Amendments to Conceptual Framework for Financial Reporting

The Conceptual Framework for Financial Reporting (Conceptual Framework) describes the objective of and concepts for general purpose financial reporting. It is a practical tool that helps the Council of the Institute of Chartered Accountants of Sri Lanka (Council) to develop requirements in Sri Lanka Accounting Standards (SLFRSs) based on consistent concepts. Consideration of these concepts, in turn, should result in the Council developing SLFRSs that require entities to provide financial information that is useful to investors, lenders and other creditors.

The Council approved revised Conceptual Framework for Financial Reporting. Included are revised definitions of an asset and a liability, as well as new guidance on measurement and derecognition, presentation and disclosure.

The revised Conceptual Framework includes:

- a new chapter on measurement;
- guidance on reporting financial performance;
- improved definitions of an asset and a liability, and guidance supporting these definitions; and
- clarifications in important areas, such as the roles of stewardship, prudence and measurement uncertainty in financial reporting.

The Council also approved references to the Conceptual Framework in SLFRSs by issuing Amendments to References to the Conceptual Framework in SLFRSs. This was done to support transition to the revised Conceptual Framework for companies that develop accounting policies using the Conceptual Framework when no SLFRSs applies to a particular transaction.

The amendments, where they actually are updates, are effective for annual periods beginning on or after 1st January 2020.

The 2018 Conceptual Framework is structured into an introductory explanation on the status and purpose of the Conceptual Framework, eight chapters, and a glossary:

Chapter	Topic
	Status and purpose of the Conceptual Framework
1	The objective of general purpose financial reporting
2	Qualitative characteristics of useful financial information
3	Financial statements and the reporting entity
4	The elements of financial statements
5	Recognition and Derecognition
6	Measurement
7	Presentation and disclosure
8	Concepts of capital and capital maintenance
Appendix A	Glossary

Summary of Main Aspects of the Conceptual Framework

New

Measurement	•Concepts on measurement, including factors to be considered when selecting a measurement basis
Presentation and Disclosure	•Concepts on presentation and disclosure, including when to classify income and expenses in other comprehensive income
Derecognition	•Guidance on when assets and liabilities are removed from financial statements

Updated

Definitions	•Definitions of an asset and a liability
Recognition	•Criteria for including assets and liabilities in financial statements

Clarified

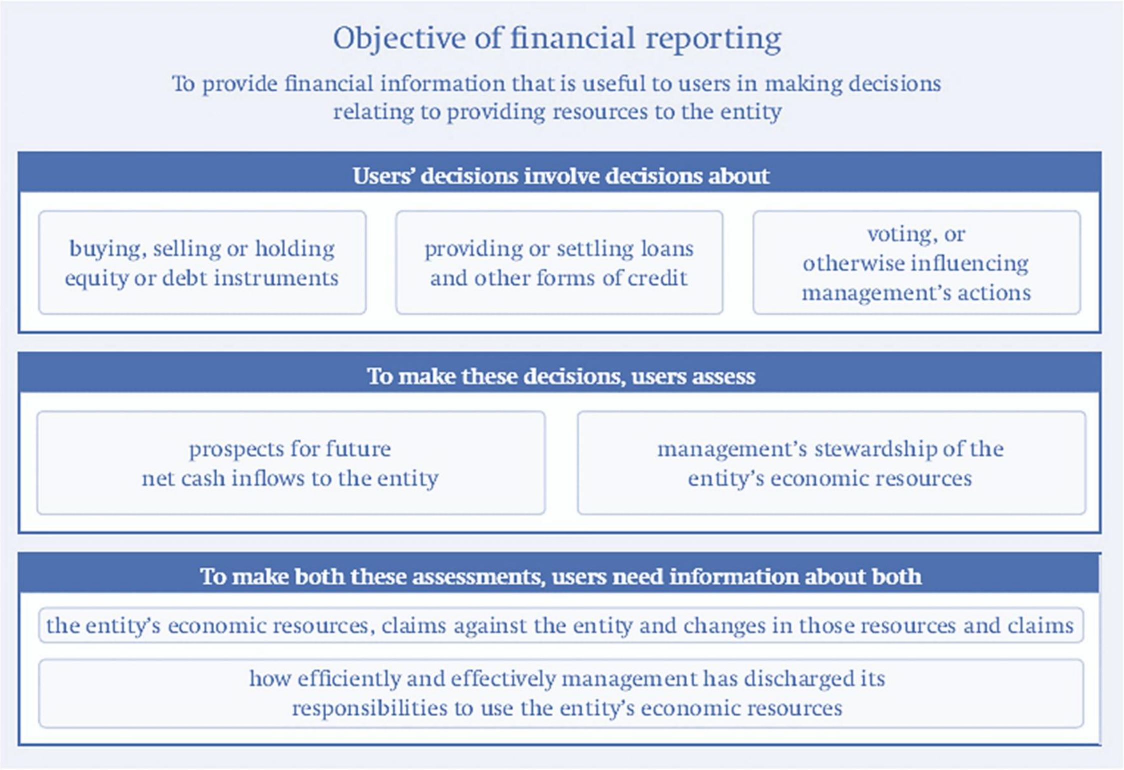
- Prudence
- Stewardship
- Measurement Uncertainty
- Substance over Form

