relevance is concerned with what particular piece of information is capable of being useful to users. On the other hand, the qualitative characteristic of faithful representation is concerned with whether that information can provide a faithful representation. Thus, measurement uncertainty associated with the estimation process does not affect relevance; it affects whether that measure can be provided in a way that produces a faithful representation.

(c) even if information is subject to a high level of measurement uncertainty, it can be relevant. For example, if the underlying phenomenon is subject to significant risks and uncertainties, a highly uncertain measure may provide the only relevant information about that phenomenon.

BC2.49 Hence, the 2018 *Conceptual Framework* describes measurement uncertainty as a factor that can affect whether it is possible to provide a faithful representation. In addition, the Board noted that addressing measurement uncertainty in the discussion of faithful representation is more consistent with a notion of a trade-off between the two fundamental qualitative characteristics—relevance and faithful representation (see paragraphs 2.22 and BC2.52–BC2.56).

Can faithful representation be empirically measured? (2010)

BC2.50 Empirical accounting researchers have accumulated considerable evidence, through correlation with changes in the market prices of entities' equity or debt instruments, supporting financial information that is relevant and provides a faithful representation. However, such studies have not provided techniques for empirically measuring faithful representation apart from relevance.

BC2.51 Both previous frameworks discussed the desirability of providing statistical information about how faithfully a financial measure is represented. That would not be unprecedented. Other statistical information is sometimes reflected in financial reports. For example, some entities disclose value at risk from derivative financial instruments and similar positions. The Board expects that the use of statistical concepts for financial reporting in some situations will continue to be important. Unfortunately, the Board and the FASB have not identified any way to quantify the faithfulness of the representations in a financial report.

Applying the fundamental qualitative characteristics (2018) (paragraphs 2.20–2.22)

BC2.52 In developing the 2018 *Conceptual Framework*, the Board discussed whether a trade-off may need to be made in applying the fundamental qualitative characteristics.

BC2.53 The notion of a trade-off between relevance and reliability—then both identified as qualitative characteristics of useful financial information—was present in the 1989 *Framework*. The 2010 *Conceptual Framework* did not mention such a trade-off but referred to the need for both characteristics—relevance and faithful representation—to be present for information to be useful. It further stated that neither a faithful representation of an irrelevant phenomenon nor an unfaithful representation of a relevant phenomenon helps users to make useful decisions. The discussion in paragraph QC16 of the 2010 *Conceptual Framework* of uncertainty in estimates[15] implied that a trade-off may need to be made between relevance and faithful representation (see paragraph BC2.47).

BC2.54 Some respondents to the 2013 Discussion Paper expressed concern about the lack of discussion of the notion of a trade-off between qualitative characteristics in the 2010 *Conceptual Framework*. Their main concern seemed to relate to the relationship between the relevance of information and the tolerable level of measurement uncertainty for that information.

BC2.55 As explained in paragraphs BC2.48–BC2.49, in the 2018 *Conceptual Framework* the Board described measurement uncertainty as a factor that can affect whether it is possible to provide a faithful representation. Further, the Board clarified in paragraph 2.22 that following the process described in paragraphs 2.20–2.21 a trade-off may need to be made between relevance and faithful representation. One case when such a trade-off may need to be made is when a high level of measurement uncertainty makes it questionable whether an estimate would provide a sufficiently faithful representation of an economic phenomenon. The material in paragraph 2.22 builds on the discussion of measurement uncertainty in paragraph QC16 of the 2010 *Conceptual Framework* (see paragraph BC2.47).

BC2.56 The Board concluded that an explicit acknowledgement of the trade-off between relevance and measurement uncertainty would help to explain why, in some cases, an estimate with a high level of measurement uncertainty might, nevertheless, provide useful information—for example, in cases when the only relevant information is a highly uncertain estimate.

15 In the context of paragraph QC16 of the 2010 *Conceptual Framework*, uncertainty of estimates refers to what the 2018 *Conceptual Framework* calls measurement uncertainty.

BC2.57 In addition, the Board updated the terminology used in the description of the process of applying fundamental qualitative characteristics. To be consistent with the description of relevance in paragraph 2.6 of the 2018 *Conceptual Framework* and to avoid confusion with the use of the term 'potential' in the definition of an economic resource (see paragraphs BC4.8–BC4.9), the Board replaced the phrase 'has the potential to be' with 'is capable of being' in paragraph 2.21.

Enhancing qualitative characteristics

Comparability (2010) (paragraphs 2.24–2.29)

BC2.58 Comparability was an important concept in both the 1989 *Framework* and Concepts Statement 2, but the two previous frameworks disagreed on its importance. The 1989 *Framework* stated that comparability is as important as relevance and faithful representation.[16] Concepts Statement 2 described comparability as a quality of the relationship between two or more pieces of information that, although important, is secondary to relevance and faithful representation.

BC2.59 Relevant information that provides a faithful representation is most useful if it can be readily compared with similar information reported by other entities and by the same entity in other periods. One of the most important reasons that Standards are needed is to increase the comparability of reported financial information. However, even if it is not readily comparable, information that is relevant and faithfully represents what it purports to represent is still useful. Comparable information, however, is not useful if it is not relevant and may mislead if it does not faithfully represent what it purports to represent. Therefore, comparability is considered an enhancing qualitative characteristic instead of a fundamental qualitative characteristic.

Verifiability (2010) (paragraphs 2.30–2.32)

BC2.60 Verifiable information can be used with confidence. Lack of verifiability does not necessarily render information useless, but users are likely to be more cautious because there is a greater risk that the information does not faithfully represent what it purports to represent.

BC2.61 The 1989 *Framework* did not explicitly include verifiability as an aspect of reliability, but Concepts Statement 2 did. However, the two frameworks are not as different as it might appear because the definition of reliability in the 1989 *Framework* contained the phrase 'and can be depended upon by users', which implies that users need assurance on the information.

BC2.62 The 2006 Discussion Paper stated that reported financial information should be verifiable to assure users that it is free from material error and bias and can be depended on to represent what it purports to represent. Therefore, verifiability was considered an aspect of faithful representation. Some respondents pointed out that including verifiability as an aspect of faithful representation could

16 The term 'reliability' was used instead of 'faithful representation', but the meaning was intended to be similar.

result in excluding information that is not readily verifiable. Those respondents recognised that many forward-looking estimates that are very important in providing relevant financial information (for example, expected cash flows, useful lives and residual values) cannot be directly verified. However, excluding information about those estimates would make the financial reports much less useful. The Board agreed and repositioned verifiability as an enhancing qualitative characteristic, very desirable but not necessarily required.

Timeliness (2010) (paragraph 2.33)

BC2.63 The 1989 *Framework* discussed timeliness as a constraint that could rob information of relevance. Concepts Statement 2 described timeliness as an aspect of relevance. However, the substance of timeliness as discussed in those two previous frameworks was essentially the same.

BC2.64 The 2006 Discussion Paper described timeliness as an aspect of relevance. However, some respondents pointed out that timeliness is not part of relevance in the same sense that predictive and confirmatory value are. The Board was persuaded that timeliness is different from the other components of relevance.

BC2.65 Timeliness is very desirable, but it is not as critical as relevance and faithful representation. Timely information is useful only if it is relevant and faithfully represents what it purports to represent. In contrast, relevant information that provides a faithful representation may still be useful (especially for confirmatory purposes) even if it is not reported in as timely a manner as would be desirable.

Understandability (2010) (paragraphs 2.34–2.36)

BC2.66 Both the 1989 *Framework* and Concepts Statement 2 included understandability, a qualitative characteristic that enables users to comprehend the information and therefore make it useful for making decisions. Both frameworks also similarly described that for financial information to be understandable, users should have a reasonable degree of financial knowledge and a willingness to study the information with reasonable diligence.

BC2.67 Despite those discussions of understandability and users' responsibilities for understanding financial reports, misunderstanding persists. For example, some have expressed the view that a new accounting method should not be implemented because some users might not understand it, even though the new accounting method would result in reporting financial information that is useful for decision-making. They imply that understandability is more important than relevance.

BC2.68 If understandability considerations were fundamental, it might be appropriate to avoid reporting information about very complicated things even if the information is relevant and provides a faithful representation. Classifying understandability as an enhancing qualitative characteristic is intended to indicate that information that is difficult to understand should be presented and explained as clearly as possible.

BC2.69 To clarify another frequently misunderstood point, since 2010 the *Conceptual Framework* has explained that users are responsible for actually studying reported financial information with reasonable diligence rather than only being willing to do so (which was the statement in the previous frameworks). In addition, since 2010 the *Conceptual Framework* has stated that users may need to seek the aid of advisers to understand economic phenomena that are particularly complex.

Qualitative characteristics not included (2010)

BC2.70 Transparency, high quality, internal consistency, true and fair view or fair presentation and credibility have been suggested as desirable qualitative characteristics of financial information. However, transparency, high quality, internal consistency, true and fair view or fair presentation are different words to describe information that has the qualitative characteristics of relevance and representational faithfulness enhanced by comparability, verifiability, timeliness and understandability. Credibility is similar but also implies trustworthiness of a reporting entity's management.

BC2.71 Interested parties sometimes suggested other criteria for standard-setting decisions, and the Board has at times cited some of those criteria as part of the rationale for some decisions. Those criteria include simplicity, operationality, practicability or practicality, and acceptability.

BC2.72 Those criteria are not qualitative characteristics. Instead, they are part of the overall weighing of benefits and costs of providing useful financial information. For example, a simpler method may be less costly to apply than a more complex method. In some circumstances, a simpler method may result in information that is essentially the same as, but somewhat less precise than, information produced by a more complex method. In that situation, a standard-setter would include the decrease in faithful representation and the decrease in implementation cost in weighing benefits against costs.

The cost constraint on useful financial reporting (2010) (paragraphs 2.39–2.43)

BC2.73 Cost is a pervasive constraint that standard-setters, as well as providers and users of financial information, should keep in mind when considering the benefits of a possible new financial reporting requirement. Cost is not a qualitative characteristic of information. It is a characteristic of the process used to provide the information.

BC2.74 The Board has attempted and continues to attempt to develop more structured methods of obtaining information about the cost of gathering and processing the information that proposed Standards would require entities to provide. The primary method used is to request interested parties, sometimes formally (such as by field tests and questionnaires), to submit cost and benefit information for a specific proposal that is quantified to the extent feasible. Those requests have resulted in helpful information and have led directly to changes to proposed requirements to reduce the costs without significantly reducing the related benefits.

from paragraph

CHAPTER 3—FINANCIAL STATEMENTS AND THE REPORTING ENTITY

Focus on financial statements (paragraph 3.1)

BC3.1 Chapter 1 sets the objective of general purpose financial reporting. Chapter 2 discusses the qualitative characteristics of financial information that is useful for achieving that objective. Those qualitative characteristics apply to both financial information provided in financial statements and financial information provided in other financial reports.

BC3.2 Financial statements are a central part of financial reporting and most issues that the Board addresses involve financial statements. Moreover, addressing issues related to other forms of financial reporting could have substantially delayed completion of the 2018 *Conceptual Framework*, thus delaying the improvements it brought. Consequently, Chapters 3–8 of the 2018 *Conceptual Framework* focus on information provided in financial statements and do not address other forms of financial reporting, for example, management commentary, interim financial reports, press releases and supplementary material provided for analysis.[17]

Objective and scope of financial statements (paragraphs 3.2–3.3)

BC3.3 The Board based the description of the objective of financial statements in the 2018 *Conceptual Framework* on the description of the objective of general purpose financial reporting (see paragraph 1.2 of the 2018 *Conceptual Framework*) and the description of the objective of financial statements in paragraph 9 of IAS 1 *Presentation of Financial Statements*, which states:

> Financial statements are a structured representation of the financial position and financial performance of an entity. The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of the management's stewardship of the resources entrusted to it. To meet this objective…

BC3.4 The description of the objective of financial statements in the 2018 *Conceptual Framework* differs from the description of their objective in IAS 1 in the following ways:

(a) to provide a link to the elements of financial statements, the description of the objective in the 2018 *Conceptual Framework* refers to:

  (i) assets, liabilities and equity instead of financial position; and

  (ii) income and expenses instead of financial performance.

(b) the description of the objective in the 2018 *Conceptual Framework* does not refer to providing information about cash flows. Although information about cash flows is important to users of financial statements, the 2018 *Conceptual Framework* does not identify cash inflows and cash outflows as elements of financial statements.

17 In 2010, the Board issued IFRS Practice Statement 1 *Management Commentary*—a broad, non-binding framework for the presentation of management commentary to accompany financial statements prepared in accordance with the Standards.

(c) the description of the objective in the 2018 *Conceptual Framework* expands on what makes information useful to primary users of financial statements in making decisions relating to providing resources to the entity. Information needs to be useful in assessing the prospects for future net cash inflows to the reporting entity and in assessing management's stewardship of the entity's economic resources.

BC3.5 The description of the information provided in financial statements refers to the statement of financial position and the statement(s) of financial performance. A few respondents to the 2015 Exposure Draft suggested that this description should also refer to the statement of cash flows and the statement of changes in equity. They argued that making explicit references only to the statement of financial position and the statement(s) of financial performance could be interpreted as implying that these two statements are more important than statements providing information about cash flows or about contributions from holders of equity claims and distributions to those holders.

BC3.6 Paragraph 3.3(c) of the 2018 *Conceptual Framework* refers to information about cash flows and about contributions from holders of equity claims and distributions to them. The Board does not view that information as less important than information provided in the statement of financial position and the statement(s) of financial performance. Nevertheless, the 2018 *Conceptual Framework* refers only to those statements because only those statements provide a summary of recognised elements—assets, liabilities, equity, income and expenses. In addition, it is necessary to identify those statements as the place where recognition occurs because otherwise it would not be possible to describe recognition clearly. In contrast, because cash inflows and cash outflows and contributions from holders of equity claims and distributions to them are not elements of financial statements, statements providing information about those items do not provide a summary of recognised elements.

Information about risks (paragraphs 3.3(c)(i)–3.3(c)(ii))

BC3.7 The 2018 *Conceptual Framework* states that financial statements provide information about the risks arising from recognised and unrecognised items that meet the definitions of an element of financial statements. Some respondents to the 2013 Discussion Paper expressed a concern that the term 'risk' was not explicitly defined. Hence, they argued that 'information about risks' could be understood to include almost any type of information, including information that would be best reported outside financial statements. Indeed, some argued that the information about how an entity manages risks belongs outside financial statements.

BC3.8 However, the Board noted that information about the risks associated with an entity's recognised and unrecognised assets and liabilities is likely to be useful in assessing the entity's ability to generate cash flows and in assessing management's stewardship of the entity's economic resources. Thus, this information contributes to meeting the objective of financial statements.

