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The New Conceptual Framework for Financial Reporting 2010: Some Reflective Comments

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ABSTRACT

A new Conceptual Framework for Financial Reporting, although in an incomplete shape, has been issued by the International Accounting Standards Board (IASB) in September 2010. Having a status of the constitution of a standard-setting body, this Conceptual Framework (CF) states the fundamental concepts in which the standards are rooted and that underlie the preparation of financial reports. This CF is to be used as a guide for developing future standards and reviewing existing standards. Due to a number of revised or new issues and as a component of authoritative guidance of the IASB in the absence of any standards or interpretations, this CF is of high importance for all the stakeholders of accounting and financial reporting. Since June 2008, the reporting framework as well as IFRSs (International Financial Reporting Standards) issued by the IASB are mandatory for a listed company in Bangladesh, the CF has also significant compliance implications. This paper has provided a comparative analysis of the new CF (2010) and the preceding Framework (1989) of the IASB to grasp the extent of revisions. The paper has also analytically reviewed the new CF with some reflective implications towards future direction of financial reporting.

Keywords: Conceptual Framework Project, Conceptual Framework, IFRSs, Concepts Statements

INTRODUCTION

The Conceptual Framework (CF) delineates the basic concepts that underlie the preparation and presentation of financial statements for external users. The CF serves as a guide to the standard-setters in developing future standards and as a guide to resolving accounting issues that are not addressed directly in an International Accounting Standard (IAS) or International Financial Reporting Standard (IFRS) or Interpretations developed by the IFRS Interpretations Committee or the former Standing Interpretations Committee (SIC).[1] In its 2003

revision of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors (revised December 2003), the IASB introduced a hierarchy of accounting rules that should be followed by preparers in seeking solutions to accounting problems. According to this hierarchy, the most authoritative guidance is IFRS (that includes existing IASs, IFRSs and the Interpretations) (Epstein & Jermakowicz, 2010; IASB, 2010a: A292). In the absence of a Standard or an Interpretation that specifically applies to a transaction, management must use its judgement in developing and applying an accounting policy that results in information that is relevant and reliable. In making that judgement, paragraph ('para' hereinafter) 11 of IAS 8 (revised 2003) requires management to consider the definitions, recognition criteria, and measurement concepts for assets, liabilities, income, and expenses in the Conceptual Framework (www.iasplus.com).

The International Accounting Standards Board (IASB) and US Financial Accounting Standards Board (FASB) both published on 28 September 2010, the Conceptual Framework for Financial Reporting ('the Conceptual Framework' hereinafter). Hence, the Framework for the Preparation and Presentation of Financial Statements ('the Framework' hereinafter) published by the International Accounting Standards Committee (IASC) in July 1989 and adopted by the IASB in April 2001 has been withdrawn. This paper is an analytical overview of the new Conceptual Framework (2010) with a detailed critical comparison with the preceding Framework (1989).

BACKGROUND OF THE NEW CONCEPTUAL FRAMEWORK

In 1976, the US FASB began to develop a conceptual framework that would be a basis for setting accounting rules and for resolving financial reporting controversies (Kieso, Weygandt, & Warfield, 2012). From November 1978 to September 2010, the FASB has issued eight Statements of Financial Accounting Concepts (SFAC) or "Concepts Statement", of which seven relate to financial reporting for business enterprises and one (SFAC No. 4) relates to that for nonbusiness organizations. But three SFACs (SFAC Nos. 1, 2 and 3) have already been replaced and now five SFACs are valid. They are as follows: SFAC No. 4:

[1] The Standing Interpretations Committee (SIC) was renamed as the International Financial Reporting Interpretations Committee (IFRIC) on March 5, 2002. The International Financial Reporting Interpretations Committee (IFRIC) has been renamed as the IFRS Interpretations Committee with effect from July 1, 2010 (www.iasplus.com; accessed 27.11.2012).

Objectives of Financial Reporting by Nonbusiness Organizations; SFAC No. 5: *Recognition and Measurement in Financial Statements of Business Enterprises;* SFAC No. 6: *Elements of Financial Statements;* SFAC No. 7: *Using Cash Flow Information and Present Value in Accounting Measurements;* SFAC No. 8: *Conceptual Framework for Financial Reporting*—Chapter 1, *The Objective of General Purpose Financial Reporting, and* Chapter 3, *Qualitative Characteristics of Useful Financial Information* (www.fasb.org).

Belated initiative has been taken by the IASC (International Accounting Standards Committee). The IASC, formed in 1973, was the predecessor body of the International Accounting Standards Board (IASB). On 1 April 2001, the IASB took over from the IASC the responsibility for setting International Accounting Standards (IAS), although newly issued standards are known as IFRS (International Financial Reporting Standard). In January 1975, the IASC issued first IAS (IAS 1 *Disclosure of Accounting Policies*) and in April 1989, it issued 28th IAS (IAS 28 *Accounting for Investments in Associates*). Thereafter, the *Framework for the Preparation and Presentation of Financial Statements* ('the Framework') was approved by the IASC Board in April 1989 for publication in July 1989, and adopted by the IASB in April 2001 (www.iasplus.com), although the Framework should assist in the development of IAS. For its delayed issuance, the first purpose of the Framework was to assist in the development of future IASs and in the review of existing IASs (paragraph 1(a) of the Framework) (IASB, 2010b: B1713).

