Compiled **FRAMEWORK**

Framework for the Preparation and Presentation of Financial Statements

This compiled Framework applies to annual reporting periods beginning on or after 1 July 2014. Early application is permitted. It incorporates relevant amendments made up to and including 4 June 2014.

Prepared on 15 March 2016 by the staff of the Australian Accounting Standards Board.

Australian Government

Australian Accounting Standards Board

Obtaining Copies of the Framework

Compiled versions of the Framework, the original Framework and amending pronouncements (see Compilation Details) are available on the AASB website: www.aasb.gov.au.

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COMPILATION DETAILS

Framework for the Preparation and Presentation of Financial Statements as amended

This compiled Framework applies to annual reporting periods beginning on or after 1 July 2014. It takes into account amendments up to and including 4 June 2014 and was prepared on 15 March 2016 by the staff of the Australian Accounting Standards Board (AASB).

This compilation is not a separate Framework issued by the AASB. Instead, it is a representation of the Framework (July 2004) as amended by other pronouncements, which are listed in the Table below.

Table of Pronouncements

Pronouncement	**Date made**	**Application date** ***(annual reporting periods … on or after …)***	**Application, saving or transitional provisions**
Framework	15 Jul 2004	*(beginning)* 1 Jan 2005	
AASB 2007-8	24 Sep 2007	*(beginning)* 1 Jan 2009	see (a) below
AASB 2007-10	13 Dec 2007	*(beginning)* 1 Jan 2009	see (a) below
AASB CF 2013-1	20 Dec 2013	*(ending)* 20 Dec 2013	see (b) below
AASB 2014-1	4 Jun 2014	Pt A *(beginning)* 1 Jul 2014	see (c) below

(a) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2009, provided that AASB 101 *Presentation of Financial Statements* (September 2007) is also applied to such periods.

(b) Entities may elect to apply this pronouncement to periods beginning on or after 1 January 2005 that end before 20 December 2013.

(c) Entities may elect to apply Part A of this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 July 2014.

Table of Amendments

Paragraph affected	**How affected**	**By … [paragraph]**
Aus1.1	amended amended	AASB 2007-8 [7] AASB CF 2013-1 [5]
Aus1.4	amended	AASB CF 2013-1 [6]
Aus1.5	amended	AASB CF 2013-1 [7]
Aus1.6	deleted	AASB 2007-10 [10]

Paragraph affected	How affected	By … [paragraph]
6-7	amended deleted	AASB 2007-10 [11] AASB CF 2013-1 [8]
8-20	deleted	AASB CF 2013-1 [8]
21	amended deleted	AASB 2007-10 [12] AASB CF 2013-1 [8]
22	deleted	AASB CF 2013-1 [8]
23	amended	AASB 2007-10 [12]
24-46	deleted	AASB CF 2013-1 [9]
72	amended	AASB CF 2013-1 [10]
83	amended	AASB CF 2013-1 [11]
84	amended	AASB CF 2013-1 [12]
86	amended	AASB 2014-1A [31]
88	amended	AASB 2007-10 [13]
Appendix	added	AASB CF 2013-1 [13]

General Terminology Amendments

References to ‘financial report(s)’ that were amended to ‘financial statements’ by AASB 2007-10, paragraph 14, are not shown in the above Table of Amendments.

COMPARISON WITH IASB FRAMEWORK

The AASB *Framework* and the IASB *Framework*

This *Framework for the Preparation and Presentation of Financial Statements* as amended incorporates the *Conceptual Framework for Financial Reporting* as issued by the International Accounting Standards Board (IASB). Paragraphs that have been added to this *Framework* (and do not appear in the text of the IASB *Framework*) are identified with the prefix "Aus", followed by decimal numbering.

FRAMEWORK

The Australian Accounting Standards Board issued the *Framework for the Preparation and Presentation of Financial Statements* on 15 July 2004.