Perspective adopted in financial statements (paragraph 3.8)

BC3.9 The 2018 *Conceptual Framework* states that financial statements provide information from the perspective of the reporting entity as a whole (often referred to as 'the entity perspective'), not from the perspective of any particular group of the entity's existing or potential investors, lenders or other creditors. This reflects the Board's view that the reporting entity is separate from its investors, lenders and other creditors (see paragraph BC1.8).

BC3.10 The Board adopted the entity perspective because it is consistent with the objective of general purpose financial reporting set out in paragraph 1.2. This objective is to provide useful information to existing and potential investors, lenders and other creditors rather than to provide information to a particular subset of those capital providers. If information were to be directed towards the needs of a particular subset of primary users, it might be necessary to provide different sets of financial statements for each subset. That could cause confusion and undermine confidence in financial reporting. In addition, as mentioned in paragraph BC1.6, providing different reports for different subsets of primary users could be expensive.

Going concern assumption (paragraph 3.9)

BC3.11 The description of the going concern assumption is brought forward from the 2010 *Conceptual Framework* largely unchanged, except that the phrase 'cease trading' replaces the phrase 'curtail materially the scale of its operations'. This change aligned the description more closely with that used in IAS 1 *Presentation of Financial Statements* and IAS 10 *Events after the Reporting Period*.

The reporting entity (paragraphs 3.10–3.18)

BC3.12 The 2010 *Conceptual Framework* did not discuss what a reporting entity is; nor did it describe how to determine what a reporting entity comprises. In developing concepts on the reporting entity for the 2018 *Conceptual Framework*, the Board considered comments received on the 2010 Exposure Draft developed jointly with the FASB[18] and comments received on the 2015 Exposure Draft.

Description and boundary of the reporting entity (paragraphs 3.10 and 3.13–3.14)

BC3.13 The 2018 *Conceptual Framework* provides a general description of a reporting entity, rather than stating who must, should or could prepare general purpose financial statements. The Board has no authority to determine who must, should or could prepare such statements.

BC3.14 When developing the description of a reporting entity for the 2018 *Conceptual Framework*, the Board considered whether that description could be improved by including material that described some key features of a reporting entity from the 2010 Exposure Draft. In particular, in the 2010 Exposure Draft the Board:

18 See the Exposure Draft *Conceptual Framework for Financial Reporting—The Reporting Entity* published in March 2010.

(a) described a reporting entity as a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders and other creditors who cannot directly obtain the information they need in making decisions about providing resources to an entity and in assessing whether management and the governing board of that entity have made efficient and effective use of the resources provided; and

(b) set out three features that are necessary—but not always sufficient—for identifying a reporting entity:

(i) economic activities of an entity are being conducted, have been conducted or will be conducted;

(ii) economic activities of the entity can be objectively distinguished from those of other entities and from the economic environment in which the entity exists; and

(iii) financial information about the economic activities of that entity has the potential to be useful in making decisions about providing resources to the entity and in assessing whether the management and the governing board have made efficient and effective use of the resources provided.

BC3.15 The Board concluded that the feature mentioned in paragraph BC3.14(b)(iii) plays a role in determining the boundary of the reporting entity (see paragraph BC3.18). However, the Board did not use other material from the 2010 Exposure Draft to expand the description of the reporting entity in the 2018 *Conceptual Framework* for the following reasons:

(a) the financial statements of an entity that has never conducted and will never conduct economic activities are unlikely to provide useful information to users of financial statements; and

(b) the terms 'circumscribed area' and 'objectively distinguished' are vague and unclear, so they would not provide clear guidance on what constitutes a reporting entity.

BC3.16 In the 2015 Exposure Draft the Board proposed that the boundary of a reporting entity would be set in such a way that its financial statements provide relevant information to existing and potential investors, lenders and other creditors and faithfully represent the economic activities of the entity. It further proposed that financial statements should describe the set of economic activities included within the reporting entity.

BC3.17 Some respondents to the 2015 Exposure Draft expressed concern that the proposal would not sufficiently restrict what can constitute a reporting entity and that, as a result, financial statements could be prepared for any arbitrary collection of assets and liabilities and thus provide incomplete and therefore misleading information. In particular, they were concerned that a reporting entity that is a portion of an entity could choose to report on an incomplete set of economic activities, for example, by excluding from its financial statements the reporting entity's share of overheads. In addition, there may be difficulties in identifying which claims should be included in financial statements if the reporting entity is a portion of an entity.

BC3.18 In the light of those concerns, the Board revised the discussion of the determination of the boundary of a reporting entity. The 2018 *Conceptual Framework* explains that, in determining the boundary of a reporting entity that is not a legal entity and does not comprise only legal entities all linked by a parent-subsidiary relationship, the focus is on users' information needs. As stated in paragraph 2.4, users need information that is relevant and faithfully represents what it purports to represent. The Board concluded that the completeness and neutrality aspects of the qualitative characteristic of faithful representation are particularly important in determining the boundary of a reporting entity. For example, if the boundary of a reporting entity were determined in such a way that the boundary contains an arbitrary or incomplete set of economic activities, financial information provided in that reporting entity's financial statements would be incomplete and may also lack neutrality. Thus, if the boundary were to be determined in such a way, the resulting information would not meet users' information needs. The Board also concluded that to help users to understand what is included in a set of financial statements, those financial statements need to describe how the boundary of the reporting entity was determined and what constitutes the reporting entity.

BC3.19 Determining the boundary of a reporting entity is normally straightforward if that entity is a legal entity or if that entity comprises only legal entities all linked by a parent-subsidiary relationship. In those cases, the boundary of the legal entity or legal entities determines the boundary of the reporting entity. Determining the boundary in this way meets users' information needs.

Combined financial statements (paragraph 3.12)

BC3.20 The 2010 Exposure Draft stated that combined financial statements might provide useful information about a reporting entity that comprises entities under common control. Many of those who commented welcomed a discussion of this issue, but disagreed with restricting the preparation of combined financial statements to entities under common control.

BC3.21 The Board concluded that combined financial statements can provide useful information to users of financial statements in some circumstances. Accordingly, paragraph 3.12 of the 2018 *Conceptual Framework* acknowledges the concept of combined financial statements. However, the 2018 *Conceptual Framework* does not discuss when or how entities could prepare combined financial statements. The Board concluded that such discussion would be best developed if the Board decides in the future to develop a Standard on this topic.

Consolidated and unconsolidated financial statements (paragraphs 3.11 and 3.15–3.18)

BC3.22 The 2018 *Conceptual Framework* discusses the usefulness of financial information provided in consolidated and unconsolidated financial statements. As stated in paragraph 3.2, the objective of financial statements is to provide useful financial information to primary users of those financial statements. In the case of consolidated financial statements, the information needs of primary users may differ depending on whether their focus is on the parent (see paragraphs BC3.23–BC3.24) or on the subsidiaries (see paragraph BC3.25).

BC3.23 In developing the 2018 *Conceptual Framework*, the Board concluded that information about the assets, liabilities, equity, income and expenses of the parent with its subsidiaries is useful to existing and potential investors, lenders and other creditors of the parent (see paragraph 3.15). Consolidated financial statements provide that information.

BC3.24 The Board also concluded that information about assets, liabilities, equity, income and expenses of the parent alone is another type of information that may be useful to existing and potential investors, lenders and other creditors of the parent (see paragraph 3.17). Hence, the 2018 *Conceptual Framework* states that a parent may be required, or choose, to:

(a) prepare unconsolidated financial statements in addition to consolidated financial statements it prepares; or

(b) provide information about the assets, liabilities, equity, income and expenses of the parent alone in consolidated financial statements, in the notes.

BC3.25 Financial statements are designed to meet the common information needs of the maximum number of primary users, so they do not necessarily include some information that is useful to only a particular subset of primary users, such as investors, lenders and other creditors of a subsidiary. For example, some information about a subsidiary's assets, liabilities, equity, income and expenses may be material to the financial statements of the subsidiary, but may not be material to the consolidated financial statements of the parent. The subsidiary's own financial statements are designed to provide the primary users of its financial statements with information about the subsidiary's assets, liabilities, equity, income and expenses.

Joint control and significant influence

BC3.26 In developing the 2018 *Conceptual Framework*, the Board considered whether the *Conceptual Framework* should explain the notions of joint control and significant influence. The 2010 Exposure Draft stated that joint control and significant influence do not give rise to control. The Board still agrees with that conclusion, but sees no need to embed the notions of joint control and significant influence in the *Conceptual Framework*. Hence, the 2018 *Conceptual Framework* does not refer to these notions. In developing the 2018 *Conceptual Framework*, the Board did not discuss whether these notions should continue to play a role in standard-setting.

from paragraph

CHAPTER 4—THE ELEMENTS OF FINANCIAL STATEMENTS

Introduction

BC4.1 The 2010 *Conceptual Framework*, and previously the 1989 *Framework*, defined the following elements of financial statements:

(a) an asset—as a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity;

(b) a liability—as a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits;

(c) equity—as the residual interest in the assets of the entity after deducting all its liabilities;

(d) income—as increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants; and

(e) expenses—as decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

BC4.2 In the 2018 *Conceptual Framework* the Board amended these definitions.

Definitions—issues common to both assets and liabilities

BC4.3 The Board found the definitions of an asset and a liability in the 2010 *Conceptual Framework* to be useful for solving many issues in standard-setting. However, some aspects of those definitions caused confusion in practice because:

(a) the explicit reference in the definitions of an asset and a liability to the flows of economic benefits blurred the distinction between the economic resource or obligation and the resulting flows of economic benefits; and

(b) some readers interpreted the term 'expected' as a probability threshold. In addition, some readers were unclear about the relationship between the terms 'expected' in the definitions and 'probable' in the recognition criteria.

BC4.4 To address these issues, and for the reasons given in paragraphs BC4.6–BC4.18, the Board revised the definitions to read as follows:

(a) an asset is a present economic resource controlled by the entity as a result of past events;

(b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events; and

(c) an economic resource is a right that has the potential to produce economic benefits.

BC4.5 Supporting guidance for the definition of an asset is discussed in paragraphs BC4.23–BC4.43 and for the definition of a liability in paragraphs BC4.44–BC4.68.

Separate definition of an economic resource (paragraph 4.4)

BC4.6 The main structural change from the 2010 *Conceptual Framework* definitions is the introduction of a separate definition of an economic resource. This moved the references to future flows of economic benefits so that they now appear in the supporting definition of an economic resource instead of in the definitions of an asset and a liability.

BC4.7 The Board concluded that this separation would help to remove the confusion mentioned in paragraph BC4.3(a). It emphasises more clearly that an asset (or liability) is an economic resource (or obligation) and that it is not the ultimate inflow (or outflow) of economic benefits that the economic resource (or obligation) may produce. This approach also streamlines the definitions and shows more clearly the parallels between assets and liabilities.

Deletion of the notion of an expected flow (paragraphs 4.14 and 4.37)

BC4.8 The 2018 *Conceptual Framework* replaces the notion used in the 2010 *Conceptual Framework* that an inflow or outflow of resources is 'expected' with the concept that an asset (or liability) 'has the potential to produce economic benefits' (or 'has the potential to require a transfer of an economic resource'). References to that concept appear in the definition of an economic resource and in the guidance supporting the definition of a liability.

BC4.9 The Board replaced the notion of an expected inflow or outflow of resources for the following reasons:

(a) removal of 'expected' appropriately focuses the definition on the economic resource or obligation. To retain a notion of expected or probable outflows or inflows could exclude many items that are clearly assets and liabilities, for example, out-of-the money purchased and written options, insurance contracts and obligations to transfer an economic resource if a specified uncertain future event occurs (see paragraph BC4.63).

(b) the notion of expected flows is unhelpful because interpretations of this term can vary widely and are often tied to a notion of a threshold level of probability.

BC4.10 The 2013 Discussion Paper used the term 'capable of' producing economic benefits rather than 'has the potential to'. However, 'capable of' is already used in the discussion of relevance in paragraphs 2.6–2.7 of the 2018 *Conceptual Framework*. It could be confusing to use the term 'capable' with one meaning describing what information is relevant and with a different meaning in defining an economic resource. To avoid such confusion, the Board introduced the phrase 'has the potential to' in the definition of an economic resource.

BC4.11 The phrase 'has the potential to produce economic benefits' (or similarly 'has the potential to require a transfer of an economic resource') captures the following points:

(a) it is not sufficient that the economic benefits may arise in the future. Those economic benefits must arise from some feature that already exists within the economic resource. For example, a purchased option has the potential to produce economic benefits for the holder, but only because the option already contains a right that will permit the holder to exercise the option.

(b) the definition is not intended to impose a minimum probability threshold. The important thing is that in at least one circumstance the economic resource will produce economic benefits.

BC4.12 Some stakeholders stated that the Board should retain the notion of an expected inflow or outflow of resources. They stated that users and preparers of financial statements do not regard an item as an asset if inflows of economic benefits are not expected or are not at least reasonably possible. Those respondents argued that the revised definitions would considerably widen the range of items identified as assets and liabilities, which might lead to:

(a) pressure to identify every possible asset and liability, imposing a significant operational burden for little benefit if ultimately the asset or liability is not recognised or is measured at nil;

(b) recognition as assets and liabilities of more items that are uncertain, improbable or hard to measure, unless the recognition criteria are made more robust;

(c) a presumption that, in principle, all assets and liabilities should be recognised even if inflows or outflows are not expected; and

(d) pressure to provide in the notes irrelevant information about unrecognised assets and liabilities for which inflows or outflows are unlikely.

BC4.13 The Board concluded that removing the notion of 'expected'—interpreted by some as a probability threshold—would not impose a significant operational burden. In practice, an entity considers the definitions of an asset and a liability and recognition criteria at the same time to identify those assets and liabilities that the entity might need to recognise, or about which it might need to provide information in the notes.

BC4.14 In addition, the Board concluded that stakeholders' concerns about recognising assets or liabilities when the probability of an inflow or outflow of economic benefits is low are best addressed in decisions about recognition, not in the definitions (see paragraphs 4.15, 4.38, 5.15–5.17 and BC5.15–BC5.20). This approach is consistent with how the Board had applied the 2010 *Conceptual Framework* definitions for several years.

Past event (paragraphs 4.26 and 4.42–4.47)

BC4.15 In the 2018 *Conceptual Framework*:

(a) the phrase 'as a result of past events' remains in the definitions of an asset and a liability; and

(b) the word 'present' remains in the definition of a liability and is inserted in the definition of an asset.

BC4.16 In developing the 2018 *Conceptual Framework* the Board considered whether references to both 'present' and 'as a result of past events' are needed in the definitions of an asset and a liability.