The IASB signed an agreement with the US FASB (the so-called Norwalk Agreement[2]) in October 2002 stating that the two boards would seek to remove differences and converge on high-quality standards (Epstein & Jermakowicz, 2010). At their joint meeting in October 2004, the IASB and the FASB decided to add to their respective agendas a joint project to develop a common conceptual framework, based on and built on both the existing IASB Framework and the FASB Conceptual Framework, that both Boards would use as a basis for their accounting standards (www.iasplus.com). The objective of the conceptual

[2] On September 18, 2002, the FASB and the IASB met jointly and agreed to work together to improve and converge U.S. GAAP and IFRS. On October 29, 2002, both the Boards (the FASB and the IASB) announced the issuance of a memorandum of understanding on this partnership. That partnership is described in "The Norwalk Agreement." The Norwalk Agreement set out the shared goal of developing compatible, high-quality accounting standards that could be used for both domestic and cross-border financial reporting. It also established broad tactics to achieve their goal: develop standards jointly, eliminate narrow differences whenever possible, and, once converged, stay converged (www.fasb.org and www.iasplus.com; accessed 31.03.2012).

framework project is "to develop an improved common conceptual framework that provides a sound foundation for developing future accounting standards" (IASB, 2010e). The Conceptual Framework project is being conducted in eight phases as follows: Phase A: Objective and qualitative characteristics; Phase B: Elements and recognition; Phase C: Measurement; Phase D: Reporting entity; Phase E: Presentation and disclosure; Phase F: Purpose and status of framework; Phase G: Applicability to not-for-profit entities; and Phase H: Other issues, if necessary. According to the discussion on the project plan, Phase A was expected to be completed by 2007, Phase B by 2008, Phase C by 2009, and Phases D to H by 2010.

Kaminski & Carpenter (2011) have examined the first four active phases of the CF project of the IASB and the FASB over about six-year period up to July 2010, i.e., before finalization of any of the phases. Results of their study indicate that progress is being achieved in reconciling differences between the current frameworks. While the joint project remains a work-in-process, the resulting new and improved conceptual framework will be the foundation for development of principles-based standards that are internally consistent and internationally converged (Kaminski & Carpenter, 2011). Until March 2012, only Phase A (Objective and qualitative characteristics) has been completed on 28 September 2010.[3] Phase D (Reporting entity) has progressed much with the publication of Exposure Draft (ED) on 11 March 2010.[4] Round-tables on Phase C (Measurement) were held in first half 2007, but deliberations not expected until after June 2011. Deliberations on Phase B (Elements and Recognition) are also not expected until after June 2011. Timing of other phases (Phases E, F, G and H) is not yet determined. The Conceptual Framework project is paused (last meeting held on 17 November 2010) until the IASB concludes its? ongoing deliberations about its future work plan (www.iasplus.com & www.ifrs.org). As a result of the successful completion of Phase A, the IASB and US FASB both published on 28 September 2010, the incomplete version of the *Conceptual Framework for Financial*

[3] DP (Discussion Paper) on Phase A issued on 6 July 2006; ED (Exposure Draft) on Phase A issued on 29 May 2008; Comment deadline 29 September 2008; Final Phase A chapters of Framework published on 28 September 2010.

[4] DP (Discussion Paper) on Phase D issued on 29 May 2008; Comment deadline 29 September 2008; ED on Phase D issued on 11 March 2010; Comment deadline 16 July 2010; Deliberations to continue second half of 2011 (www.iasplus.com). However, in a joint meeting held on 17 November 2010, the IASB and FASB decided that, because of the need to give priority to other projects targeted for completion in June 2011, the Reporting Entity chapter of the Conceptual Framework will not be finalised during the first quarter of 2011, as had been planned previously (www.ifrs.org).

Reporting ('the Conceptual Framework' hereinafter) showing Chapter 2 as "Chapter 2 The reporting entity *to be added*" in IASB's Conceptual Framework and "Chapter 2: (Reserved for the Chapter on the Reporting Entity)" in FASB's Conceptual Framework (FASB, 2010; IASB, 2010c). Due to a number of new issues, this Conceptual Framework (2010) is important for all the stakeholders of accounting and financial reporting.

As stated by Bullen & Crook (2005), the common Conceptual Framework (CF) of the IASB and the FASB was needed to make the accounting standards "principles-based", since they cannot be a collection of *conventions* but rather must be rooted in fundamental *concepts*. Hence, the fundamental *concepts* would constitute the CF for standards on various issues to result in coherent financial accounting and reporting (Bullen & Crook, 2005). In the words of Johnson (2004b), "A conceptual framework provides the unity and consistency that is required and, with that, the direction and means to help in making those decisions. Without a set of unified concepts, standard setters are like a ship in a storm without an anchor."

As mentioned by the US FASB (2010),

> *The Conceptual Framework is a coherent system of interrelated objectives and fundamental concepts that prescribes the nature, function, and limits of financial accounting and reporting and that is expected to lead to consistent guidance. It is intended to serve the public interest by providing structure and direction to financial accounting and reporting to facilitate the provision of unbiased financial and related information. That information helps capital and other markets to function efficiently in allocating scarce resources in the economy and society.*

Pounder (2010) observes that the concepts addressed by CFs tend to be "general in nature, broad in scope, and stable over time" to eliminate the need for a standards setter to reestablish core concepts each time it develops or updates a standard and hence, "by consistently referring to a stable conceptual framework, a standards setter is more likely to promulgate standards that are consistent with each other as well as with significant assumptions and constraints."