This compiled version of the *Framework* applies to annual reporting periods beginning on or after 1 July 2014. It incorporates relevant amendments contained in other AASB pronouncements up to and including 4 June 2014 (see Compilation Details).

FRAMEWORK FOR THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

Application

Aus1.1 The concepts in this *Framework* are not set out as requirements for the purpose of preparing general purpose financial statements. This is consistent with the:

(a) [deleted]

(b) [deleted]

(c) *Australian Securities and Investments Commission Act 2001*, section 227(1).

Aus1.2 This *Framework* applies to periods beginning on or after 1 January 2005.
[Note: For application dates of paragraphs changed or added by an amending pronouncement, see Compilation Details.]

Aus1.3 This *Framework* shall not be applied to annual reporting periods beginning before 1 January 2005.

Aus1.4 When applicable, this *Framework* supersedes:

(a) Statement of Accounting Concepts SAC 2 *Objective of General Purpose Financial Reporting* as issued in August 1990;

(b) Statement of Accounting Concepts SAC 3 *Qualitative Characteristics of Financial Information* as issued in August 1990; and

(c) Statement of Accounting Concepts SAC 4 *Definition and Recognition of the Elements of Financial Statements* as issued in March 1995.

Aus1.5 SAC 2, SAC 3 and SAC 4 remain applicable until superseded by this *Framework*.

Introduction

Purpose and Status

1 This *Framework* sets out the concepts that underlie the preparation and presentation of financial statements for external users. The purpose of the *Framework* is to:

(a) assist the AASB in the development of future Australian Accounting Standards and in its review of existing Australian Accounting Standards, including evaluating proposed International Accounting Standards Board pronouncements;

(b) assist the AASB in promoting harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by Australian Accounting Standards;

(c) [deleted by the AASB];

(d) assist preparers of financial statements in applying Australian Accounting Standards and in dealing with topics that have yet to form the subject of an Australian Accounting Standard;

(e) assist auditors in forming an opinion as to whether financial statements conform with Australian Accounting Standards;

(f) assist users of financial statements in interpreting the information contained in financial statements prepared in conformity with Australian Accounting Standards; and

(g) provide those who are interested in the work of the AASB with information about its approach to the formulation of Australian Accounting Standards.

2 This *Framework* is not an Australian Accounting Standard and hence does not define standards for any particular measurement or disclosure

issue. Nothing in this *Framework* overrides any specific Australian Accounting Standard.

3 The AASB recognises that in a limited number of cases there may be a conflict between the *Framework* and an Australian Accounting Standard. In those cases where there is a conflict, the requirements of the Australian Accounting Standard prevail over those of the *Framework*. As, however, the AASB will be guided by the *Framework* in the development of future Standards and in its review of existing Standards, the number of cases of conflict between the *Framework* and Australian Accounting Standards will diminish through time.

4 The *Framework* will be revised from time to time on the basis of the Board's experience of working with it.

Scope

5 The *Framework* deals with:

(a) the objective of financial statements;

(b) the qualitative characteristics that determine the usefulness of information in financial statements;

(c) the definition, recognition and measurement of the elements from which financial statements are constructed; and

(d) concepts of capital and capital maintenance.

6-8 [Deleted – replaced by concepts in the Appendix, Chapter 1]

Users and Their Information Needs

9-11 [Deleted – replaced by concepts in the Appendix, Chapter 1]

The Objective of Financial Statements

12-21 [Deleted – replaced by concepts in the Appendix, Chapter 1]

Underlying Assumptions

Accrual Basis

22 [Deleted]

Going Concern

23 The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis and, if so, the basis used is disclosed.

Qualitative Characteristics of Financial Statements

24-46 [Deleted – replaced by concepts in the Appendix, Chapter 3]

The Elements of Financial Statements

47 Financial statements portray the financial effects of transactions and other events by grouping them into broad classes according to their economic characteristics. These broad classes are termed the elements of financial statements. The elements directly related to the measurement of financial position in the balance sheet are assets, liabilities and equity. The elements directly related to the measurement of performance in the income statement are income and expenses. The cash flow statement usually reflects income statement elements and changes in balance sheet elements; accordingly, this *Framework* identifies no elements that are unique to this statement.