BC4.17 The Board did not identify any significant problems that had arisen from including the phrase 'as a result of past events' in the definitions of an asset and a liability. Moreover, by identifying the past event, an entity can determine how to report that event in its financial statements; for example, how to classify and present income, expenses or cash flows arising from that event. Paragraphs BC4.64–BC4.68 discuss why the phrase 'as a result of past events' is particularly important to the revised definition of a liability. Hence, the Board retained that phrase in the definitions.

BC4.18 If a past event created an asset or liability, that fact alone does not confirm that the asset or liability still exists: it is also necessary to consider whether the entity still controls a present economic resource or is still bound by a present obligation. Thus, the Board also retained the reference to 'present' in the definition of a liability and added it to the definition of an asset. That addition emphasises the parallels between the two definitions.

Testing of revised definitions

BC4.19 In 2016, the Board analysed the effects of changes to the definitions of an asset and a liability proposed in the 2015 Exposure Draft. This exercise had two objectives:

(a) to enable both the Board and stakeholders to assess implications of the proposals for future Standards; and

(b) to help to identify any problems with the proposed definitions and supporting guidance.

BC4.20 This exercise involved:

(a) analysing the outcome of applying the proposed definitions and supporting guidance to 23 illustrative examples;

(b) identifying ways in which the proposed definitions and supporting guidance could help the Board to reach decisions in some of its current projects; and

(c) discussing the illustrative examples with participants at the meeting of World Standard-setters in September 2016.

BC4.21 The examples were selected and developed to examine questions raised by respondents to the 2015 Exposure Draft. These examples included rights and obligations that meet the definitions of an asset or a liability but have a low probability of inflows or outflows of economic benefits or have highly uncertain outcomes. The analysis of those examples explained not only why an asset or liability exists, but also why, applying the recognition criteria in Chapter 5, that asset or liability would not necessarily be recognised in the financial statements. The examples also included transactions for which respondents to the 2015 Exposure Draft thought the implications of the proposed definitions and supporting guidance were unclear and were possibly inconsistent with requirements in Standards. The analysis of those examples illustrated how and why applying the proposed definitions and supporting guidance could, in many cases, lead to conclusions consistent with the requirements in the Standards.

BC4.22 Feedback from the participants at the World Standards-setters meeting in September 2016 highlighted a few areas in which the wording of the proposed guidance was not sufficiently clear. In developing the revised definitions and supporting guidance, the Board considered this feedback together with other feedback received on the proposals.

Definition of an asset

BC4.23 This section discusses the following aspects of the definition of an asset:

(a) economic resource (see paragraphs BC4.24–BC4.27);

(b) focus on rights (see paragraphs BC4.28–BC4.39); and

(c) control (see paragraphs BC4.40–BC4.43).

Economic resource (paragraphs 4.4 and 4.14–4.18)

BC4.24 Paragraphs BC4.6–BC4.7 explain the Board's decision to introduce a separate definition of an economic resource and paragraphs BC4.8–BC4.14 discuss the Board's decision to remove the notion of expected flows from the definition of an asset and not to include that notion in the definition of an economic resource.

BC4.25 The Board concluded that the definition of an asset should refer to the economic resource, not to the resulting economic benefits. Although an asset derives its value from its potential to produce future economic benefits, what the entity controls is the present right that contains that potential. The entity does not control the future economic benefits.

BC4.26 The Board considered whether to use the term 'resource' instead of 'economic resource'. Some respondents to the 2013 Discussion Paper suggested that the term 'economic resource' is too limiting and would cover only resources that have a market value. The Board intended that the term 'economic resource' cover all resources that have the potential to produce economic benefits rather than be limited to resources for which a market currently exists. The Board chose the term 'economic resource' because it helps to emphasise that the resource in question is not, for example, a physical object, but rights over a physical object, as discussed in paragraphs 4.11–4.12 of the 2018 *Conceptual Framework*.

BC4.27 In some jurisdictions, the Board's *Conceptual Framework* is applied in the public sector and in other settings outside the financial markets, including the not-for-profit sector. Consequently, some stakeholders stated that the definition of an asset should include resources that produce benefits other than cash flows, for example, social or environmental services or benefits to the reporting entity, to other parties or to wider society. Similarly, the definition of a liability should, some stakeholders suggested, include obligations to transfer such benefits as well as obligations entered into for prudential or moral purposes, to meet expectations of a broader group of stakeholders or to maintain public support. However, the Board focuses currently on for-profit entities, and, therefore, concluded that the definition of an asset should continue to focus on resources that have the potential to produce economic benefits and that the definition of a liability should continue to focus on obligations to transfer an economic resource.

Focus on rights (paragraphs 4.6–4.13)

BC4.28 Prior to the publication of the 2018 *Conceptual Framework*, the definition of an asset included the term 'resource'. The 2018 *Conceptual Framework* uses the term 'economic resource' and defines an economic resource and, hence, an asset as a right. To illustrate the effect of this change in emphasis, the 2018 *Conceptual Framework* states that, for a physical object, such as an item of property, plant and equipment, the economic resource is not the physical object but a set of rights over that object. Examples of such rights are listed in paragraph 4.11.

BC4.29 In developing the 2018 *Conceptual Framework*, the Board considered a suggestion made by some respondents to the 2013 Discussion Paper and a few respondents to the 2015 Exposure Draft that an asset should be defined as a right or resource, not merely as a right. These respondents argued that:

(a) some assets, for example, tangible assets, are best described as resources instead of rights. The concept of accounting for tangible assets as a set of rights is inconsistent with practice, they argued, especially when that concept is combined with the idea of 'unbundling' rights and recognising them as separate assets.

(b) unless the *Conceptual Framework* explains what factors drive the identification of the unit of account, it would be difficult to explain consistently for a single asset comprising several rights whether to recognise that single asset as a whole or to recognise some of those rights separately.

(c) a focus on rights within a larger set of rights would put more pressure on the recognition and derecognition criteria and the unit of account. Entities would need to ask themselves numerous questions in order to confirm whether new assets or liabilities exist, without providing any clear benefit to users of financial statements. These respondents argued that the rights approach has caused challenges in developing Standards and also in applying them, particularly in relation to derecognition decisions.

BC4.30 The Board noted that many assets are rights that are established by contract, legislation or similar means, for example, financial assets, a lessee's rights of use of a leased machine, and many intangible assets, such as patents. It is equally true that ownership of a physical object arises because of rights conferred by law. Furthermore, although they differ in extent, the rights conferred by full legal ownership of a physical object and by a contract to use an object for 99% (or 50% or even 1%) of its useful life are all rights of one kind or another. In addition, because of legal differences or changes, a particular set of rights may constitute full legal ownership in one jurisdiction but not in another jurisdiction, or at one date but not at another date.

BC4.31 Hence, the Board saw no advantage in defining two separate types of asset, one described in financial statements as a resource (for example, in cases of full legal ownership of a physical object) and the other described as a right (all other rights over all or part of a resource). Nevertheless, the 2018 *Conceptual Framework* notes in paragraph 4.12 that describing the set of rights as the physical object will often provide a faithful representation of those rights in the most concise and understandable way.

Goodwill

BC4.32 In developing the 2018 *Conceptual Framework*, the Board did not reconsider the conclusions in paragraphs BC313–BC323 of the Basis for Conclusions on IFRS 3 *Business Combinations*. Those paragraphs explain what constitutes 'core' goodwill and state that core goodwill meets the definition of an asset.

BC4.33 In finalising the 2018 *Conceptual Framework*, the Board concluded that including in the *Conceptual Framework* a reference to one particular asset—goodwill—was not appropriate. Accordingly, the 2018 *Conceptual Framework* does not mention goodwill.

Identifiability and separability

BC4.34 IAS 38 *Intangible Assets* requires an intangible asset to be identifiable, so as to distinguish it from goodwill. IAS 38 states that an asset is identifiable if it either is separable from the entity, or arises from contractual or other legal rights. Therefore, in developing the 2018 *Conceptual Framework*, the Board discussed whether the definition of an asset should require an asset to be identifiable and whether that definition should require an asset to be separable. The Board concluded that if an asset is separable or arises from contractual or other legal rights, it is likely to be easier to identify, measure and describe the asset. This may affect whether recognising the asset would provide relevant information and whether it is possible to represent it faithfully. However, the Board concluded that identifiability and separability should not form part of the definition of an asset.

Other sources of value

BC4.35 In developing the 2018 *Conceptual Framework*, the Board discussed items, such as know-how, that an entity obtains in ways other than by contract, legislation and similar means. The Board concluded that such items can be assets. It considered whether the term 'right' was broad enough to capture such items, or whether the Board should instead define an economic resource by reference to a 'right or other source of value'.

BC4.36 The Board concluded that the notion of 'other sources of value' was too vague to be useful in a formal definition. Instead, the 2018 *Conceptual Framework* explains that the term 'right' captures not merely rights obtained by contract, legislation and similar means, but also rights obtained in other ways, for example, by acquiring or creating know-how that is not in the public domain. Paragraph 4.22 further explains why the entity could control the right to use such know-how even if that know-how is not protected by a registered patent. This explanation of the concept is not new—it builds on material in paragraph 4.12 of the 2010 *Conceptual Framework*.

Goods or services that are immediately consumed (paragraph 4.8)

BC4.37 The 2018 *Conceptual Framework* clarifies that goods or services that are received and immediately consumed create a momentary right to obtain the economic benefits produced by those goods or services. That right exists momentarily until the goods or services are consumed, at which point the consumption is recognised as an expense. This is consistent with IFRS 2 *Share-based Payment*, which treats employees' services received as an asset that is immediately consumed.

Economic benefits available to all other parties (paragraph 4.9)

BC4.38 The 2018 *Conceptual Framework* explains that if rights are available to all other parties without significant cost, those rights are typically not assets for the entities that hold them. The Board included this explanation in the 2018 *Conceptual Framework* to clarify that defining an asset as a right would not compel entities to identify and recognise as assets their holdings of a possibly large array of rights.

BC4.39 There are various ways to explain why rights available to all other parties are typically not assets of a particular entity. One reason could be that such rights, for example, public rights of way over land, do not have a potential to produce for that entity economic benefits beyond those available to all other parties. An alternative or additional reason could be that such rights are not controlled by the entity—the entity cannot deny other parties access to any economic benefits that may flow from those rights.

Control (paragraphs 4.19–4.25)

BC4.40 The 2018 *Conceptual Framework* kept in the definition of an asset the requirement for the economic resource to be 'controlled by the entity'. It also introduced a definition of control. The Board built that definition on the definitions of control in IFRS 15 *Revenue from Contracts with Customers*, which defines control of an asset, and in IFRS 10 *Consolidated Financial Statements*, which defines control of an entity.[19] Although the definitions in these Standards differ, they are based on the same basic concepts—that the entity has the ability to direct the use of the asset (or of the entity) and to obtain economic benefits (or returns). The 2018 *Conceptual Framework* uses the concept of control both in the definition of an asset and in its description of a parent's control of its subsidiaries.

19 See paragraph 33 of IFRS 15 and paragraphs 5–7 of IFRS 10.

Risks and rewards of ownership

BC4.41 The Board considered whether the definition of an asset should incorporate the notion of exposure to risks and rewards of ownership. Some Standards identify that exposure (or the related notion of exposure to variable returns) as either an aspect of control or an indicator of control:

(a) IFRS 10 states that 'an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee'.

(b) IFRS 15 states that one of the indicators that control of an asset has been transferred to a customer is that 'the customer has the significant risks and rewards of ownership of the asset'. The Basis for Conclusions on IFRS 15 explains that exposure to the risks and rewards of ownership of an asset may indicate control.

BC4.42 The 2018 *Conceptual Framework* explains in general terms the relationship between control and exposure to the risks and rewards of ownership. However, instead of using the phrase 'risks and rewards of ownership', the 2018 *Conceptual Framework* refers to 'exposure to significant variations in the amount of economic benefits' (see paragraph 4.24).

Rejected suggestions

BC4.43 In developing the 2018 *Conceptual Framework*, the Board considered and rejected other suggested changes to the definition and treatment of control:

(a) a suggestion to exclude a reference to control from the definition of an asset because it is implicit in the definition of an economic resource as a right that the entity controls the resource. The Board agreed that this is implicit in the definition of an economic resource but decided that explicitly referring to control is a helpful way of structuring the definition and supporting guidance.

(b) a suggestion that the requirement for control to exist should be a recognition criterion, instead of part of the definition of an asset. A few stakeholders argued that this approach would separate two questions that are independent of each other (namely: does an asset exist? and to whom does the asset belong?). The Board did not move the reference to control into the asset recognition criteria because such a move would be unlikely to change which assets would be recognised and because the Board has identified no problems in practice that would be addressed by such a move.

(c) a suggestion that the Board should amend the definition of control to refer to 'substantially all' economic benefits. The Board noted that the reference to 'substantially all' economic benefits would be redundant, and possibly confusing, if an entity recognises only the rights it controls. For example, if an entity controls the right to obtain 20% of the economic benefits from a building, its asset is the right to obtain 20% of the economic benefits from the building. The entity would not need the right to obtain all, or even substantially all, the economic benefits from the building because its asset is not a right over the whole building. The question of whether to include a threshold such as ‘substantially all’ may arise when developing Standards, for example, if a Standard requires an entity to account for a group of rights as a single asset (a single unit of account).

Definition of a liability (paragraphs 4.26–4.47)

BC4.44 The 2018 *Conceptual Framework* defines a liability as a present obligation of the entity to transfer an economic resource as a result of past events. The main changes from the previous definition are as follows:

(a) deletion of the reference to an expected outflow of economic benefits. For reasons discussed in paragraphs BC4.8–BC4.14, that reference was replaced by supporting guidance explaining that an obligation to transfer an economic resource must have the potential to require the entity to transfer an economic resource to another party (see paragraph 4.37).

(b) replacement of the phrase ‘resources embodying economic benefits’ with the new defined term ‘economic resource’ (see paragraphs BC4.6–BC4.7).

BC4.45 As mentioned in paragraph BC0.15, the 2018 *Conceptual Framework* does not address classification of financial instruments with characteristics of both liabilities and equity. The Board is exploring how to distinguish liabilities from equity in its research project on Financial Instruments with Characteristics of Equity. If necessary, the *Conceptual Framework* will be updated as one possible outcome of that project. In finalising the 2018 *Conceptual Framework*, the Board sought not to add new concepts and new guidance that it may need to revisit after that research project.

BC4.46 In developing the 2018 *Conceptual Framework*, the Board concluded that for a liability to exist, three criteria must all be satisfied:

(a) the entity has an obligation (see paragraphs BC4.47–BC4.61);

(b) the obligation is to transfer an economic resource (see paragraphs BC4.62–BC4.63); and

(c) the obligation is a present obligation that exists as a result of past events (see paragraphs BC4.64–BC4.68).