The Conceptual Framework of the IASB shares this attribute in that it is rarely a focal point when analysing financial statements and yet it is at the heart of every accounting standard ensuring consistency of terminology, recognition and measurement (Rodgers, 2007). In accordance with Christensen (2010), in the

context of the demand for a CF from an information economics perspective, the focal point of the CF of financial reporting must also be the comparative advantage of accounting (which always produces information late in a decision process) over other, perhaps more timely, information sources.

STRUCTURE OF THE CONCEPTUAL FRAMEWORK

Following table (Table I) has shown a comparative picture of the IASB's Framework for the Preparation and Presentation of Financial Statements (the Framework) issued in July 1989 and the Conceptual Framework for Financial Reporting (the Conceptual Framework) issued on 28 September 2010. If we observe the number of paragraphs ('paras' hereinafter) [5] in the two Frameworks, the body of Conceptual Framework (2010) contains 125 paragraphs in total (21 paragraphs in Chapter 1, 39 paragraphs in Chapter 2, and 65 paragraphs in Chapter 4), whereas the old Framework (1989) contains corresponding 105 paragraphs in total (16 paragraphs against new Chapter 1 contents, 23 paragraphs in new Chapter 2 contents, and 66 paragraphs in new Chapter 4 contents). Only one paragraph of the old Framework ('Accrual basis' under para 22 as an "UNDERLYING ASSUMPTION") is not carried over in the new Conceptual Framework.

MAJOR CHANGES IN THE CONCEPTUAL FRAMEWORK (2010)

Although, structurally the scope of the new and old Frameworks is the same, but in the Conceptual Framework (2010), the contents have been revised significantly in Chapters 1 and 3 and a little in Chapter 4. Following are the major changes so far.

Chapter 1: The Objective of General Purpose Financial Reporting

There is a significant shifting in the Conceptual Framework with respect to the "Objectives" of financial statements/reporting as shown in the following table (Table II).

Table I: *Comparative Position of New and Old Frameworks*

THE CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING	*paragraphs*	**Framework for the Preparation and Presentation of Financial Statements**	*paragraphs*
INTRODUCTION		**PREFACE**	
Purpose and status		**Purpose and status**	**1–4**
Scope		**Scope**	**5**
CHAPTERS			
1 The objective of general purpose financial reporting	**OB1–OB21**	**Scope**	**6-8**
		Users and their information needs	**9–11**
		THE OBJECTIVE OF FINANCIAL STATEMENTS	**12–21**
2 The reporting entity *to be added*		—	—
3 Qualitative characteristics of useful financial information	**QC1–QC39**	**QUALITATIVE CHARACTERISTICS OF FINANCIAL STATEMENTS**	**24–46**
4 The *Framework* (1989): the remaining text			
Underlying assumption	4.1	**UNDERLYING ASSUMPTIONS**	**22–23**
The elements of financial statements	4.2–4.36	**THE ELEMENTS OF FINANCIAL STATEMENTS**	**47–81**
Recognition of the elements of financial statements	4.37–4.53	**RECOGNITION OF THE ELEMENTS OF FINANCIAL STATEMENTS**	**82–98**
Measurement of the elements of financial statements	4.54–4.56	**MEASUREMENT OF THE ELEMENTS OF FINANCIAL STATEMENTS**	**99–101**
Concepts of capital and capital maintenance	4.57–4.65	**CONCEPTS OF CAPITAL AND CAPITAL MAINTENANCE**	**102–110**

Source: IASB, 2010d; and IASB, 2010b: B1709- B1733.

Table II: Comparative "Objective"

Issues	*Framework* (1989)	*Conceptual Framework* (2010)
Title	**The objective of financial statements**	**The objective of general purpose financial reporting**
Content	The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions (para 12).	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. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit [para OB2].
Scope	financial statements (of an entity) [financial statements of all commercial, industrial and business reporting entities, whether in the public or the private sectors (para 8)	general purpose financial reporting (of the reporting entity)
Users	a wide range of users and they include "present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public" (para 9)	existing and potential investors, lenders and other creditors are "primary users" [para OB5] and "regulators and members of the public other than investors, lenders and other creditors" may be users but those are not the parties to whom general purpose financial reports are primarily directed [para OB10]
Use	in making economic decisions	in making decisions about providing resources to the entity
Information about	information about the financial position, performance and changes in financial position of an entity	financial information about the reporting entity [thus does not list the information within the 'objective' itself]

Source: IASB, 2010d: 9-11; and IASB, 2010b: B1713- B1717

Scope

Previously, in the FASB's Conceptual Framework, the objective was of "financial reporting" and in IASB's Framework, it was of "financial statements". Now, it has been of financial reporting and not just of financial statements. Financial statements are a central part of financial reporting, but do not cover all. Financial statements form part of the process of financial reporting and special purpose financial reports were outside the scope of the old Framework. Therefore, the new scope of the Conceptual Framework is broader [para BC1.4 of the Conceptual Framework; paras 6-7 of the Framework]. In place of "financial statements" in general in old Framework, "general purpose financial reporting" have been mentioned with reference to "the reporting entity" in the Conceptual

Framework. This is due to the fact 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" [para BC1.8]. The use of 'financial reporting' also justifies the name of the standard as IFRS in place of IAS.