The key content of each chapter is summarised below:

Status and purpose of the Conceptual Framework

The first section notes that the Conceptual Framework's purpose is to assist the Council in developing and revising SLFRSs that are based on consistent concepts, to help preparers to develop consistent accounting policies for areas that are not covered by a standard or where there is choice of accounting policy, and to assist all parties to understand and interpret SLFRS. It maintains that the framework does not override any specific SLFRS.

Chapter 1 - The objective of general purpose financial reporting



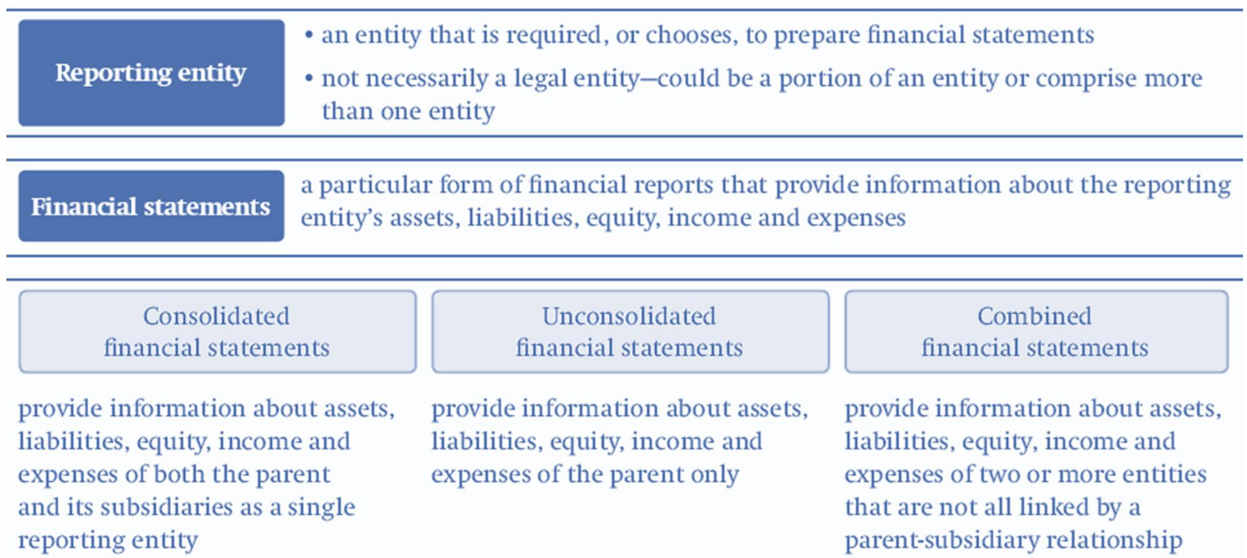
The chapter notes that objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity. This is identified as information about the entity's economic resources and the claims against the reporting entity as well as information about the effects of transactions and other events that change a reporting entity's economic resources and claims. The chapter newly stresses that information can also help users to assess management's stewardship of the entity's economic resources.