48 The presentation of these elements in the balance sheet and the income statement involves a process of sub-classification. For example, assets and liabilities may be classified by their nature or function in the business of the entity in order to display information in the manner most useful to users for purposes of making economic decisions.

Financial Position

49 The elements directly related to the measurement of financial position are assets, liabilities and equity. These are defined as follows:

(a) An asset is 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 is 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 is the residual interest in the assets of the entity after deducting all its liabilities.

Aus49.1 In respect of not-for-profit entities in the public or private sector, in pursuing their objectives, goods and services are provided that have the capacity to satisfy human wants and needs. Assets provide a means for entities to achieve their objectives. Future economic benefits or service potential is the essence of assets. Future economic benefits is synonymous with the notion of service potential, and is used in this *Framework* as a reference also to service potential. Future economic benefits can be described as the scarce capacity to provide benefits to the entities that use them, and is common to all assets irrespective of their physical or other form.

50 The definitions of an asset and a liability identify their essential features but do not attempt to specify the criteria that need to be met before they are recognised in the balance sheet. Thus, the definitions embrace items that are not recognised as assets or liabilities in the balance sheet because they do not satisfy the criteria for recognition discussed in paragraphs 82 to 98. In particular, the expectation that future economic benefits will flow to or from an entity must be sufficiently certain to meet the probability criterion in paragraph 83 before an asset or liability is recognised.

51 In assessing whether an item meets the definition of an asset, liability or equity, attention needs to be given to its underlying substance and economic reality and not merely its legal form. Thus, for example, in the case of finance leases, the substance and economic reality are that the lessee acquires the economic benefits of the use of the leased asset for the major part of its useful life in return for entering into an obligation to pay for that right an amount approximating to the fair value of the asset and the related finance charge. Hence, the finance lease gives rise to items that satisfy the definition of an asset and a liability and are recognised as such in the lessee's balance sheet.

52 Balance sheets drawn up in accordance with current Australian Accounting Standards may include items that do not satisfy the definitions of an asset or liability and are not shown as part of equity. The definitions set out in paragraph 49 will, however, underlie future reviews of existing Australian Accounting Standards and the formulation of further Standards.

Assets

53 The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash

equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.

54 An entity usually employs its assets to produce goods or services capable of satisfying the wants or needs of customers; because these goods or services can satisfy these wants or needs, customers are prepared to pay for them and hence contribute to the cash flow of the entity. Cash itself renders a service to the entity because of its command over other resources.

Aus54.1 In respect of not-for-profit entities, whether in the public or private sector, the future economic benefits are also used to provide goods and services in accordance with the entities' objectives. However, since the entities do not have the generation of profit as a principal objective, the provision of goods and services may not result in net cash inflows to the entities as the recipients of the goods and services may not transfer cash or other benefits to the entities in exchange.

Aus54.2 In respect of not-for-profit entities, the fact that they do not charge, or do not charge fully, their beneficiaries or customers for the goods and services they provide does not deprive those outputs of utility or value; nor does it preclude the entities from benefiting from the assets used to provide the goods and services. For example, assets such as monuments, museums, cathedrals and historical treasures provide needed or desired services to beneficiaries, typically at little or no direct cost to the beneficiaries. These assets benefit the entities by enabling them to meet their objectives of providing needed services to beneficiaries.

55 The future economic benefits embodied in an asset may flow to the entity in a number of ways. For example, an asset may be:

(a) used singly or in combination with other assets in the production of goods or services to be sold by the entity;

(b) exchanged for other assets;

(c) used to settle a liability; or

(d) distributed to the owners of the entity.