Users

Previously, the user group was "a wide range of users" (that includes "present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public") without any focus. Now, the primary users are "existing and potential investors, lenders and other creditors" (para OB2) but without "a hierarchy of primary users" and the phrase is intended to encompasses the 'present and potential investors, employees, lenders, suppliers and other trade creditors', and the advisers of investors (para 9 of the Framework). There is a list of other potential users such as customers, governments and their agencies, and the public who may be interested in financial reports but are not primary users [para BC1.10]. According to IASB, without a defined group of primary users, the Conceptual Framework would risk becoming unduly abstract or vague [para BC1.14]. The reasons why the IASB 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 IASB'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; and (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 [para BC1.16]. However, Zhang (2011) has evaluated the IASB's declaration that "its basic mission ... is to serve the information needs of participants in capital markets" (para BC1.23) as a remarkable statement, as for an organisation that coordinates the financial reporting practices of the majority sectors across the world it bears such a narrowed vision of its responsibility.

Use

Previously, the use of information was "in making economic decisions." The information needs of the seven groups of users (investors, employees, lenders, 'suppliers and other trade creditors', customers, 'governments and their agencies' and the public) were separately provided previously in the old Framework (para 9 of the Framework). Under the new Conceptual Framework, the use of financial information is "in making decisions about providing resources to the entity" and the decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit [para OB2]. Under the old Framework, financial statements show the results of the stewardship of management, or the accountability of management for the resources entrusted to it (para 14 of the Framework). The IASB has not used the term stewardship because there would be difficulties in translating it into other languages. Instead, the IASB has described what stewardship encapsulates. Accordingly, the objective of financial reporting acknowledges that users make resource allocation decisions as well as decisions as to whether management has made efficient and effective use of the resources provided [para BC1.28]. However, the non-use of stewardship is mentioned as 'sidelining' and 'obviously unacceptable' by Zhang (2011). According to Bjerke (2007), "The decision-usefulness/stewardship controversy can be resolved simply by portraying economic information in an economic statement for decision-making purposes" (Bjerke, 2007).

Information about

According to the old Framework, "information" is "about the financial position, performance and changes in financial position of an entity". In accordance with the new Conceptual Framework "financial information" is "about the financial position of a reporting entity, which is information about the entity's economic resources and the claims against the reporting entity", and "about the effects of transactions and other events that change a reporting entity's economic resources and claims" as useful input for decisions about providing resources to an entity [para OB12]. Under para OB15 of the Conceptual Framework, "changes in a reporting entity's economic resources and claims" result (1) from that entity's financial performance reflected by accrual accounting (paras OB17–OB19) or reflected by past cash flows (para OB20), and (2) from other events or transactions such as issuing debt or equity instruments (para OB21). Under BC1.32, a reporting

entity's financial performance is "represented by comprehensive income, profit or loss or other similar terms". The concept of 'comprehensive income' has first been incorporated in revised IAS 1 Presentation of Financial Statements (revised in September 2007 effective for annual periods beginning on or after January 1, 2009, with early application permitted). The revised IAS 1 (September 2007) is largely into line with the corresponding US GAAP standard–Statement of Financial Accounting Standards (SFAS) No. 130, Reporting Comprehensive Income issued in 1997 (Epstein & Jermakowicz, 2010).[6] As per para 7 of IAS 1 (revised 2007), "Total comprehensive income comprises all components of 'profit or loss' and of 'other comprehensive income'." Total comprehensive income is the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners. Profit or loss is the total of income less expenses, excluding the components of other comprehensive income. Other comprehensive income comprises items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other IFRSs (IASB, 2010a: A292-A293). The 'income statement' (as was in para 7 of previous IAS 1) has been renamed as 'statement of comprehensive income' as per para 10 of revised IAS 1 (IASB, 2010a: A294). This is due to the adoption of 'asset and liability view' of income in which income is a measure of the increase in the net resources of the enterprise during a period and it includes 'unrealized gain'.[7] Under the alternative view (known as revenue and expense view), income is the difference between outputs

[1] As per para BC106 of IAS 1 (2007), the differences from SFAS 130 with respect to 'reporting comprehensive income' are: (a) Reporting and display of comprehensive income: Para 22 of SFAS 130 permits a choice of displaying comprehensive income and its components, in one or two statements of financial performance or in a statement of changes in equity. IAS 1 (as revised in 2007) does not permit display in a statement of changes in equity. (b) Reporting other comprehensive income in the equity section of a statement of financial position: Para 26 of SFAS 130 specifically states that the total of other comprehensive income is reported separately from retained earnings and additional paid-in capital in a statement of financial position at the end of the period. A descriptive title such as accumulated other comprehensive income is used for that component of equity. IAS 1 (as revised in 2007) does not specifically require the display of a total of accumulated other comprehensive income in the statement of financial position. (c) Display of the share of other comprehensive income items of associates and joint ventures accounted for using the equity method: Para 82 of IAS 1 (as revised in 2007) requires the display in the statement of comprehensive income of the investor's share of the investee's other comprehensive income. Paragraph 122 of SFAS 130 does not specify how that information should be displayed (IASB 2010b: B675).

[2] As per para 4.25(a) of the CF, "Income is 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." Thus, as per para 4.31, "The definition of income also includes unrealised gains" (IASB, 2010d: 30-32).

from and inputs to the enterprise's earning activities during a period). The revenue and expense view has not been accepted since revenue, expense, or income is challenging to define directly, without reference to assets or liabilities or recourse to highly subjective terminology like proper matching (Bullen & Crook, 2005).

As found from literature survey by Zhang (2011), the concept of comprehensive income may cause confusion among some financial statement users about true earnings, since its disclosure may create an additional performance measure that has been proven to be more volatile than net income and it may actually undermine the quality of accounting information (Zhang, 2011).

Chapter 2: The Reporting Entity [To Be Added]

Chapter 2 on "The Reporting Entity" is not yet finalized and not incorporated in the Conceptual Framework (2010). On the basis of the Exposure Draft (issued in March 2010 with Comments deadline 16 July 2010; vide IASB, 2010c), following comparison can be shown (Table III).