Obligation (paragraphs 4.28–4.35)

BC4.47 In applying the previous definition of a liability, it was generally accepted that an entity has a present obligation to transfer an economic resource when that obligation is unconditional and legally enforceable—in such situations, the entity clearly has no ability to avoid the transfer. However, in some other situations an entity has some limited ability to avoid a future transfer. Both in developing Standards and in applying them, problems had arisen because it was unclear how limited that ability must be for an entity to have a ‘present obligation’.

BC4.48 The 2018 *Conceptual Framework* defines an obligation as a duty or responsibility, as did the 2010 *Conceptual Framework*. However, to clarify the meaning of the term 'obligation', the 2018 *Conceptual Framework* states that an entity has an obligation if it has a duty or responsibility that it has no practical ability to avoid.

No practical ability to avoid (paragraphs 4.29–4.34)

BC4.49 The Board developed the 'no practical ability to avoid' criterion by considering the problems arising when:

(a) an entity does not have a legally enforceable obligation to transfer an economic resource, but its ability to avoid the transfer is limited by its customary practices, published policies or specific statements (such obligations are sometimes referred to as 'constructive obligations'); or

(b) a requirement already exists for an entity to transfer an economic resource, but the outcome of that requirement is conditional on the action that the entity itself may take.

BC4.50 Although the 2013 Discussion Paper considered those two situations separately, some respondents noted that the underlying issues are similar in both situations—the entity's ability to avoid a transfer is limited. In the 2018 *Conceptual Framework*, the 'no practical ability to avoid' criterion applies in both situations. However, the factors used to assess whether an entity has the practical ability to avoid a particular transfer would depend on the nature of the entity's duty or responsibility and would be considered when developing Standards.

BC4.51 Different Standards required different approaches to situations in which an entity can avoid a transfer of economic resources through its future action. The Board identified three views applied at that time in Standards to determine when a present obligation to transfer an economic resource has arisen:

(a) View 1—an entity must have no ability to avoid the future transfer. For example, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, as it had been interpreted in IFRIC 21 *Levies*, required that for a present obligation to exist, the entity must have no ability, even in theory, to avoid the future transfer.

(b) View 2—an entity must have no practical ability to avoid the future transfer. For example, IAS 34 *Interim Financial Reporting* specified that, if a lease provides for variable lease payments based on the entity achieving a specified level of annual sales, an obligation can arise before that level has been achieved if that level is expected to be achieved and the entity therefore has no realistic alternative but to make the future lease payments.

(c) View 3—there need be no limits on an entity's ability to avoid the future transfer. It is sufficient that, as a consequence of a past event, the entity may have to transfer an economic resource if further conditions are met. For example, IAS 19 *Employee Benefits* required a liability to be recognised for benefits that are conditional on future employment (unvested benefits) if those benefits are given in exchange for service already provided by employees. IAS 19 did not require an entity to assess whether it has the practical ability to avoid paying those benefits.

BC4.52 In the 2018 *Conceptual Framework* the Board adopted View 2 for the following reasons:

(a) the Board rejected View 1 because when an entity has the theoretical ability to avoid transferring an economic resource but no practical ability to avoid that transfer, omitting from a list of the entity's obligations the requirement to make that transfer would exclude information that many users of financial statements would find useful. That omission would place too much emphasis on legal form and not enough weight on faithfully representing the substance of obligations that are, in practice, as binding as obligations that are legally enforceable. Moreover, if an entity has a theoretical right to take action that would avoid an obligation, but has no practical ability to exercise that right, that obligation binds the entity as effectively as if it did not have that theoretical right.

(b) the Board rejected View 3 because the term 'obligation' implies some limit on the entity's ability to avoid the transfer of an economic resource.

BC4.53 The Board rejected a suggestion made by several stakeholders to apply a threshold based on the probability of future outflows. Those respondents suggested that an entity should be regarded as having an obligation if it were probable or, perhaps, reasonably certain that the entity would transfer an economic resource. They argued that such a threshold would provide the most relevant measure of the expenses in the period. Nevertheless, in the 2018 *Conceptual Framework* the definition of a liability focuses on the existence of an obligation for the reasons set out in paragraphs BC4.9(a), BC4.52(b) and BC4.94(d). The supporting guidance focuses on what an entity is obliged to do—not on the likelihood of the possible outcomes.

Interpreting 'no practical ability to avoid'

BC4.54 The Board concluded that the factors used to assess whether an entity has the practical ability to avoid a particular transfer should depend on the nature of the entity's duty or responsibility. Applying the criterion of 'no practical ability to avoid' will require judgement. Some stakeholders were concerned that allowing preparers of financial statements to apply this criterion would lead to diverse practice and that in some circumstances entities would recognise a liability when, in the view of some of those stakeholders, the entity does not have a genuine obligation. However, the Board noted that preparers of financial statements will rarely be required to apply that criterion without further requirements and guidance. The Board will, if necessary, develop guidance on applying that criterion to particular cases as it develops Standards.

BC4.55 Paragraph 4.34 of the 2018 *Conceptual Framework* refers to actions that would have economic consequences significantly more adverse than a transfer of economic resources as an example of when an entity may have no practical ability to avoid a transfer. This is intended to mean not just that it would be economically advantageous to make the transfer. Rather, the adverse economic consequences of not making the transfer are so severe that the entity has no practical ability to avoid the transfer. Although the entity has the theoretical right to avoid the transfer, it has no practical ability to exercise that right.

Terminology

BC4.56 The Board considered whether phrases such as the following could be easier to interpret than 'no practical ability to avoid':

(a) 'no realistic alternative'; or

(b) 'little or no discretion (in practice) to avoid'.

BC4.57 These two phrases have a meaning similar to 'no practical ability to avoid'. The Board chose the phrase 'no practical ability to avoid' because it most effectively conveys the need to identify what an entity is obliged to do, instead of focusing on the probable outcome. Furthermore, it mirrors the term 'practical ability', which is applied in some Standards in assessing whether an entity controls an asset, and the term 'present ability' used for a similar purpose in paragraphs 4.20 and 4.22 of the 2018 *Conceptual Framework*.

BC4.58 Some Standards developed before the 2018 *Conceptual Framework* use the term 'constructive obligation' to refer to some circumstances that give rise to an obligation or the term 'economic compulsion' to refer to some circumstances that give rise to no obligation. The 2018 *Conceptual Framework* does not use those terms to distinguish circumstances when an obligation exists from circumstances when an obligation does not exist because the Board concluded that those terms have not proved helpful for that purpose and are not necessary.

An obligation for one party is a right for another party

BC4.59 Paragraph 4.30 of the 2018 *Conceptual Framework* states that if one party has an obligation to transfer an economic resource, it follows that another party (or parties) has a right to receive that economic resource. The Board decided that this statement would help entities to apply the definition of a liability because it may sometimes be easier to identify whether that other party (or parties) has a right than to identify whether the first party has an obligation.

BC4.60 The Board considered whether another party has any asset that it controls if the reporting entity's obligation is not legally enforceable but arises from the reporting entity's customary practices, published policies or specific statements, or is conditional on the entity's own future actions. The Board concluded that the counterparty does control an asset in such cases. According to paragraph 4.23, if an entity is the party that will obtain economic benefits produced by an economic resource, that entity controls the economic resource.

BC4.61 In developing the 2018 *Conceptual Framework*, the Board discussed whether environmental obligations are an exception to the general principle that for every obligation, a corresponding right to receive the economic resource exists. It concluded that in the case of such obligations a corresponding right is controlled by society at large—the people living in the area. They have the right to receive the services required to restore their environment. Therefore, the 2018 *Conceptual Framework* identifies no exception to the general principle.

Transfer of an economic resource (paragraphs 4.36–4.41)

BC4.62 The 2018 *Conceptual Framework* states that the second criterion for a liability is that the obligation must have the potential to require the entity to transfer an economic resource. Paragraphs BC4.8–BC4.14 explain why the Board replaced the notion that an outflow of resources is expected with the concept that a liability has the potential to require a transfer of an economic resource.

BC4.63 An obligation to transfer an economic resource if a specified uncertain future event occurs has the potential to require a transfer of an economic resource and hence can give rise to a liability. That would be the case if the obligation is a present obligation that has arisen as a result of the past events discussed in paragraphs BC4.64–BC4.68. Such obligations are sometimes referred to as 'stand-ready obligations'. The 2018 *Conceptual Framework* does not use that term because the Board considered it unnecessary.

Present obligation as a result of past events (paragraphs 4.42–4.47)

BC4.64 The definition of a liability in the 2010 *Conceptual Framework* required a present obligation to be the result of past events but did not specify how to identify which event results in creation of a present obligation (sometimes referred to as the 'obligating event'). The 2018 *Conceptual Framework*, however, explains how to interpret the phrase 'as a result of past events'.

BC4.65 Some obligations arise from a single obligating event, for example, receiving goods. Other obligations build up over time through a continuous obligating event, for example, conducting a continuous activity.

BC4.66 In some cases, a chain of events creates an obligation. For example, an obligation may arise if a minimum threshold is reached in a period (such as a minimum amount of revenue, a minimum number of employees or a minimum amount of assets) and if the reporting entity is still operating on a specified later date. In such cases, identifying which of those events (reaching the threshold or operating on the specified date) is the obligating event can be particularly difficult. If the definition of obligations encompassed only unconditional obligations (View 1 discussed in paragraph BC4.51(a)), the explicit reference to a past event would, arguably, have been redundant. That is because under View 1 the obligating event would be the event that makes the obligation unconditional. In the example given in this paragraph that event is operating on the specified later date.

BC4.67 However, the Board adopted a broader 'no practical ability to avoid' approach (View 2 discussed in paragraph BC4.51(b)). Applying this concept, an entity may have an obligation if only some of the events in the chain have occurred: an entity could have an obligation if it has no practical ability to avoid the events that have not yet occurred. Therefore, it is important to explain which of the events in the chain must have occurred for an entity to have a present obligation 'as a result of past events'.

BC4.68 The Board concluded that the concept 'as a result of past events' means that:

(a) an entity has obtained economic benefits or taken an action.

(b) as a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer. The activity increases the magnitude of the economic resources that the entity will or may have to transfer.

Assets and liabilities

Non-reciprocal transactions

BC4.69 The Board considered whether the 2018 *Conceptual Framework* should explicitly discuss assets and liabilities that arise in non-reciprocal transactions, for example, donations, income taxes and other taxes and levies. It noted that the guidance in the 2018 *Conceptual Framework* had been developed without assuming that all transactions are reciprocal exchanges. Indeed, some guidance—in particular, the guidance supporting the liability definition—was developed with significant thought given to non-reciprocal transactions.

BC4.70 The Board concluded that its guidance supporting the definitions of an asset and a liability is equally suitable for reciprocal exchange transactions and non-reciprocal transactions. In both cases, the starting point is to identify the rights and obligations arising from the transaction. Therefore, the 2018 *Conceptual Framework* does not contain guidance that specifically addresses non-reciprocal transactions.

Contingent liabilities and contingent assets

BC4.71 The 2018 *Conceptual Framework* does not use the terms 'contingent liability' and 'contingent asset'. In IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, developed before the 2018 *Conceptual Framework*, the term 'contingent liability' is used as a collective label encompassing three categories of items that fail to meet that Standard's recognition criteria:

(a) the first category is possible obligations whose existence is uncertain and will be confirmed only by the occurrence or non-occurrence of uncertain future events not wholly within the control of the entity. Paragraphs 4.35 and 5.14 of the 2018 *Conceptual Framework* analyse such items as cases of existence uncertainty—it is uncertain whether a liability exists.

(b) the second category is present obligations that arise from past events but are not recognised because it is not probable that an outflow of economic resources will be required to settle them. Paragraphs 4.37–4.38 and 5.15–5.17 of the 2018 *Conceptual Framework* analyse these items as cases of liabilities with a low probability of an outflow of economic benefits.

(c) the last category is present obligations that arise from past events but are not recognised because their amount cannot be measured with sufficient reliability. Paragraphs 2.19, 2.22 and 5.19–5.23 of the 2018 *Conceptual Framework* analyse these items as cases of liabilities that are subject to a high level of measurement uncertainty.

BC4.72 The term 'contingent liability' is not used in the 2018 *Conceptual Framework* because:

(a) the three categories of item encompassed by the IAS 37 definition do not form a single natural class. The items in category (a) may be liabilities but are subject to existence uncertainty. The items in categories (b) and (c) are liabilities but might or might not be recognised after applying the recognition criteria described in Chapter 5—*Recognition and derecognition*.

(b) contingent liabilities are not a further element of financial statements, additional to liabilities and equity. Moreover, some 'contingent liabilities' are liabilities, but others are not.

(c) in common usage, the term 'contingent liability' is not used in the same way as in IAS 37. It often refers to an item that may give rise to an outflow of economic resources if some uncertain future event occurs. Depending on the circumstances, an obligating event might or might not have occurred. If an obligating event has occurred, the item might be a liability subject to existence uncertainty, outcome uncertainty, measurement uncertainty or any combination of those uncertainties. The liability might be recognised or unrecognised.

BC4.73 Similar considerations apply for 'contingent assets'.

Unit of account (paragraphs 4.48–4.55)

BC4.74 It would be impossible to set out recognition requirements or a measurement basis for a particular item without selecting a unit of account to which those requirements apply. Likewise, selecting a unit of account without considering how recognition or measurement requirements would apply may not result in useful information. Therefore, the 2018 *Conceptual Framework* explains that the unit of account and recognition and measurement requirements for a particular item are all considered at the same time.

BC4.75 In developing the 2018 *Conceptual Framework*, the Board considered whether the unit of account for recognition could differ from the unit of account for measurement. In the Board's view, it is possible for items to qualify for recognition on an individual basis and to be measured on a group basis. For example, a collection of items qualifying for recognition on an individual basis:

(a) could be measured as a single unit of account when estimating their recoverable amount; or

(b) may sometimes, as a practical expedient, be measured as a portfolio.

Hence, the Board concluded that sometimes it might be appropriate to select one unit of account for recognition and a different unit of account for measurement.

BC4.76 Decisions about the unit of account are linked to decisions about recognition and measurement that are made in developing Standards. Hence, the Board concluded that decisions about selecting a unit of account will need to be made in developing Standards, not in the *Conceptual Framework*.

BC4.77 The 2018 *Conceptual Framework* includes a discussion of the factors to consider when determining which unit of account to use. The Board did not rank the factors by priority because their relative importance depends on the specific features of the item for which the entity is accounting. In the Board's view, no single ranking could be used to determine the most useful unit of account consistently for a broad range of Standards.