Chapter 2 - Qualitative characteristics of useful financial information

The chapter explains the fundamental qualitative characteristics (relevance and faithful representation) and the enhancing qualitative characteristics (comparability, verifiability, timeliness, and understandability) of useful financial information and notes the cost constraint. Materiality is noted as an entity-specific aspect of relevance. The chapter reintroduces an explicit reference to the notion of prudence and states that the exercise of prudence supports neutrality. Prudence is defined as the exercise of caution when making judgements under conditions of uncertainty. New is also a clarification that faithful representation means representation of the substance of an economic phenomenon instead of representation of its legal form only.

Chapter 3 - Financial Statements and the reporting entity

The chapter states the objective of financial statements (to provide information about an entity's assets, liabilities, equity, income and expenses that is useful to financial statements users in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources) and sets out the going concern assumption. It only mentions two statements explicitly: the statement of financial position and the statement(s) of financial performance (the latter being the former statement of comprehensive income); the rest are "other statements and notes".



The chapter notes that financial statements are prepared for a specified period of time and provide comparative information and under certain circumstances forward-looking information. New to the framework is the definition of a reporting entity and the boundary of it. The chapter also states the Council's conviction that, generally, consolidated financial statements are more likely to provide useful information to users of financial statements than unconsolidated financial statements.

Chapter 4 - The elements of financial statements

The main focus of this chapter is on the definitions of assets, liabilities, and equity as well as income and expenses. The definitions are quoted below:

	Existing definition	Revised Definition
An Asset	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.**	A **present economic resource** controlled by the entity as a result of past events
A Liability	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.**	A present obligation of the entity to **transfer an economic resource** as a result of past events **An obligation is a duty or responsibility that the entity has no practical ability to avoid**
An Economic Resource	Not defined.	An economic resource is a right that has the potential to produce economic benefits
Equity	Residual interest in the assets of the entity after deducting all its liabilities.	No Change
Income	Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decrease of liabilities that result in increase in equity, other than those relating to contributions from equity participants.	Increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims
Expenses	Decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decrease in equity, other than those relating to distributions to equity participants.	Decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims

New is the introduction of a separate definition of an economic resource to move the references to future flows of economic benefits out of the definitions of an asset and a liability. The expression "economic resource" instead of simply "resource" stresses that the Council no longer thinks of assets as physical objects but as sets of rights. The definitions of assets and liabilities also no longer refer to "expected" inflows or outflows. Instead, the definition of an economic resource refers to the potential of an asset/liability to produce/to require a transfer of economic benefits.

Chapter 5 - Recognition and Derecognition

Recognition

The process of capturing for inclusion in the statement of financial position or the statement(s) of financial performance an item that meets the definition of an asset, a liability, equity, income or expenses

Recognition is appropriate if it results in both relevant information about assets, liabilities, equity, income and expenses and a faithful representation of those items, because the aim is to provide information that is useful to investors, lenders and other creditors

Recognition criteria

Relevance	Faithful representation
• whether recognition of an item results in relevant information may be affected by, for example:	• whether recognition of an item results in a faithful representation may be affected by, for example:
low probability of a flow of economic benefits	measurement uncertainty
existence uncertainty	recognition inconsistency (accounting mismatch)
	presentation and disclosure

Derecognition

The removal of all or part of a recognised asset or liability from an entity's statement of financial position

Derecognition normally occurs

For an asset	For a liability
when the entity loses control of all or part of the recognised asset	when the entity no longer has a present obligation for all or part of the recognised liability

Derecognition aims to faithfully represent both

- any assets and liabilities retained after the transaction that led to the derecognition
- the change in the entity's assets and liabilities as a result of that transaction

The Conceptual Framework states that only items that meet the definition of an asset, a liability or equity are recognised in the statement of financial position and only items that meet the definition of income or expenses are to be recognised in the statement(s) of financial performance. However, their recognition depends on two criteria: their recognition provides users of financial statements with (1) relevant information about the asset or the liability and about any income, expenses or changes in equity and (2) a faithful representation of the asset or the liability and of any income, expenses or changes in equity. The framework also notes a cost constraint.