Table III: Comparative Explanations of the Reporting Entity

Issues	*Framework* (1989)	ED on "The Reporting Entity" (IASB, 2010c)
Definition of Reporting Entity	A reporting entity is an entity for which there are users who rely on the financial statements as their major source of financial information about the entity [para 8].	A **reporting entity** is 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 the entity and in assessing whether management and the governing board of that entity have made efficient and effective use of the resources provided. [RE2] A **reporting entity** has three features: (a) economic activities of an entity are being conducted, have been conducted or will be conducted; (b) those economic activities can be objectively distinguished from those of other entities and from the economic environment in which the entity exists; and (c) 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. These features are necessary but not always sufficient to identify a reporting entity. [RE3]

Source: IASB, 2010c; and IASB, 2010b: B1714

Chapter 3: Qualitative Characteristics of Useful Financial Information

Major changes have been brought in this chapter. According to the title, new version of "Qualitative Characteristics" are of "Useful Financial Information" and the old version of "Qualitative Characteristics" are of "Financial Statements" only. In line with the title, the coverage of the new version of "Qualitative Characteristics" is broader than the older one (also substantiated by more number of paragraphs–39 paragraphs against 23 paragraphs). Following table (Table IV) shows the comparative position of the qualitative characteristics of financial statements/information.

Table IV: Comparative Qualitative Characteristics

Issues	***Framework* (1989)**	**ED on "The Reporting Entity"** (IASB, 2010c)
Definition of Reporting Entity	A reporting entity is an entity for which there are users who rely on the financial statements as their major source of financial information about the entity [para 8].	A **reporting entity** is 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 the entity and in assessing whether management and the governing board of that entity have made efficient and effective use of the resources provided. [RE2] A **reporting entity** has three features: (a) economic activities of an entity are being conducted, have been conducted or will be conducted; (b) those economic activities can be objectively distinguished from those of other entities and from the economic environment in which the entity exists; and (c) 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. These features are necessary but not always sufficient to identify a reporting entity. [RE3]

Source: IASB, 2010c: 15-23; and IASB, 2010b: B1718-B1722.

Under the previous Framework, qualitative characteristics are the attributes that make the information provided in financial statements useful to users [para 24 of the Framework]. Under the new Conceptual Framework, the qualitative characteristics of useful financial information apply to financial information provided in financial statements, as well as to financial information provided in other ways [para QC3].

Under the previous Framework, the four **principal** qualitative characteristics are *understandability, relevance, reliability* and *comparability* [para 24 of the Framework]. Under the new Conceptual Framework, the **fundamental qualitative characteristics** *are relevance* and *faithful representation* [para QC5] and the **enhancing qualitative characteristics** are *comparability, verifiability, timeliness* and *understandability,* that enhance the usefulness of information that is relevant and faithfully represented [para QC19].

The discussion of *faithful representation* in new Conceptual Framework differs from that in the previous Framework in two significant ways. First, it uses the term *faithful representation* instead of the term *reliability*.[8] Second, *substance over form* [para 35 of the Framework], *prudence* (conservatism) [para 37 of the Framework] and *verifiability* [para 31 of the Framework, where it is presumed to be mentioned as *free from material error*], which were aspects of *reliability* in the previous Framework, are not considered aspects of *faithful representation. Substance over form* has been removed from the new Conceptual Framework due to 'redundancy' and in this new Conceptual Framework, *faithful representation* means that financial information represents the substance of an economic phenomenon rather than merely representing its legal form. *Prudence* is not included as an aspect of faithful representation because including either would be inconsistent with neutrality. 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. If financial information is biased in a way that encourages users to take or avoid predetermined actions, that information is not neutral. *Verifiability* is now described as an enhancing qualitative characteristic rather than as part of this fundamental qualitative characteristic [paras BC3.19, BC3.26-BC3.29]. However, the replacement of the term Reliability by the term Faithful Representation has been considered sometimes as an important change to eliminate the possibility of a trade-off between relevance and reliability (Zhang,

[8] The clarification given by the IASB in replacing reliability by faithful representation in para BC3.25 as follows: "Many respondents [out of 142 in number] to the discussion paper and the 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" (IASB, 2010d: 60).

2011). Even there is criticism towards possible 'unreliable' implementation of some accounting measurements given the significant amount of subjective 'professional' judgment involved (Zhang, 2011).

The old Framework (1989) did not explicitly include the word verifiability as an aspect of reliability and according to it, 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 [para 31 of the Framework], although 'free from error' is often interpreted as 'verifiable'.[9] Since including verifiability as an aspect of faithful representation could result in excluding information that is not readily verifiable (for example, expected cash flows, useful lives and salvage values). However, excluding information about those estimates would make the financial reports much less useful. Hence, verifiability is considered as an enhancing qualitative characteristic, very desirable but not necessarily required [para BC3.36].

In the old Framework, constraints include "timeliness", "balance between benefit and cost", and "balance between qualitative characteristics" (paras 43-45). But in the new Conceptual Framework, "timeliness" has been shifted in the list of enhancing qualitative characteristics, "balance between benefit and cost" has been referred to as "cost constraint" [paras QC35-QC39] and another one ("balance between qualitative characteristics") is not carried over in its previous form, but discussed under "Applying the fundamental qualitative characteristics" [paras QC17 and QC18] and "Applying the enhancing qualitative characteristics" [paras QC33 and QC34].

