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IFRS in Focus
IASB completes first phase of joint project on Conceptual Framework for Financial Reporting

Contents

The Bottom Line

- The IASB and FASB completed the first phase of their joint project to develop an improved and converged conceptual framework with the issue of Chapter 1: *The objective of general purpose financial reporting* and Chapter 3: *Qualitative characteristics of useful financial information.*
- The objective of 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 fundamental qualitative characteristics of useful financial information are "relevance" and "faithful representation". These fundamental characteristics are further enhanced if information is "comparable, verifiable, timely, and understandable".
- A decision about whether to include information in financial reports should take into account materiality and cost-benefit constraints.

The proposal

On 28 September 2010, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) completed the first phase of their joint project to develop an improved and converged conceptual framework for International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (US GAAP) with their issue of Chapter 1: *The objective of general purpose financial reporting* and Chapter 3: *Qualitative characteristics of useful financial information.* The objective of the conceptual framework project is to create a sound foundation for future accounting standards that are principles-based, internally consistent and internationally converged.

The Conceptual Framework project is being carried out in phases. As a chapter is finalised, the relevant paragraphs in the *Framework for the Preparation and Presentation of Financial Statements* will be replaced.

The objective of general purpose financial reporting

The Conceptual Framework establishes the objective of financial reporting and not just of financial statements, and states that the overriding objective of 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 users' expectations about returns (e.g., cash available for dividends, ability to make principal and interest payments, projected increase in market value) depend on their assessment of the amount, timing and uncertainty of future net cash inflows to the entity.

For more information please see the following websites:

www.iasplus.com

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To make these assessments, users need information about the economic resources and claims against the entity (i.e., financial position); changes in these resources and claims from operations and changes from other events or transactions (e.g., issuing additional shares); and the impact of operating, investing, and financing activities on an entity's cash flows.

The concepts in Chapter 1 state that general purpose financial reports are based on management's best estimates, judgements, and models (as established in the joint conceptual framework project), rather than exact depictions and are "not designed to show the value of a reporting entity; but they provide information … to estimate the value of the reporting entity."

Qualitative characteristics of useful financial information

Chapter 3 states that if the financial information "is to be useful, it must be relevant and faithfully [represent] what it purports to represent." These two fundamental qualitative characteristics – "relevance" and "faithful representation" – constitute the essence of useful financial information.

Financial information is relevant when it is "capable of making a difference in the decisions made by users." Information is capable of making a difference in a decision making process when it is used as an input to predict future outcomes, provides feedback to confirm or change previous inputs used to predict future outcomes, or both. Relevant financial information must also be faithfully represented to be useful. A faithful representation is one that is "complete, neutral, and free from error," to the extent possible.

Furthermore, Chapter 3 notes that the usefulness of these fundamental characteristics is enhanced if the information is "comparable, verifiable, timely, and understandable" and that such enhancements also should be "maximised to the extent possible." However, these qualitative characteristics cannot make information useful if the information is irrelevant or not faithfully represented.

A decision about whether to include information in financial reports should take into account materiality (i.e., an omission or misstatement of financial information could influence a user's decision making) and cost-benefit constraints. The cost to report certain financial information should be justified by the benefits of providing that information.

Next steps

Three additional phases of this project are currently active: the reporting entity, measurement, and elements and recognition phases. The reporting entity phase aims to define what constitutes a reporting entity. An ED on the reporting entity concept was published in March 2010 with the final chapter expected towards the end of 2010. The Boards have not indicated when they expect to issue an ED for either the measurement phase or the elements and recognition phase or when it will begin discussions on the remaining phases.

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Back to contents

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