New to the framework is the discussion of derecognition. The requirements as presented in the framework are driven by two aims: the assets and liabilities retained after the transaction or other event that led to derecognition must be presented faithfully and the change in the entity's assets and liabilities as a result of that transaction or other event must also be presented faithfully. The framework also describes alternatives when it is not possible to achieve both aims.

Chapter 6 – Measurement

Historical cost measurement bases

- historical cost provides information derived, at least in part, from the price of the transaction or other event that gave rise to the item being measured
- historical cost of assets is reduced if they become impaired and historical cost of liabilities is increased if they become onerous
- one way to apply a historical cost measurement basis to financial assets and financial liabilities is to measure them at amortised cost

Current value measurement bases

- current value provides information updated to reflect conditions at the measurement date
- current value measurement bases include:

fair value	• the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date • reflects market participants' current expectations about the amount, timing and uncertainty of future cash flows
value in use (for assets) fulfilment value (for liabilities)	• reflects entity-specific current expectations about the amount, timing and uncertainty of future cash flows
current cost	• reflects the current amount that would be: ▪ paid to acquire an equivalent asset ▪ received to take on an equivalent liability

This chapter is dedicated to the description of different measurement bases (historical cost and current value (fair value, value in use/fulfilment value, and current cost)), the information that they provide and their advantages and disadvantages. Current cost is newly introduced into the Conceptual Framework as it is widely advocated in academic literature. A table offers an overview of the information provided by various measurement bases.

The framework also sets out factors to consider when selecting a measurement basis (relevance, faithful representation, enhancing qualitative characteristics and the cost constraint, factors specific to initial measurement, as well as more than one measurement basis) and points out that consideration of the objective of financial reporting, the qualitative characteristics of useful financial information and the cost constraint are likely to result in the selection of different measurement bases for different assets, liabilities and items of income and expense.

The framework does 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. On equity, the framework offers some limited discussion, although total equity is not measured directly. Still, the framework maintains, it may be appropriate to measure directly individual classes of equity or components of equity to provide useful information.

Chapter 7 - Presentation and disclosure

The statement of profit or loss

- The statement of profit or loss is the primary source of information about an entity's financial performance for the reporting period
- Profit or loss could be a section of a single statement of financial performance or a separate statement
- The statement(s) of financial performance include(s) a total (subtotal) for profit or loss
- In principle, all income and expenses are classified and included in the statement of profit or loss

Other comprehensive income

- In exceptional circumstances, the Board may decide to exclude from the statement of profit or loss income or expenses arising from a change in current value of an asset or liability and include those income and expenses in other comprehensive income
- The Board may make such a decision when doing so would result in the statement of profit or loss providing more relevant information or a more faithful representation

Recycling

- In principle, income and expenses included in other comprehensive income in one period are recycled to the statement of profit or loss in a future period when doing so results in the statement of profit or loss providing more relevant information or a more faithful representation
- When recycling does not result in the statement of profit or loss providing more relevant information or a more faithful representation, the Board may decide income and expenses included in other comprehensive income are not to be subsequently recycled

In this chapter, the framework discusses concepts that determine what information is included in the financial statements and how that information should be presented and disclosed. The statement of statement of comprehensive income is newly described as "statement of financial performance", however, the framework does not specify whether this statement should consist of a single statement or two statements, it only requires that a total or subtotal for profit or loss must be provided. It also notes that the statement of profit or loss is the primary source of information about an entity's financial performance for the reporting period and that only in "exceptional circumstances" the Board may decide that income or expenses are to be included in other comprehensive income. Notably, the framework does not define profit or loss, thus the question of what goes into profit or loss or into other comprehensive income is still unanswered.

Chapter 8 - Concepts of capital and capital maintenance

The content in this chapter was taken over from the existing Conceptual Framework and discusses concepts of capital (financial and physical), concepts of capital maintenance (again financial and physical) and the determination of profit as well as capital maintenance adjustments. The Council might consider revising the description and discussion of capital maintenance in the future if it considers such a revision necessary.