In the old Framework, "true and fair view/fair presentation" of financial statements was mentioned as desirable qualitative characteristics of financial information [para 46]. But these are not included in the new Conceptual Framework, because they are different words to describe information that has the qualitative characteristics of relevance and representational faithfulness enhanced by comparability, verifiability, timeliness and understandability [para BC3.44]. However, under the corporate regulatory environment of Bangladesh, there is still "true and fair view" concept. In accordance with section 213 of the Companies Act 1994, the auditor shall make a report which shall state whether, in his opinion, the audited accounts of a company 'give a true and fair view' of the state of its affairs

[9] As explained by Nikolai, Bazley and Jones (2010), reliable information is reasonably free from error and bias, and faithfully represents what it is intended to represent. That is, to be reliable, information must be verifiable, neutral, and possess representational faithfulness (Nikolai et el., 2010: 48).

in case of the balance sheet and of the profit or loss in case of the profit and loss account (Dhar, 1998). Under rule 13(3B) of the Securities and Exchange Rules 1987, the audited financial statements should reflect 'the true state of affairs' of the listed companies and in the 'Form B: Form of the Auditors' Report' [under rule 12(3)], the auditors of listed company have to give opinion that its audited financial statements should 'give a true and fair view of the state of its affairs' (SEC, 2010). If the concept of "true and fair view" is used in place 'fair presentation' under the regulatory requirement, this can be stated as a "true and fair" override (Kieso, Weygandt, & Warfield, 2012).

Chapter 4: The Framework (1989): The Remaining Text

Since this chapter covers "the remaining text" of the old Framework, a little change has been made in the new Conceptual Framework (Table V).

Table V: Corresponding Paragraphs of Chapter 4

Issues	Current paragraphs	Past paragraphs
Underlying assumption	4.1	22*, 23
The elements of financial statements	4.2–4.36	47-81
Recognition of the elements of financial statements	4.37–4.53	82–98
Measurement of the elements of financial statements	4.54–4.56	99–101
Concepts of capital and capital maintenance	4.57–4.65	102–110

*Paragraph 22 is not carried over.
Source: IASB, 2010c: 24-40; and IASB, 2010b: B1717-B1718 & B1722-B1733.

In the old Framework, "Underlying assumptions" include two assumptions: "Accrual basis" (para 22 of the Framework) and "Going concern" (para 23 of the Framework). But in the new Conceptual Framework, only one "Underlying assumption" has been carried over: "Going concern" (para 4.1) although in IAS 1 Presentation of Financial Statements, "Accrual basis of accounting" has been covered in paragraphs 27–28 and "Going concern" in paragraphs 25–26.

Also under new Conceptual Framework, "Financial performance reflected by accrual accounting" has been mentioned in paragraphs OB17–OB19. According to para OB17, accrual accounting is important because then information provides a

better basis for assessing the entity's past and future performance than information solely about cash receipts and payments during that period [para OB17]. Under para 27 of IAS 1, an entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting (IAS 1.27).

APPLICABILITY OF IFRS AND THE CONCEPTUAL FRAMEWORK IN BANGLADESH

Sub-rules (2) and (3) were inserted in rule 12 of the Securities and Exchange Rules 1987 (SER 1987) by the Notification of the Securities and Exchange Commission (SEC) numbered as SEC/Section-7/SER/03/132, dated October 22, 1997, published in the official Gazette on December 29, 1997. Under rule 12(2) of the SER 1987, "The financial statements of an issuer of a listed security shall be prepared in accordance with the requirements laid down in the Schedule and the International Accounting Standards as adopted by the Institute of Chartered Accountants of Bangladesh" (SEC, 2010). The auditors of a listed company have to audit the set of financial statements "in due conformance with generally accepted accounting principles, procedures and also the applicable International Accounting Standard (IAS)" [Form B: Forms of the Independent Auditor's Report under rule 12(3) of the SER; vide SEC, 2010: 108]. Here, International Accounting Standard (IAS) refers to the accounting standards issued by the International Accounting Standards Committee (SEC, 2010), although on April 1, 2001, the IASC has been reconstituted under the new name IASB. Although since 1984, the ICAB (Institute of Chartered Accountants of Bangladesh) has been adopting accounting standards, previously as Accounting Standard with own serial number, later on IAS as Bangladesh Accounting Standard (BAS) and IFRS as Bangladesh Financial Reporting Standard (BFRS) (ICAB, 1984), but the SEC gave statutory cognizance only in October 1997.

BRPD Circular No.14 dated June 25, 2003 was issued by the Banking Regulation & Policy Department (BRPD) of Bangladesh Bank for preparation of financial statements by a scheduled bank, which was prepared in accordance with IAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions (www.bangladesh-bank.org). Although IAS 30 was issued in August 1990 with effect from (w.e.f.) 1991, reformatted in 1994 and then amended by IAS 39 Financial Instruments: Recognition and Measurement in December 1998 w.e.f.

2001 and finally superseded by IFRS 7 Financial Instruments: Disclosures issued in August 2005 w.e.f. 01.01.2007.

But since June 4, 2008, in accordance with the SEC's Notification No. SEC/CMRRCD/2008-181/53/Admin/03/28, issued on 04.06.2008 under the superpower of section 2CC of the Securities and Exchange Ordinance 1969, published in the official gazette on September 02, 2008, all the effective IFRSs/IASs are applicable for a listed company in Bangladesh. Under this notification, a listed company, in its yearly and periodical financial statements, shall include (i) a clear and unambiguous statement of the reporting framework on which the accounting policies are based"; and (ii) a 'statement that explains that the financial statements are in compliance with International Financial Reporting Standard (IFRS) issued by the International Accounting Standards Board (IASB)" (SEC, 2010). Thus, the adoption of IAS/IFRS as BAS/BFRS by the ICAB is immaterial after this SEC's notification in June 2008 and all effective IASs/IFRSs are applicable from the date of effect prescribed by the IASB.