Executory contracts (paragraphs 4.56–4.58)

BC4.78 The 2018 *Conceptual Framework* provides revised and more extensive supporting guidance on executory contracts. It clarifies that:

(a) an executory contract establishes a combined right and obligation to exchange economic resources;

(b) that combined right and obligation to exchange economic resources are interdependent and cannot be separated; and

(c) the combined right and obligation constitute a single asset or liability.

BC4.79 Although some stakeholders expressed a view that executory contracts give rise to a right (to receive one economic resource) and a separate obligation (to transfer a second economic resource), the Board noted that the right and obligation are highly interdependent: the right to receive the first resource is conditional on fulfilling the obligation to transfer the second resource and the obligation to transfer the second resource is conditional on receiving the first resource.

BC4.80 The Board further noted that even if the parties transfer economic resources at different times, a simultaneous exchange occurs at the time of the first transfer. For example, an entity might have a contract to sell goods to a customer and receive payment from the customer at a later date. When the entity transfers the goods to the customer, it simultaneously receives a right to receive payment from the customer. At that time, the customer receives the goods and incurs an obligation to pay for them. Each party's combined right and obligation to exchange economic resources is satisfied at the time of the first transfer and replaced at that time by a new right (in this example to receive payment) or obligation (in this example to make payment).

BC4.81 The Board therefore concluded that an executory contract contains a combined right and obligation to exchange economic resources, not a right to receive one economic resource and a separate obligation to transfer another economic resource.

BC4.82 The Board considered whether the combined right and obligation to exchange economic resources could give a reporting entity both a separate asset (a right to exchange resources, equivalent to a purchased option) and a separate liability (the obligation to exchange resources, equivalent to a written option).

BC4.83 A purchased option to exchange economic resources gives the holder the right either to make an exchange or to withdraw from the exchange without penalty. Conversely, the issuer of the written option undertakes the obligation to make the exchange, if the holder exercises its right. However, if an entity is both the holder of a purchased option and the issuer of an identical written option for the same underlying exchange of economic resources:

(a) the entity's right under its purchased option to withdraw from the exchange is nullified by its obligation to exchange if the counterparty exercises its right under the entity's written option; and

(b) the counterparty's right under the entity's written option to withdraw from the exchange is nullified by its obligation to exchange if the entity exercises its right under its purchased option.

BC4.84 Consequently, if an entity is both the holder of a purchased option and the issuer of a written option for the same underlying exchange on the same terms, neither party has the right to avoid exchanging economic resources. It follows that for an executory contract, the terms of the contract provide for only one outcome—the exchange will occur unless both parties agree to terminate the contract. Moreover, the entity's right and obligation to exchange economic resources are so interdependent that they cannot be separated. Hence, the contract cannot be separated into more than a single asset or liability. If the exchange is on terms that are currently favourable to the reporting entity, the contract is an asset; if it is on terms that are currently unfavourable, it is a liability.

BC4.85 Some respondents to the 2015 Exposure Draft asked how the Board's conclusion on executory contracts could affect the treatment of assets and liabilities arising in a lease contract or could affect trade date accounting for financial assets:

(a) as explained in the Basis for Conclusions on IFRS 16 *Leases*, at the commencement date, a lessee has obtained the right to use an underlying asset for a period of time and the lessor has delivered that right by making the asset available for use by the lessee. Once the lessor has performed its obligation to deliver that right, the lease contract is no longer an executory contract. The lessee controls the right-of-use asset and has a liability for the lease payments.

(b) IFRS 9 *Financial Instruments* permits 'trade date accounting' for a 'regular way' purchase or sale of a financial asset. Trade date accounting treats the financial asset as having already been delivered at the commitment (trade) date, instead of accounting for the purchase or sale contract as a derivative until settlement. IFRS 9 permits trade date accounting as a simple and practical method of managing and recording transactions that have only a short duration. In other words, permitting this method results from considering the cost constraint—from considering the relative costs and benefits of trade date accounting and settlement date accounting (the other method permitted by IFRS 9).

BC4.86 The 2018 *Conceptual Framework* does not specifically discuss recognition of executory contract assets and liabilities because it does not set out specific recognition requirements for any other types of assets and liabilities. The Board will set recognition requirements for executory contracts in developing Standards in the same way it sets recognition requirements for other assets and liabilities.

BC4.87 In the light of stakeholders' concerns, the Board considered whether the revised concepts on executory contracts could result in more assets and liabilities arising from executory contracts being recognised. In many cases in current practice, an asset or liability is not recognised for an executory contract. The Board expects that this will continue to be so. The same measurement considerations that apply to all other assets and liabilities (see Chapter

6—*Measurement*) apply also to the single asset or liability that arises from an executory contract. When a historical cost measurement basis is applied to an executory contract, the contract is typically measured at zero (which has the same practical effect as not recognising the contract) unless it is onerous. For example, the historical cost of an executory contract for the purchase of inventories is zero (assuming no transaction costs) unless the contract is onerous.

Reporting the substance of contractual rights and obligations (paragraphs 4.59–4.62)

BC4.88 As explained in paragraph 2.12, the 2018 *Conceptual Framework* explicitly states that, to provide a faithful representation of an economic phenomenon, an entity should report the substance of that phenomenon. The 2018 *Conceptual Framework* includes concepts for reporting the substance of contractual rights and contractual obligations. Those concepts drew on concepts developed by the Board in standard-setting projects. The Board decided that including the underlying concepts in the 2018 *Conceptual Framework* would help to ensure that these concepts are applied more consistently in Standards.

Definition of equity (paragraphs 4.63–4.67)

BC4.89 The 2018 *Conceptual Framework* continues:

(a) to make a binary distinction between liabilities and equity;

(b) to define equity as the residual interest in the assets of the entity after deducting all its liabilities; and

(c) not to discuss what forms of presentation and disclosure are appropriate if an entity's equity comprises different classes of equity claims and different components of equity (see paragraphs 7.12–7.13).

BC4.90 The Board considered whether continuing to make a binary distinction between liabilities and equity is sufficient to provide users of financial statements with useful information about claims against the entity. The inherent limitation of a binary distinction between liabilities and equity is that it attempts to make a single distinction between claims that have various characteristics in varying degrees. Eliminating that binary distinction and defining a single element for all claims would allow the accounting for each type of claim to be determined individually to depict its specific characteristics. However, unless all claims are measured directly, any approach would need to identify at least one residual class of claim that would be measured indirectly by reference to the carrying amounts of assets and liabilities. Moreover, it is not possible to measure all claims directly without valuing the entire entity, which goes beyond the stated objective of general purpose financial reports. Thus, dividing claims into at least two classes is unavoidable.

BC4.91 Some respondents to the 2013 Discussion Paper suggested that defining equity directly and introducing another element (a third class of claim) may better depict claims that have some characteristics of both liabilities and equity. However, the Board concluded that introducing another element would make the classification and resulting accounting more complex. In addition, it would be necessary to determine whether changes in this third class of claim should meet the definition of income or expenses. An outcome similar to introducing a new element could instead be achieved by separately presenting different classes within liabilities or within equity.

BC4.92 The Board will further explore how to distinguish liabilities from equity in its research project on Financial Instruments with Characteristics of Equity. That research project:

(a) will consider approaches to distinguishing liabilities from equity, including approaches that could require changes to the definitions of a liability or equity in the *Conceptual Framework*. The Board will use the output from that project when it decides, in due course, whether to add to its active agenda a project to amend the relevant Standards, the *Conceptual Framework*, or both. Any decision to start an active project would require the Board to go through its due process for adding a project to its agenda.

(b) is unlikely to result in changes to the supporting guidance in paragraphs 4.28–4.35 that focuses on identifying whether the reporting entity has an obligation to transfer an economic resource. That guidance was not designed to help to distinguish liabilities from equity (see paragraph BC4.45).

Definitions of income and expenses (paragraphs 4.68–4.72)

Income and expenses defined in terms of changes in assets and liabilities

BC4.93 The 2010 *Conceptual Framework* defined income and expenses in terms of changes in assets and liabilities. A few respondents to the 2013 Discussion Paper questioned this approach. They argued that it gives undue primacy to the statement of financial position over the statement(s) of financial performance and insufficiently acknowledges the importance of accounting for transactions in the statement(s) of financial performance or of matching income and expenses.

BC4.94 The Board disagreed with these arguments, concluding that:

(a) it is incorrect to assume that the Board focuses solely or primarily on the statement of financial position. Financial statements are intended to provide information about an entity's financial position and its financial performance (see paragraph 3.3). Hence, when making decisions about recognition, measurement and presentation and disclosure, the Board considers whether the resulting information provides useful information about both an entity's financial position and its financial performance. The Board has not designated one type of information—about financial position or about financial performance—as the primary focus of financial reporting.

(b) information about transactions is relevant to users of financial statements. Hence, much of financial reporting is currently based on transactions and will continue to be so.

(c) transactions that result in income and expenses also cause changes in assets and liabilities. Consequently, identifying income and expenses necessarily leads to identifying which assets and liabilities have changed. The Board and other standard-setters have found over many years that it is more effective, efficient and rigorous to define assets and liabilities first and to define income and expenses as changes in assets and liabilities, instead of trying to define income and expenses first and then describe assets and liabilities as by-products of the recognition of income and expenses.

(d) the definitions of an asset and a liability are not merely accounting technicalities. They refer to real economic phenomena (economic resources and obligations to transfer economic resources). A statement of financial position depicting assets, liabilities and equity provides users with more relevant and understandable information about an entity's financial position than does a mere summary of amounts that have arisen as by-products of a matching process. Those amounts do not necessarily depict economic phenomena.

(e) an approach based on matching income and expenses does not define the period to which the income and expenses relate. As explained in paragraph 5.5 of the 2018 *Conceptual Framework*, if income and expenses relate to each other, they will often be recognised simultaneously because of simultaneous changes in related assets and liabilities. However, an intention to match income and expenses does not justify the recognition in the statement of financial position of items that do not meet the definitions of an asset or a liability.

BC4.95 The Board noted that no major problems had been identified with the definitions of income and expenses. Hence, the only changes made in the 2018 *Conceptual Framework* were those necessary to make the definitions of income and expenses consistent with the revised definitions of an asset and a liability.

Types of income and expenses

BC4.96 Much of the discussion of income and expenses in the 2010 *Conceptual Framework* related to their presentation and disclosure. Presentation and disclosure are discussed in Chapter 7—*Presentation and disclosure* of the 2018 *Conceptual Framework*. The rest of the discussion in the 2010 *Conceptual Framework* referred to various types of income and expenses, for example, revenue, gains and losses. That material was not included in the 2018 *Conceptual Framework*. The material was originally included to emphasise that income includes revenue and gains and that expenses include losses. The Board decided that that emphasis is now unnecessary and the implication that the *Conceptual Framework* defines subclasses of income and expenses is unhelpful. The Board does not expect the removal of that material to cause any changes in practice.

Other possible definitions

BC4.97 In developing the 2018 *Conceptual Framework*, the Board considered whether to define as elements of financial statements contributions from holders of equity claims and distributions to holders of equity claims, and cash inflows and cash outflows. Because the Board concluded that the absence of such definitions had not caused major problems, it did not include such definitions in the 2018 *Conceptual Framework*.

from paragraph

CHAPTER 5—RECOGNITION AND DERECOGNITION

Recognition (paragraphs 5.6–5.25)

BC5.1 The recognition criteria in the 2010 *Conceptual Framework* stated that an entity recognises an item that meets the definition of an element if:

(a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and

(b) the item has a cost or value that can be measured with reliability.

BC5.2 The recognition criteria created the following problems:

(a) some Standards developed before the 2018 *Conceptual Framework* applied a probability recognition criterion, but they did not use it consistently. They used different probability thresholds which included 'probable', 'more likely than not', 'virtually certain' and 'reasonably possible'.

(b) the application of the probability criterion to some recognition questions could lead to loss of relevant information or a misleading representation of the entity's financial position or financial performance. For example, applying the criterion could prevent the recognition of some derivative financial instruments. Moreover, it could result in a gain being recognised for a transaction when no economic gain has occurred. For example, suppose that, in exchange for receiving cash, an entity incurs a liability to pay a fixed amount if some unlikely event occurs in the future. If the liability is not recognised because an outflow of economic benefits is not considered probable when the entity receives the cash, the entity will recognise an immediate gain at that time. To avoid such problems, some Standards developed before the 2018 *Conceptual Framework*, for example, IFRS 9 *Financial Instruments*, applied no probability recognition criterion.

(c) the reference to reliability was unclear and could result in inappropriate outcomes. Although reliability was identified as a qualitative characteristic in the 1989 *Framework*, in the 2010 *Conceptual Framework*, the term 'reliability' was no longer used to refer to a qualitative characteristic and was not defined (see paragraphs BC2.21–BC2.31). In practice, a 'reliable' measure was usually interpreted as one with a tolerable level of measurement uncertainty and perhaps also as verifiable and free from error. Hence, a recognition criterion referring to reliable measurement could be interpreted as one prohibiting recognition of any item that has a high level of measurement uncertainty, even if recognising such an item would provide useful information.

BC5.3 The 2018 *Conceptual Framework* states that an asset or liability is recognised only if such recognition provides users of financial statements with useful information, namely:

(a) relevant information about the asset or liability and about any resulting income, expenses or changes in equity; and

(b) a faithful representation of the asset or liability and of any resulting income, expenses or changes in equity.

BC5.4 The approaches in the 2010 *Conceptual Framework* and the 2018 *Conceptual Framework* have similar objectives but sought to achieve them by different means:

(a) the 2010 *Conceptual Framework* set up practical, but subjective filters for cases where recognition is not likely to provide information with the qualitative characteristics of useful financial information. Those filters referred to probability and reliability.

(b) the 2018 *Conceptual Framework* refers directly to the qualitative characteristics and then provides guidance on how to apply them. That guidance explains when recognition might produce information that lacks those qualitative characteristics—including some (but not necessarily all) cases where applying the 2010 *Conceptual Framework* might have led to a conclusion that a flow of economic benefits is not probable or that reliable measurement is not possible.

BC5.5 The Board considered whether the 2018 *Conceptual Framework* should include a presumption (or overarching principle) that every item meeting the definition of an asset or a liability is recognised. This would have meant that if the Board had decided that recognition of a particular item would not provide useful information, it would have had to include an exception to this principle in particular Standards.

BC5.6 The Board rejected that approach because it expects that in some circumstances it will continue to conclude that recognising particular assets or particular liabilities will not provide useful information or that the costs of recognising them would exceed the benefits of doing so. To be useful to the Board, the *Conceptual Framework* needs to give guidance on how to approach decisions about setting recognition requirements in Standards. A presumption or overarching principle that every item meeting the definition of an asset or a liability should be recognised would be too restrictive and would not provide such guidance.