Although half-yearly reporting was made mandatory under rule 13 of the SER 1987 since its effectiveness on September 28, 1987, but it was not as per IAS. It was made as per IAS by amending rule 13 on October 22, 1997 (the very date of IAS implementation in Bangladesh). However, when the SEC's Notification No. SEC/CMRRCD/2008-183/Admin/03-34, dated 27.09.2009, was issued for implementation of quarterly reporting with effect from the quarter ending September 2009, then IAS 34 Interim Financial Reporting (issued in February 1998 and a limited amendment was made in 2000) has been effectively implemented (SEC, 2010).

POTENTIAL BENEFITS OF THE NEW CONCEPTUAL FRAMEWORK

Based on the above discussions, it can be said that the new Conceptual Framework has a number of transformational aspects including broadened objectives, narrowly defined user group, inclusion of "unrealized gains" in the definition of income, discontinued use of the term stewardship, realigning the qualitative characteristics through removing the attributes of *substance over form, prudence* [10] and true and fair view/fair presentation. These aspects are already being

[10] However, the use of prudence in a specific standard is still available. See para 9 of IAS 2 Inventories, under which inventories shall be measured at the lower of cost and net realisable value (IASB, 2010a: A328).

considered in the development of new accounting standards or revising the existing ones. [11] As a product of the joint initiative of the most influential two accounting regulatory Boards (the IASB and the FASB), this would be a universal global foundation for accounting concepts and principles.

The use of the concept of "comprehensive income" following the 'asset and liability view" of income in place of "profit or loss" and hence, the inclusion of 'other comprehensive income' in the definition of 'income' is a major shifting in the new CF. This expanded concept of income is in line with the presentation of the financial reports (financial statements and other relevant reports) at fair value, which is a desperate attempt to remove the limitations of financial statements prepared and presented under the historical cost regime. Fair value disclosure is more useful, comparable and relevant, but very challenging for developing countries, where fair value is not normally available.

The 'asset and liability view" of the elements of financial statements has another objective of translating off-balance sheet items into visible figures in the statement of financial position. The initiative of reporting all leases in the statement of financial position by replacing IAS 17 Leases with a new one will remove the inconsistencies between the definition of liability and the treatment of lessees not recognizing the future operating lease rentals as liabilities under existing IAS 17 as an off-balance sheet item.[12]

In the new CF, the term faithful representation has been used instead of the term reliability. Researches also show that reliability is less preferable to relevance.[13]

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[11] For instance, on May 12, 2011, new IFRSs (IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities and IFRS 13 Fair Value Measurement) have been issued and existing IASs have been revised (IAS 27 Consolidated and Separate Financial Statements and IAS 28 Investments in Associates revised as IAS 27 Separate Financial Statements and IAS 28 Investments in Associates and Joint Ventures respectively) with effect from January 1, 2013 with the option of early adoption (www.iasplus.com).

[12] An earlier G4+1 Study in 1999/2000 entitled 'G4+1 Special Report: Leases: Implementation of a New Approach' had recommended capitalizing property rights inherent in all leases (PwC, 2010: 3). In July 2006, the joint IASB-FASB leasing project was added to the IASB's agenda seeking to improve the accounting for leases by developing an approach that is more consistent with the CF definitions of assets and liabilities and the project would result in a replacement of IAS 17 Leases. On 19? March? 2009, Discussion Paper DP/2009/1 Leases: Preliminary Views was published with the comment deadline of 17 July 2009. On 17 August?2010, Exposure Draft ED/2010/9 Leases was published with the comment deadline of 15 December 2010. On 21?July?2011, the IASB and the FASB announced the intention to re-expose proposals and the ED is expected in first half of 2012 (www.iasplus.com; accessed 31.03.2012).

[13] Exploring the relative desirability of two dimensions (relevance and reliability) of earnings quality in light of decision usefulness of earnings information, Barua (2005) has found that investors, in general, prefer relevance to reliability dimension of earnings.

But the change is for replacing the 'true and fair view' because of the fact that one presents one's kind of truth what that person believes to be true or wants to represent.[14] This might be an acknowledgement of a truth that a discipline with assumptions and judgments cannot present the true picture and it is actually a faithful representation.

However, the significant benefit the changes in the new conceptual framework will provide is the betterment of financial reporting. This fact is clear through the change made to the objective in the new conceptual framework. The objective of the conceptual framework (2010) has specified the needs and uses of financial reporting. In the previous framework (1989), the objective was not so clearly specified. This change has focused on the objective of financial reporting that should always be kept in mind when preparing general purpose financial reports. The new scope of conceptual framework is broader than the previous one. The scope is now refined to general purpose financial reporting, not financial statements so that, it is now possible to give better and wider information. The new conceptual framework (2010) has a clear focus on the users of accounting information. It has differentiated the primary and secondary users and also mentioned that the primary users are the intended users to whom general purpose financial reports are primarily directed. This will help the preparers and standard-setters to focus on the needs of the users. The new conceptual framework (2010) has also identified the use as making decisions about providing economic resources to the entity. This change suggests that the financial reporting will help the users to make resource allocation decisions. Previously, the use was confined only to reflect the managements' stewardship function, but now with this change, the new conceptual framework (2010) will clarify that the uses also involve the users' decision-making functions. The new conceptual framework (2010) will provide information about the reporting entity. So, the new conceptual framework (2010) has suggested that all the information that should be reported in respect of a reporting entity should be

[14] Economic historians have acknowledged that truth has multidimensional appearances. See Tapan Raychaudhuri's book, Bangalnama (Ananda Publishers, Kolkata, 2007) and Akbar Ali Khan's book Pararthoparatar Arthaniti (University Press Limited, Dhaka, First Published in August 2000, reprinted in March 2008). In the words of Khan, "The creator cannot modify what has happened; historians can – not only then can do, they do so frequently. Of course, here the historians have been defeated to the creator – the creator knows the whole truth, He does not require changing His history. Historians never know the whole of the truth; the partial appearances of the truth come to them as the blind sees an elephant. Thus, the historians' explanations in relation to an event change frequently. From these partial explanations, we see the multidimensional appearances of the truth" (p. 1; translation by the author from Bengali).

stated in the financial reports. The Exposure Draft on reporting entity (which is expected to be issued as the final version without any further major changes) has clearly defined it and also mentioned its three features. This will help the preparers and users to identify a reporting entity for which financial reporting should be done in accordance with IFRSs.

The new conceptual framework (2010) has given the qualitative characteristics of useful financial information which are applicable to financial information provided in both financial statements as well as in other parts of financial reports. The fundamental qualitative characteristics (relevance and faithful representation) will make the financial reports more valuable and useful. The term "reliability" has now been replaced. This change might help in overcoming the previous problem on ensuring trade-off between "relevance" and "reliability". The new changes will result in more objective financial statements, given the limitations of assumptions and judgments. This will help the preparers to direct what to report without giving any scope of exercising discretion. It will also help the users to understand the level of quality of the financial information.

CONCLUSION

As stated above, many of the issues in the new Conceptual Framework are to some extent revolutionary in nature and hence its role in resolving financial reporting controversies may be counter-active in creating confusions and ambiguities. The significant shift with respect to the objective from 'financial statement' to 'financial reporting' may be broad-based, but the broadness might lose the refined application in addressing a special issue. The downsizing the target users to existing and potential investors, lenders and other creditors from the wide range of users is also narrowing the responsibility of a world organization. The use of information by not using the term stewardship is also a depiction of reduced target to capital markets only. The information about financial performance through comprehensive income including unrealized gains might be the most confusing part of the CF and hence the historical characteristic of prudence (or conservatism) has been discontinued. In a developing country, where valuation is still in controversy due to lack of professional appraisers, accounting fraud may be invited by allowing this unrealized gain in showing financial performance. The reporting entity issue is incorporated in the finalized parts of CF, without resolving

the issue and keeping the second chapter as 'yet to be added' and this is an indication of slow and weak progress of the CF project.

Significant changes have been brought in qualitative characteristics of accounting information by dividing into two groups – fundamental and enhancing – in place of previous principal characteristics, redefining the faithful presentation and not using the term reliability. Besides substance over form, prudence (conservatism) and verifiability, which were aspects of reliability in the previous Framework, are not considered aspects of faithful representation in the new CF, although verifiability is an enhancing qualitative characteristic under the new CF. As a result, there is a general hunch of introducing 'unreliability' and 'imprudence' in financial reporting. The long historical use of "true and fair view/fair presentation" of financial statements has also been discontinued in the new CF, although these are often a statutory requirement for financial reporting and the public accountants have to authenticate this aspect.

Bjerke has identified a problem with the CF is that it displays economic-study results in a financial statement, since the result of an economic study is an economic statement. Although economic statements may be displayed in an accounting format as pro-forma statements, they still remain economic statements (Bjerke, 2007). Considering Boyle's argument (vide Boyle, 2010) that the CF is needed to demonstrate the technical credentials of the IASB (or FASB), Macve (2010) expects that a CF should be the current type of CF to ensure as much consistency as possible across time (not least as Board members change) (Macve, 2010).

As mentioned by Pounder (2010), because the US CF is not itself authoritative, the recent revisions to it do not change authoritative US GAAP (generally accepted accounting principles) but the revisions do change authoritative IFRSs because of the authoritative status of the CF. Finding the consensus of the FASB and the IASB on some portions of a common CF, Pounder sees that "the Boards are indeed capable of converging their standards at the conceptual level and are intent on achieving even more conceptual convergence in the years ahead" (Pounder, 2010). But the current progress is so slow, no optimistic view on the successful completion of the remaining phases in reasonable duration can be assumed.

In a speech in Korea on 04 April 2012, IASB President Hans Hoogervorst has mentioned the following about the recent Conceptual Framework:

[T] here is almost universal support for completing revisions to our conceptual framework. This framework serves as a point of reference for the IASB's decision-making. Where choices are not clear-cut, the framework serves to encourage the IASB to make decisions that are consistent across the standards. The framework is also an important reference for companies when applying principle-based standards. We already have a framework that works reasonably well. However, areas such as Measurement are still less than perfect, to put it mildly. It is easy to understand why this is the case. After all, measurement is the most judgmental, difficult and politicized part of accounting. We need to bring more rigor and clarity here, but it will be an extremely arduous task which will require a lot of brainpower and courage (www.ifrs.org).

We expect that the extremely arduous task should finally be completed under the courageous leadership of the current IASB president with successful completion of all the phases of the CF project as quickly as possible.

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