BC5.7 Some stakeholders expressed a concern that the approach now included in the 2018 *Conceptual Framework* would not provide enough direction because it is too abstract and subjective. These stakeholders suggested that the Board needs more concrete and robust recognition criteria to ensure that it develops Standards with consistent requirements that result in useful information.

BC5.8 In considering that concern, the Board noted that the 1989 *Framework* and the 2010 *Conceptual Framework* also set abstract and subjective criteria—probability and reliability. The revised approach in the 2018 *Conceptual Framework* is linked directly to the qualitative characteristics of useful financial information and provides clearer and more developed guidance than the previous approach. In the Board's view, setting more rigid recognition criteria in the *Conceptual Framework* would not help the Board to set recognition requirements in Standards that result in useful information to users of financial statements at a cost that does not exceed the benefits.

BC5.9 Some stakeholders disagreed with the revised approach to recognition because they were concerned that it could increase the range of recognised assets and liabilities.

BC5.10 In developing the revised recognition criteria, the Board aimed to develop tools that would help it to base decisions on a more coherent set of principles. It did not have an objective of either increasing or decreasing the range of assets and liabilities recognised. Paragraphs BC5.15–BC5.20 provide the Board's responses to specific concerns in relation to situations when probability of inflows or outflows of economic benefits is low and paragraphs BC5.21–BC5.22 provide the Board's responses to specific concerns in relation to measurement uncertainty.

BC5.11 Further, the Board noted that, as explained in paragraph SP1.2 of the 2018 *Conceptual Framework*, the *Conceptual Framework* does not override requirements in Standards, so the 2018 revision of recognition criteria will not affect how preparers of financial statements apply recognition criteria developed in Standards issued before the 2018 *Conceptual Framework*.

Relevance (paragraphs 5.12–5.17)

BC5.12 The guidance supporting the revised recognition criteria provides examples of factors that may indicate when recognising an asset or liability may fail to provide users of financial statements with relevant information. Two of those factors relate to cases in which:

(a) it is uncertain whether an asset or liability exists (see paragraphs BC5.13–BC5.14); or

(b) an asset or liability exists, but the probability of an inflow or outflow of economic benefits is low (see paragraphs BC5.15–BC5.20).

Existence uncertainty (paragraph 5.14)

BC5.13 It is sometimes uncertain whether an asset or liability exists (existence uncertainty). The Board concluded that it is helpful to consider existence uncertainty separately from outcome uncertainty and separately from measurement uncertainty. Although existence uncertainty may contribute to outcome uncertainty and measurement uncertainty, conceptually it is different and could affect recognition decisions differently. Distinguishing different types of uncertainty makes it easier to decide what information is most likely to be relevant to users of financial statements and how to provide that information in a way that provides a faithful representation.

BC5.14 The 2018 *Conceptual Framework* does not provide detailed guidance on how to consider existence uncertainty in making recognition decisions because the appropriate approach will depend on facts and circumstances.

Low probability of an inflow or outflow of economic benefits (paragraphs 5.15–5.17)

BC5.15 Many respondents both to the 2013 Discussion Paper and to the 2015 Exposure Draft argued that the recognition criteria should continue to refer to probability. They argued that:

(a) the probability criterion had proved to be a practical way of applying the qualitative characteristics. The proposed supporting guidance on items with a low probability of generating a flow of economic benefits was not clear enough and would lead to doubt and inconsistency.

(b) the removal of the probability criterion, in combination with the removal of the reference to 'expected' from the definitions of an asset and a liability, could lead to requirements for entities to recognise more assets and liabilities with a low probability of inflows or outflows of economic benefits. Recognising such assets and liabilities would not provide useful information. In addition, preparers of financial statements might have to search extensively for rights and obligations. (The deletion of the notion of an 'expected' flow is discussed in paragraphs BC4.8–BC4.14.)

(c) if assets and liabilities with a low probability of future inflows and outflows were recognised, they might have to be measured at amounts based on expected value. Such measurement is difficult and puts a burden on preparers of financial statements. Sometimes, providing information about the range and distribution of possible outcomes is more useful than providing a measure based on expected value. Such measures may provide an illusion of precision that does not exist.

BC5.16 Some respondents suggested applying a probability filter for some assets or liabilities (for example, for patents or research and development), but not for all (for example, not for derivative financial assets), or for some transactions but not for others (for example, not for the acquisition of an asset for cash). Those respondents suggested it is not reasonable to remove the probability requirement from the recognition criteria simply to permit the recognition of some financial instruments. Including an exception for particular financial instruments in a Standard would be sufficient to achieve that result.

BC5.17 The Board acknowledged that a probability threshold could be a practical way to filter out assets and liabilities whose recognition might not provide relevant information. However, this approach would lead to not recognising assets and liabilities in some cases when recognition could provide relevant information. It would also be difficult to set a probability threshold that could be applied across all Standards and in all recognition events.

BC5.18 The Board also noted that, whatever measurement basis is used for an asset or liability with a low probability of an inflow or outflow of economic benefits, that basis would be likely to reflect that low probability—it is unlikely that a required measurement basis would reflect only the maximum inflow or maximum outflow of economic benefits.

BC5.19 The 2018 *Conceptual Framework*, therefore, does not include a probability threshold. Instead, the low probability of an inflow or outflow of economic benefits is discussed as an indicator that, in some cases, recognition may not provide relevant information, for the reasons discussed in paragraphs 5.16–5.17.

BC5.20 Some stakeholders expressed a concern that the term 'low probability' is too subjective to be interpreted consistently. However, the Board's objective in discussing situations of low probability was to indicate that in some such situations, the Board might conclude that some information may not be relevant. The Board's objective was not to identify a threshold above which information would always be relevant and below which it would always be irrelevant.

Faithful representation (paragraphs 5.18–5.25)

BC5.21 As discussed in paragraphs BC5.2–BC5.4, the recognition criteria in the 2018 *Conceptual Framework* do not include a requirement to recognise an asset or liability only if it has a cost or value that can be measured with reliability. The Board concluded that a high level of measurement uncertainty would not necessarily preclude a measure from providing useful information about an asset or liability, so it would be difficult to set a single threshold based on measurement uncertainty that could be applied across all Standards and in all recognition events. Hence, the 2018 *Conceptual Framework* discusses measurement uncertainty as a factor that may affect whether faithful representation can be provided by recognition of an asset or liability, supported, if necessary, by explanatory information. This discussion is based on the discussion of measurement uncertainty in Chapter 2—*Qualitative characteristics of useful financial information* (see paragraphs 2.19, 2.22 and BC2.46–BC2.49).

BC5.22 Some respondents to the 2013 Discussion Paper and to the 2015 Exposure Draft suggested that a higher level of measurement uncertainty is tolerable when recognising liabilities or expenses than when recognising assets or income. They described this as an application of prudence (asymmetric prudence, applying the terminology used in paragraph BC2.37). The Board concluded that the level of measurement uncertainty beyond which a measure does not provide a faithful representation depends on facts and circumstances and so can be determined only when developing Standards (see paragraph 5.9). Paragraphs BC2.44–BC2.45 provide further discussion of symmetry in decisions about recognition and measurement.

Derecognition (paragraphs 5.26–5.33)

BC5.23 The 2010 *Conceptual Framework* did not define derecognition; nor did it describe when derecognition occurs.

BC5.24 Discussions about derecognition have typically contrasted two approaches to derecognition:

(a) a control approach—derecognition is the mirror image of recognition. Thus, an entity derecognises an asset or liability when it no longer meets the criteria for recognition (or no longer exists, or is no longer an asset or liability of the entity).

(b) a risks-and-rewards approach—an entity continues to recognise an asset or liability until the entity is no longer exposed to most of the risks and rewards generated by that asset or liability. This continued recognition would apply even if that asset or liability would not qualify for recognition at the date when the entity disposed of the transferred component, if at that date it acquired only the retained component and had not previously recognised the retained component.[20]

20 Paragraph 5.28 of the 2018 *Conceptual Framework* explains what is included in the transferred component and the retained component.

BC5.25 To address some apparent conflicts between the control approach and the risks-and-rewards approach, the Board explained in the 2018 *Conceptual Framework* that:

(a) if an entity has apparently transferred an asset but retains exposure to significant positive or negative variations in the amount of economic benefits that may be produced by the asset, this sometimes indicates that the entity might continue to control that asset; and

(b) if an entity has transferred an asset to another party that holds the asset as an agent for the entity, the transferor still controls the asset.

BC5.26 In developing the 2018 *Conceptual Framework*, the Board concluded that accounting requirements for derecognition should aim to faithfully represent both:

(a) any 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.

BC5.27 In the Board's view, the control approach focuses more on the aim described in paragraph BC5.26(a) and the risks-and-rewards approach focuses more on the aim described in paragraph BC5.26(b). If an entity transfers an entire asset or an entire liability and retains no exposure to that asset or liability, the control approach and the risks-and-rewards approach both lead to the same outcome. Moreover, in such cases, achieving both aims described in paragraph BC5.26 is straightforward.

BC5.28 In contrast, the Board has encountered difficulties in standard-setting when an entity transfers only part of an asset or liability or retains some exposure to variations. In those cases, the control approach does not always lead to the same outcome as the risks-and-rewards approach and the two aims described in paragraph BC5.26 sometimes conflict. The Board views both aims as valid. Accordingly, in the 2018 *Conceptual Framework* the Board did not specify the use of the control approach or the risks-and-rewards approach.

BC5.29 Instead, the Board adopted an approach that involves:

(a) derecognising the transferred component.

(b) continuing to recognise the retained component, if any.

(c) applying one or more of the following procedures if necessary to achieve one or both of the aims described in paragraph BC5.26:

(i) present any retained component separately in the statement of financial position;

(ii) present separately in the statement(s) of financial performance any income and expenses recognised as a result of derecognition of the transferred component; and

(iii) provide explanatory information.

(d) as a last resort, if derecognition of the transferred component is not sufficient to achieve both aims described in paragraph BC5.26 even when supported by separate presentation or by explanatory information, considering whether continuing to recognise the transferred component would achieve those aims. That continued recognition would need to be supported by separate presentation or explanatory information because financial statements would include as assets and liabilities, and as related income and expenses, items that do not meet the definition of an element of financial statements.

BC5.30 The Board considered whether the description of aims of accounting requirements for derecognition should explicitly refer to the qualitative characteristic of relevance in addition to the qualitative characteristic of faithful representation. The Board noted that the aims described in paragraph BC5.26 identify what economic phenomena need to be represented faithfully when derecognition is being considered. In the Board's view, information about those economic phenomena is what would be relevant to users of financial statements. Therefore, the Board concluded that adding an explicit reference to relevance would not change how it would seek to achieve the two aims.

from paragraph

CHAPTER 6—MEASUREMENT

Introduction

BC6.1 In developing the 2018 *Conceptual Framework*, the Board did not provide detailed guidance on when a particular measurement basis would be suitable because the suitability of particular measurement bases will vary depending on facts and circumstances. Instead, the 2018 *Conceptual Framework*:

(a) describes measurement bases and the information they provide; and

(b) discusses the factors to consider when selecting a measurement basis.

BC6.2 Some respondents to the 2015 Exposure Draft questioned whether simply describing the measurement bases and discussing the factors to consider when selecting a measurement basis would provide the Board with sufficient guidance to develop measurement requirements in Standards. These respondents suggested that the Board should undertake further research on measurement and either:

(a) delay issuing a revised *Conceptual Framework* until that research is completed;

(b) issue a revised *Conceptual Framework* without a measurement section; or

(c) develop high-level interim guidance on measurement for use until more complete concepts and principles can be developed.

BC6.3 The Board rejected these suggestions. The 2010 *Conceptual Framework* provided little guidance on measurement. This lack of guidance was a significant gap in the 2010 *Conceptual Framework* that needed to be addressed. The Board concluded that the guidance in the 2018 *Conceptual Framework* will help it to develop measurement requirements in Standards.

BC6.4 Further, the Board considered whether the 2018 *Conceptual Framework* needs to identify a separate overall objective for measurement. The Board concluded that a separate measurement objective is unlikely to provide useful additional guidance to help it to develop measurement requirements. Instead, the 2018 *Conceptual Framework* describes how measurement contributes to the objective of general purpose financial statements—see paragraph 6.45.

Mixed measurement (paragraph 6.2)

BC6.5 In developing the 2018 *Conceptual Framework*, the Board considered whether the *Conceptual Framework* should advocate using a single measurement basis. The main advantages of using a single measurement basis would be:

(a) the amounts included in the financial statements could be more meaningfully added, subtracted and compared; and

(b) the financial statements would be less complex and, arguably, more understandable.

BC6.6 In addition, if the Board were to identify a concept of wealth or capital that would meet the information needs of users of financial statements, a single measurement basis would be required in order to produce a measure of that wealth or capital. However, as discussed in paragraphs BC8.1–BC8.4 the Board decided not to update the discussion of capital and capital maintenance and not to seek to identify a concept of wealth or capital that would meet the information needs of users of financial statements.

BC6.7 Both the 2013 Discussion Paper and the 2015 Exposure Draft suggested that a single measurement basis for all assets, liabilities, income and expenses might not always provide the most relevant information to users of financial statements. Nearly all respondents who commented on this issue supported the suggested approach.

BC6.8 However, a few respondents disagreed and proposed one of the following as a single measurement basis:

(a) historical cost;

(b) fair value;

(c) current entry value (for example, current cost, see paragraphs 6.21–6.22 of the 2018 *Conceptual Framework*); or

(d) deprival (relief) value (see paragraph BC6.29(a)).

BC6.9 Most of the respondents who suggested the use of a single measurement basis conceded that this could not be achieved in practice, at least in the short term. However, they said that the Board should describe a default measurement basis that it would use when developing Standards. The Board should then commit to explaining any decisions to use any other measurement basis.

BC6.10 The Board concluded that in different circumstances different measurement bases may provide information relevant to users of financial statements. In addition, in different circumstances, a particular measurement basis may be:

(a) easier to understand and implement than another;

(b) more verifiable, less prone to error or subject to a lower level of measurement uncertainty than another; or

(c) less costly to implement than another.

BC6.11 Hence, the 2018 *Conceptual Framework* states that consideration of the qualitative characteristics of useful financial information and of the cost constraint is likely to result in the selection of different measurement bases for different assets, liabilities, income and expenses.

Measurement bases and the information they provide (paragraphs 6.4–6.42)

BC6.12 The 2018 *Conceptual Framework* identifies two categories of measurement bases. Paragraphs BC6.19–BC6.22 discuss historical cost measurement bases and paragraphs BC6.23–BC6.29 discuss current value measurement bases.

BC6.13 The 2013 Discussion Paper identified cash-flow-based measurements as a separate category of measurement bases. The 2018 *Conceptual Framework* does not do so because the Board concluded that cash-flow-based measurements are not measurement bases in their own right. Instead, cash-flow-based measurement techniques can be used to estimate a measure in applying a specified measurement basis. Paragraphs 6.91–6.95 of the 2018 *Conceptual Framework* discuss how those techniques can be used in this way.

BC6.14 The Board considered and rejected the idea of categorising measurement bases according to whether they provide information about the cost of inputs to an entity's business activities—entry values such as historical cost and current cost—or information about the cost of outputs from an entity's business activities—exit values such as fair value, value in use and fulfilment value. The Board did not find such a distinction useful when describing or selecting a measurement basis for use in a particular Standard because the difference between entry and exit values in the same market is often small, except for transaction costs (see paragraphs BC6.30–BC6.33).

BC6.15 The 2018 *Conceptual Framework* describes the measurement bases the Board is likely to consider selecting when developing Standards. It acknowledges in paragraph 6.3 that a Standard may need to describe how to implement the measurement basis selected in that Standard.

BC6.16 In addition, the 2018 *Conceptual Framework* discusses the information provided by particular measurement bases. Identifying that information will help to identify whether a particular measurement basis is likely to provide useful information to the users of financial statements in particular circumstances.

BC6.17 A few respondents to the 2015 Exposure Draft said the discussion of measurement bases is biased: some suggested that the discussion is biased against historical cost; conversely, others perceived a bias against current values. In developing the 2018 *Conceptual Framework*, the Board sought to provide a balanced description of the measurement bases and the information that they provide. The Board did not intend to favour one measurement basis over the others.

BC6.18 In the measurement chapter, the term 'value' is used to refer in general terms to an economic value of an asset or liability, rather than its carrying amount (see paragraph 5.1) and rather than a specific current value such as fair value. That term is used, for example, when that economic value may differ from the amount of a future cash payment or future cash receipt, for example, because of factors such as the time value of money.

Historical cost (paragraphs 6.4–6.9 and 6.24–6.31)

BC6.19 The 2018 *Conceptual Framework* explains that the historical cost of an asset is initially the value of the costs incurred in acquiring or creating the asset, comprising the consideration paid to acquire or create the asset plus transaction costs. The historical cost of a liability when it is incurred or taken on is initially the value of the consideration received to incur or take on the liability minus transaction costs. When developing Standards, the Board will decide whether to specify how those initial values are determined.

BC6.20 Consumption of all or part of an asset leads to derecognition of the part of the asset that is consumed. If the asset is measured at historical cost, this derecognition is reflected through depreciation or amortisation of the asset. Similarly, fulfilment of all or part of a liability leads to derecognition of the part of the liability that is fulfilled.

BC6.21 If an asset has become impaired or a liability has become onerous, the cost determined at initial recognition is unlikely to provide relevant information if it is not updated. Consequently, the 2018 *Conceptual Framework* describes the historical cost of an asset as being updated to reflect the fact that part of the historical cost is no longer recoverable, that is, the carrying amount of the asset is updated to reflect impairment. Similarly, the historical cost of a liability is updated to reflect changes that result in the liability becoming onerous, that is, the consideration received to incur or take on the liability is no longer sufficient to depict the obligation to fulfil the liability. However, historical cost does not reflect changes in value of an asset that is not impaired or of a liability that is not onerous.

BC6.22 The amortised cost of a financial asset or financial liability reflects estimates of future cash flows discounted at a rate that is not updated after initial recognition, unless the asset or liability bears interest at a variable rate. For loans given or received, if interest is receivable or payable regularly, the amortised cost of the loan typically approximates the amount originally paid or received. In addition, the carrying amount of a loan given is reduced if it is impaired. Therefore, the 2018 *Conceptual Framework* categorises amortised cost of financial assets and financial liabilities as a form of historical cost.

Current value (paragraphs 6.10–6.22 and 6.32–6.42)

BC6.23 The 2018 *Conceptual Framework* identifies current value measures as providing monetary information about assets, liabilities and related income and expenses using information updated to reflect conditions at the measurement date. It states that current measurement bases include fair value, value in use (for assets), fulfilment value (for liabilities) and current cost.

BC6.24 The description of fair value in the 2018 *Conceptual Framework* is consistent with its description in IFRS 13 *Fair Value Measurement*. The descriptions of value in use and fulfilment value are derived from the definition of value in use in IAS 36 *Impairment of Assets*, which is the most explicit of the various definitions of entity-specific value in Standards developed before the 2018 *Conceptual Framework*. The description of current cost is derived from descriptions of current cost in various academic sources.

BC6.25 Some Standards developed before the 2018 *Conceptual Framework* use value in use, but not as a separate measurement basis. In those Standards, value in use is used in determining the recoverable amount of an asset that is measured at historical cost and may be impaired. Within that context, if value in use is used to determine the recoverable amount of an impaired asset, immediately after the impairment loss has been recognised, the carrying amount of the asset equals its value in use. Nevertheless, the 2018 *Conceptual Framework* identifies value in use as a separate measurement basis because:

(a) it differs conceptually from historical cost, even though value in use is used in determining recoverable historical cost; and

(b) the Board might decide that in some circumstances an entity should measure an asset using an entity-specific current value (ie value in use) instead of fair value.

BC6.26 The 2018 *Conceptual Framework* explains that value in use and fulfilment value reflect the same factors as fair value, but using entity-specific assumptions, not assumptions by market participants.

BC6.27 Value in use and fulfilment value, therefore, reflect the price for bearing the uncertainty inherent in the cash flows—a risk premium. Including such a risk premium produces information that can be relevant because it reflects the economic difference between items subject to different levels of uncertainty. The inclusion of a risk premium is implicit in how value in use is described in IAS 36.[21]

BC6.28 Although current cost is not widely used in IFRS Standards, there is a significant body of academic literature that advocates the use of current cost in financial reporting. Consequently, the 2018 *Conceptual Framework* describes current cost.

BC6.29 The 2018 *Conceptual Framework* does not describe the following current value measurement bases:

(a) deprival value for assets or relief value for liabilities. The deprival value of an asset is the loss that an entity would suffer if it were deprived of the asset being measured. Similarly, the relief value of a liability is the benefit that an entity would enjoy if it were relieved of the liability being measured. The Board did not include a discussion of deprival value or relief value because they are more complex than other measurement bases and have been used in few jurisdictions. Hence, the Board concluded that it is unlikely to use deprival value or relief value when developing Standards.

(b) net realisable value. Net realisable value depicts the estimated consideration from the sale of the asset reduced by the estimated costs of sale. The Board concluded that it is unnecessary to describe net realisable value separately, because it is derived from another current measure.

(c) cost of release. Cost of release depicts the estimated cost (including transaction costs) of obtaining release from a liability by negotiation with the counterparty. Because it is relatively unusual for entities to obtain release from liabilities, instead of fulfilling them, the Board concluded that it is unnecessary to describe this measurement basis in the 2018 *Conceptual Framework*.

Transaction costs

BC6.30 Transaction costs can arise both when:

(a) an asset is acquired or a liability is incurred or taken on; and

(b) an asset is sold or disposed of or a liability is settled or transferred.

BC6.31 Defining which costs are transaction costs is beyond the scope of the *Conceptual Framework*. They have normally been defined in particular Standards as incremental costs, other than the transaction price, that would not have been

21 See paragraphs 55–56, A1 and A15–A21 of IAS 36 *Impairment of Assets*.

incurred if the particular asset (or liability) being measured had not been acquired (incurred) or sold or disposed of (transferred or settled).

BC6.32 Transaction costs incurred in acquiring an asset or incurring a liability are a feature of the transaction in which the asset was acquired or the liability was incurred. Hence:

(a) the historical cost and current cost of an asset or liability reflect those transaction costs. Although the transaction costs are not part of the transaction price, the entity could not have acquired the asset or incurred the liability without incurring those transaction costs.

(b) if the measure is intended to depict the fair value, fulfilment value or value in use of an asset or liability, the measure does not reflect those transaction costs. Those costs do not affect the current value of that asset or liability.

BC6.33 Transaction costs that would be incurred in selling or disposing of an asset or in settling or transferring a liability are a feature of a possible future transaction. Hence:

(a) value in use and fulfilment value reflect those transaction costs if the entity expects to incur them;

(b) fair value does not reflect those transaction costs; and

(c) historical cost and current cost do not reflect transaction costs that would be incurred in selling or disposing of an asset or in settling or transferring a liability because these measurement bases are entry values—they reflect the costs of acquiring the asset or incurring the liability.

Factors to consider when selecting a measurement basis (paragraphs 6.43–6.86)

BC6.34 To meet the objective of financial statements, information provided by a particular measurement basis must be useful to users of financial statements. A measurement basis achieves this if it provides information that is relevant and faithfully represents what it purports to represent. The 2018 *Conceptual Framework* discusses how relevance and faithful representation affect the selection of a measurement basis.

BC6.35 The Board considered whether to prescribe the order in which factors should be considered in selecting a measurement basis (for example, using a hierarchy or decision tree). However, the Board concluded that this would not be possible or desirable. The relative importance of the factors will depend on facts and circumstances. Indeed, in many cases it will be important to consider several factors when selecting a measurement basis.

Effect on both the statement of financial position and the statement(s) of financial performance (paragraph 6.43)

BC6.36 The 2018 *Conceptual Framework* states that when selecting a measurement basis it is necessary to consider the nature of the information that the measurement basis will produce in both the statement of financial position and the statement(s) of financial performance. Some respondents to the 2015 Exposure Draft stated that the *Conceptual Framework* should give more weight to the effect that a particular measure would have on the statement(s) of financial performance. In their view, the statement(s) of financial performance is more useful than the statement of financial position to users of financial statements. However, the Board concluded that the relative importance of the information produced in those statements will depend on how users will use the resulting information in their analysis, which will, in turn, depend on facts and circumstances.

Relevance (paragraphs 6.49–6.57)

BC6.37 The 2018 *Conceptual Framework* discusses the following factors that can affect the relevance of the information provided by a measurement basis:

(a) characteristics of the asset or liability; and

(b) contribution to future cash flows (see paragraphs BC6.38–BC6.42).

BC6.38 Paragraph 1.14 notes that some economic resources produce cash flows directly, whereas other economic resources are used in combination to produce cash flows. Building on this idea, the 2018 *Conceptual Framework* identifies as one factor in the selection of a measurement basis the way in which an asset or liability contributes to future cash flows.

BC6.39 The 2018 *Conceptual Framework* states that the way in which an asset or liability contributes to future cash flows depends, in part, on the nature of the business activities conducted by the entity. For example, depending on the nature of an entity's business activities, the same asset could be sold as inventory, leased to another entity or used in the entity's business. The Board acknowledged that measuring in the same way assets or liabilities that contribute to cash flows differently could reduce comparability by making different things appear the same.[22]

BC6.40 Although some respondents to the 2015 Exposure Draft expressed a concern that subjectivity could result if the nature of an entity's business activities were to be considered when selecting a measurement basis, many supported this approach. In addition, the Board noted that, in many cases, the nature of an entity's business activities is a matter of fact, not an opinion or management intent. When this is not the case, the Board will need to consider how to address any subjectivity.

BC6.41 The 2018 *Conceptual Framework* does not refer explicitly to any particular business activity, for example, long-term investment, for the reasons set out in paragraph BC0.39.

BC6.42 To help in the selection of a measurement basis, the 2018 *Conceptual Framework* also provides guidance on when historical cost or current value measurement bases might provide relevant information about financial assets and financial liabilities. That guidance builds on concepts identified by the Board in

22 Paragraph 2.27 of the 2018 *Conceptual Framework* states: 'Comparability is not uniformity. For information to be comparable, like things must look alike and different things must look different.'

developing IFRS 9 *Financial Instruments*. The Basis for Conclusions on IFRS 9 explains why the Board decided to use those concepts.

Faithful representation (paragraphs 6.58–6.62)

BC6.43 The 2018 *Conceptual Framework* identifies the following as factors that can affect whether the information provided by a particular measurement basis provides a faithful representation of the economic phenomena that are being depicted:

(a) whether the assets and liabilities are related in some way; and

(b) measurement uncertainty (see paragraphs BC6.44–BC6.45).

BC6.44 Some respondents to the 2013 Discussion Paper suggested that one factor to be considered in selecting a measurement basis is the level of measurement uncertainty associated with that measurement basis. Some respondents used the term 'reliability' to describe that factor. As discussed in paragraphs BC2.28–BC2.31, the Board did not reintroduce the term 'reliability'. Paragraph 2.22 of the 2018 *Conceptual Framework* explains that if a high level of measurement uncertainty is involved in making an estimate, that may indicate that different information about the economic phenomenon might be more useful (see paragraphs BC2.55–BC2.56). In addition, Chapter 6—*Measurement* discusses how measurement uncertainty can affect the selection of a measurement basis.

BC6.45 Some respondents to the 2015 Exposure Draft stated that applying prudence as they understand the term would imply that the tolerable level of measurement uncertainty would always be higher for liabilities than for assets (see paragraphs BC2.37(b), BC2.41–BC2.45 and BC2.55–BC2.56). The Board disagreed with this view, concluding that the tolerable level of measurement uncertainty depends on facts and circumstances and can be decided only when developing Standards.

Enhancing qualitative characteristics (paragraphs 6.63–6.76)

BC6.46 The 2018 *Conceptual Framework* identifies four 'enhancing qualitative characteristics' that make financial information more useful—comparability, verifiability, timeliness and understandability. In developing the 2018 *Conceptual Framework*, the Board identified no specific implications of timeliness for selection of a measurement basis beyond those discussed in Chapter 2—*Qualitative characteristics of useful financial information*. The 2018 *Conceptual Framework* discusses the general implications that comparability, verifiability and understandability have for the selection of a measurement basis.

BC6.47 In developing the 2018 *Conceptual Framework*, the Board considered these suggestions made by respondents:

(a) verifiability should play a more significant role in selecting a measurement basis; and

(b) comparability could be enhanced if the Board, when developing Standards, prevented preparers of financial statements from choosing between measurement bases.

BC6.48 The Board concluded that the discussion of verifiability appropriately reflects the role of verifiability as a factor to consider when selecting a measurement basis. Further, the Board concluded that additional discussion of the disadvantages of developing Standards that allow preparers to choose between alternative measurement bases is unnecessary because paragraph 2.29 acknowledges that permitting alternative accounting methods for the same economic phenomenon diminishes comparability.

Factors specific to initial measurement (paragraphs 6.77–6.82)

BC6.49 The 2015 Exposure Draft discussed both exchanges of items of similar value and exchanges of items of different value. Respondents to the 2015 Exposure Draft commented that the meaning of the terms 'similar value' and 'different value' was unclear. To respond to such concerns, the 2018 *Conceptual Framework* refers instead to whether the terms of a transaction are market terms.

More than one measurement basis (paragraphs 6.83–6.86)

BC6.50 The 2018 *Conceptual Framework* discusses situations in which more than one measurement basis is needed for an asset or liability and for related income and expenses to provide users of financial statements with useful information.

BC6.51 One way in which such information could be provided is to use a current measurement basis for an asset or liability in the statement of financial position and to use a different measurement basis for the related income or expenses in the statement of profit or loss. In such cases, the difference between the income or expenses included in the statement of profit or loss and the change in current value of the asset or liability is included in other comprehensive income. As discussed in paragraph 7.17, the Board would decide to require information to be provided in this way only in exceptional circumstances—and only if doing so would result in the statement of profit or loss providing more relevant information or providing a more faithful representation of the entity's financial performance for the period.

Measurement of equity (paragraphs 6.87–6.90)

BC6.52 Although total equity is not measured directly, it may be appropriate to measure directly individual classes of equity or components of equity to provide useful information. The 2018 *Conceptual Framework* discusses this idea.

BC6.53 A few respondents to the 2015 Exposure Draft disagreed with the proposal that some individual classes or components of equity could be measured directly. The respondents said they disagreed because:

(a) measuring a class of equity or a component of equity directly would be inappropriate because equity is defined as a residual interest; and

(b) it would be inconsistent with the reporting entity perspective because dividing total equity between classes and into components would result in the reporting of items that do not have a financial effect on the reporting entity as a whole.

BC6.54 Although the total carrying amount of equity (total equity) is measured as a residual, the Board noted that equity is defined as a type of claim—a residual interest in the assets of the entity after deducting all its liabilities. Measuring some classes of equity, or some components of equity, directly does not contradict that definition and differs from measuring total equity directly. Even if some individual classes or components of equity are measured directly, total equity will continue to equal the total of the carrying amounts of all recognised assets minus the total of the carrying amounts of all recognised liabilities. Consequently, if an entity has more than one class of equity or more than one component of equity, at least one of them is measured as a residual.

BC6.55 The Board also concluded that the direct measurement of some individual classes of equity or components of equity would not contradict the entity perspective adopted in financial statements. Those direct measures might provide users of financial statements with information useful in making decisions relating to providing resources to the entity. This information would be provided from the perspective of the entity and reflect the equity claims held against the entity. Such information would not be provided from the perspective of a particular claimholder.

from paragraph

CHAPTER 7—PRESENTATION AND DISCLOSURE

Introduction

BC7.1 The topic of presentation and disclosure was not addressed in the 2010 *Conceptual Framework*. Respondents to the Board's public consultation on its agenda in 2011 identified this topic as a priority. A particular issue identified was providing information about an entity's financial performance, including the use of other comprehensive income.

BC7.2 In response to that feedback, the 2018 *Conceptual Framework* introduces for the first time:

(a) concepts that describe how information should be presented and disclosed in financial statements. Those concepts will guide the Board in setting presentation and disclosure requirements in Standards and may guide entities in providing information in financial statements.

(b) guidance on classifying income and expenses for the Board to use when it decides whether they are included in the statement of profit or loss or are included outside the statement of profit or loss, in other comprehensive income (see paragraphs 7.15–7.18).

(c) guidance for the Board on whether and when income and expenses included in other comprehensive income should subsequently be reclassified into the statement of profit or loss (paragraph 7.19).

BC7.3 When it issued the 2018 *Conceptual Framework*, the Board was undertaking:

(a) a Disclosure Initiative, a collection of implementation and research projects aimed at improving disclosure in financial statements by providing additional guidance that builds on the presentation and disclosure concepts set out in the *Conceptual Framework*.

(b) a research project on primary financial statements. That project was examining potential targeted improvements to the structure and content of the statement(s) of financial performance and the statement of cash flows and perhaps also the statement of financial position and the statement of changes in equity.

Classification of equity (paragraphs 7.12–7.13)

BC7.4 The 2018 *Conceptual Framework* provides only high-level guidance on when it may be appropriate to present separately different classes of equity claims, and different components of equity. This guidance is based on the concepts for classification in paragraphs 7.7–7.8.

BC7.5 The Board may explore enhancements to the statement of changes in equity or other enhancements to presentation or disclosure requirements as part of its research project on Financial Instruments with Characteristics of Equity. Such enhancements might include some approaches the Board explored in the 2013 Discussion Paper.

Classification of income and expenses (paragraphs 7.14–7.19)

Terminology

BC7.6 The 2018 *Conceptual Framework* introduced the term ‘statement(s) of financial performance’ to refer to the statement or section of profit or loss together with the statement or section showing other comprehensive income.

BC7.7 The 2018 *Conceptual Framework* uses that term because it is consistent with the term ‘statement of financial position’ used in Standards and is clearer than the term ‘statement of comprehensive income’ sometimes used by the Board.

BC7.8 In 2007, the Board introduced a requirement to present all income and expenses recognised outside profit or loss in a statement of comprehensive income. The Board also introduced the term ‘other comprehensive income’ at that point. That term refers to income and expenses not included in the statement of profit of loss. Some respondents suggested that the term ‘other comprehensive income’ is neither particularly descriptive nor well understood by users of financial statements. Nonetheless, the Board concluded that avoiding the use of that term or using a different term could be confusing. Hence, the 2018 *Conceptual Framework* uses that term.

Approach to guidance on presentation and disclosure of income and expenses

BC7.9 Over the years, the Board has decided that several items of income and expenses may or must be recognised outside profit or loss. Those decisions were made for particular reasons in particular projects, not for a single consistently applied conceptual reason.

BC7.10 The 1989 *Framework* and the 2010 *Conceptual Framework* contained no reference to income or expenses presented outside the statement of profit or loss and no reference to other comprehensive income.

BC7.11 The Board decided it was important for the *Conceptual Framework* to include some discussion of this topic. However, the Board decided that the *Conceptual Framework* should not discuss whether income and expenses should be presented in a single statement of financial performance or in two statements, viewing this as a decision to be made when developing Standards. Since 2007, that decision has been set out in IAS 1 *Presentation of Financial Statements*.

BC7.12 In developing the 2018 *Conceptual Framework*, the Board considered the following questions:

(a) how to define or describe profit or loss (see paragraphs BC7.15–BC7.20);

(b) how to decide which income and expenses are included in the statement of profit or loss and which income and expenses are included in other comprehensive income (see paragraphs BC7.21–BC7.25); and

(c) whether and when the amounts included in other comprehensive income should be reclassified into the statement of profit or loss (see paragraphs BC7.26–BC7.33).

BC7.13 Many respondents to the 2013 Discussion Paper and to the 2015 Exposure Draft expressed a view that the proposed guidance on presentation of income and expenses was insufficient and would not provide the Board with a clear basis for standard-setting. Many respondents asked the Board to do further work on reporting financial performance.

BC7.14 However, the Board decided that the lack of guidance on the presentation of income and expenses was a significant gap in the 2010 *Conceptual Framework*. The Board concluded that it had made significant progress in developing high-level guidance on presentation of income and expenses and that this guidance would help the Board to develop presentation requirements in Standards. Hence, the Board decided to include such guidance in the 2018 *Conceptual Framework*, rather than to explore the use of the statement of profit or loss and other comprehensive income in a separate project. That decision will not preclude further work on reporting financial performance.

Describing profit or loss (paragraph 7.16)

BC7.15 The 2018 *Conceptual Framework* describes:

(a) the statement of profit or loss as the primary source of information about an entity's financial performance for the reporting period; and

(b) the total or subtotal for profit or loss as a highly summarised depiction of the entity's financial performance for the period.

BC7.16 Those descriptions are consistent with the fact that many users of financial statements incorporate the total or subtotal for profit or loss in their analysis, either as a starting point or as the main indicator of an entity's financial performance.

BC7.17 Merely describing the statement of profit or loss in the manner set out in paragraph 7.16 will be unlikely to satisfy those who asked for a definition of 'profit or loss' or for a more precise description. However, on the basis of its previous work the Board concluded that no single characteristic, or small number of characteristics, is shared by all items included in the statement of profit or loss but not shared by items that are most appropriately included in other comprehensive income. Consequently, the Board concluded that it is not possible to produce a robust conceptual definition of profit or loss or of other comprehensive income.

BC7.18 The Board also concluded that it could not create a prescriptive list of all categories of items that are most appropriately included in the statement of profit or loss. Such a list could never be complete and would inevitably lead to reporting in other comprehensive income some, perhaps many, items that would generally be regarded as being more appropriately included in the statement of profit or loss.

BC7.19 A number of stakeholders repeatedly asked the Board to define profit or loss. A few of them provided suggestions for how to develop such a definition or for distinguishing income and expenses to be included in the statement of profit or loss from income and expenses to be included in other comprehensive income. However, no consensus on a viable approach emerged.

BC7.20 As discussed in paragraphs BC7.17–BC7.19 of this Basis for Conclusions, the Board concluded that it was not possible to develop a robust conceptual definition of profit or loss or of other comprehensive income or a prescriptive list of all categories of items that are most appropriately included in the statement of profit or loss. Nevertheless, the 2018 *Conceptual Framework* introduces for the first time guidance on when it might be appropriate for the Board to include income or expenses in other comprehensive income. The Board concluded that introducing guidance on this topic was a significant improvement.

Profit or loss and other comprehensive income (paragraph 7.17)

BC7.21 As mentioned in paragraph BC7.17, the Board did not identify a single characteristic or a single set of characteristics shared by all items that are most appropriately included in the statement of profit or loss.

BC7.22 Further, the Board explored whether it might be possible to define a small number of categories of items that would or might be included in other comprehensive income. The Board described one approach to doing that in the 2013 Discussion Paper, but that approach did not attract significant support from respondents.

BC7.23 For the 2018 *Conceptual Framework*, the Board developed an approach to classifying income and expenses that is based on the description of the statement of profit or loss. As mentioned in paragraph BC7.15, that description states that the statement of profit or loss is the primary source of information about an entity's financial performance for the reporting period. If that statement is the primary source of that information, excluding income and expenses from that statement without compelling reasons could make that statement less useful.

BC7.24 Accordingly, the 2018 *Conceptual Framework* sets out a principle that all income and expenses are included in the statement of profit or loss. The Board's intention in establishing this principle was to emphasise that the statement of profit or loss is the default location for income and expenses. Thus, decisions to exclude any income and expenses from the statement of profit or loss and to include them in other comprehensive income can be made only in exceptional circumstances. Those exceptional circumstances would be when the Board concludes that requiring or permitting the exclusion of particular items of income or expenses from the statement of profit or loss would result in the statement of profit or loss providing more relevant information or providing a more faithful representation of an entity's financial performance for that period.

BC7.25 The 2018 *Conceptual Framework* does not include specific guidance on how the Board might reach that conclusion. The Board expects to take that decision when developing Standards and to explain its reasons in the bases for conclusions on those Standards. Entities cannot take that decision (see paragraph 88 of IAS 1).

Reclassifying items into the statement of profit or loss (paragraph 7.19)

BC7.26 The Board considered whether items of income and expenses included in other comprehensive income should be subsequently reclassified into the statement of profit or loss. Such reclassification is sometimes referred to as 'recycling'.

BC7.27 Some of the Standards developed before the 2018 *Conceptual Framework* require such reclassification; other Standards prohibit reclassification. The differences between these requirements arose because the Board had taken different approaches to the issue at different times. Sometimes, the Board's approach was to view the statement(s) of financial performance as a single performance statement so that each item of income or expenses should appear only once in that statement. To be consistent with that approach, the Board generally prohibited reclassification in Standards it developed at those times. At other times, the Board's approach was that all income and expenses should be included in the statement of profit or loss at some point. To achieve that objective, reclassification would be necessary.

BC7.28 It would have been undesirable for the Board's decisions on reclassification to continue to fluctuate over time in line with changes in the composition of the Board and in the Board's approach. Accordingly, the 2018 *Conceptual Framework* sets out the principle that the Board will apply in making decisions about reclassification.

BC7.29 The Board concluded that if the statement of profit or loss is the primary source of information about an entity's financial performance for the period, the cumulative amounts included in that statement over time need to be as complete as possible. Hence, income and expenses can be permanently excluded from the statement of profit or loss only if there is a compelling reason in that particular case.

BC7.30 Accordingly, the 2018 *Conceptual Framework* includes a principle that income and expenses included in other comprehensive income are subsequently reclassified into the statement of profit or loss. The reporting period in which reclassification takes place is the period when doing so results in the statement of profit or loss providing more relevant information or providing a more faithful representation of the entity's financial performance for that period.

BC7.31 Paragraphs 6.83–6.86 describe an approach that uses one measurement basis in the statement of financial position and a different measurement basis in the statement of profit or loss. When this approach is used, reclassification is the only way to ensure that, over the holding period of the asset or liability, the cumulative amount of income or expenses included in the statement of profit or loss for that asset or liability is the amount determined using the measurement basis selected for that statement.

BC7.32 In some cases, it might not be possible to identify any period when reclassifying income and expenses into the statement of profit or loss would have the result described in paragraph BC7.30. In such cases, without an appropriate, non-arbitrary basis for reclassification, reclassification would not provide useful information.

BC7.33 The 2018 *Conceptual Framework* does not include specific guidance on when reclassification would not provide useful information. The Board expects to take that decision when developing Standards and to explain its reasons in the bases for conclusions on those Standards. Entities cannot take that decision.

CHAPTER 8—CONCEPTS OF CAPITAL AND CAPITAL MAINTENANCE

BC8.1 The Board decided that updating the discussion of capital and capital maintenance was not feasible when it developed the 2018 *Conceptual Framework* and could have delayed the completion of the 2018 *Conceptual Framework* significantly.

BC8.2 The Board decided that it would be inappropriate for the 2018 *Conceptual Framework* to exclude a discussion of capital and capital maintenance altogether. Those concepts are important to financial reporting and influence the definitions of income and expenses, the selection of measurement bases, and presentation and disclosure decisions.

BC8.3 Therefore, the material in Chapter 8—*Concepts of capital and capital maintenance* of the 2018 *Conceptual Framework* has been carried forward unchanged from the 2010 *Conceptual Framework*. That material originally appeared in the 1989 *Framework*.

BC8.4 The Board may decide to revisit the concepts of capital and capital maintenance in the future if it considers such a revision necessary.

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SET ISBN 978-1-911040-89-7

ISBN 978-1-911040-91-0