56 Many assets, for example, property, plant and equipment, have a physical form. However, physical form is not essential to the existence of an asset; hence patents and copyrights, for example, are assets if future economic benefits are expected to flow from them to the entity and if they are controlled by the entity.

57 Many assets, for example, receivables and property, are associated with legal rights, including the right of ownership. In determining the existence of an asset, the right of ownership is not essential; thus, for example, property held on a lease is an asset if the entity controls the benefits which are expected to flow from the property. Although the capacity of an entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control. For example, know-how obtained from a development activity may meet the definition of an asset when, by keeping that know-how secret, an entity controls the benefits that are expected to flow from it.

58 The assets of an entity result from past transactions or other past events. Entities normally obtain assets by purchasing or producing them, but other transactions or events may generate assets. Examples include property received by an entity from government as part of a program to encourage economic growth in an area, and the discovery of mineral deposits. Transactions or events expected to occur in the future do not, in themselves, give rise to assets. Hence, for example, an intention to purchase inventory does not, of itself, meet the definition of an asset.

59 There is a close association between incurring expenditure and generating assets but the two do not necessarily coincide. Hence, when an entity incurs expenditure, this may provide evidence that future economic benefits were sought but is not conclusive proof that an item satisfying the definition of an asset has been obtained. Similarly the absence of a related expenditure does not preclude an item from satisfying the definition of an asset and thus becoming a candidate for recognition in the balance sheet. For example, items that have been donated to the entity may satisfy the definition of an asset.

Liabilities

60 An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business

relations or act in an equitable manner. If, for example, an entity decides as a matter of policy to rectify faults in its products even when these become apparent after the warranty period has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities.

61 A distinction needs to be drawn between a present obligation and a future commitment. A decision by the management of an entity to acquire assets in the future does not, of itself, give rise to a present obligation. An obligation normally arises only when the asset is delivered or the entity enters into an irrevocable agreement to acquire the asset. In the latter case, the irrevocable nature of the agreement means that the economic consequences of failing to honour the obligation, for example, because of the existence of a substantial penalty, leave the entity with little, if any, discretion to avoid the outflow of resources to another party.

62 The settlement of a present obligation usually involves the entity giving up resources embodying economic benefits in order to satisfy the claim of the other party. Settlement of a present obligation may occur in a number of ways, for example, by:

(a) payment of cash;

(b) transfer of other assets;

(c) provision of services;

(d) replacement of that obligation with another obligation; or

(e) conversion of the obligation to equity.

An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

63 Liabilities result from past transactions or other past events. Thus, for example, the acquisition of goods and the use of services give rise to trade payables (unless paid for in advance or on delivery), and the receipt of a bank loan results in an obligation to repay the loan. An entity may also recognise future rebates based on annual purchases by customers as liabilities; in this case, the sale of the goods in the past is the transaction that gives rise to the liability.

64 Some liabilities can be measured only by using a substantial degree of estimation. Some entities describe these liabilities as provisions. In some countries, such provisions are not regarded as liabilities because the concept of a liability is defined narrowly so as to include only

amounts that can be established without the need to make estimates. The definition of a liability in paragraph 49 follows a broader approach. Thus, when a provision involves a present obligation and satisfies the rest of the definition, it is a liability even if the amount has to be estimated. Examples include provisions for payments to be made under existing warranties and provisions to cover pension obligations.

Equity

65 Although equity is defined in paragraph 49 as a residual, it may be sub-classified in the balance sheet. For example, in a corporate entity, funds contributed by shareholders, retained earnings, reserves representing appropriations of retained earnings and reserves representing capital maintenance adjustments may be shown separately. Such classifications can be relevant to the decision-making needs of the users of financial statements when they indicate legal or other restrictions on the ability of the entity to distribute or otherwise apply its equity. They may also reflect the fact that parties with ownership interests in an entity have differing rights in relation to the receipt of dividends or the repayment of contributed equity.

66 The creation of reserves is sometimes required by statute or other law in order to give the entity and its creditors an added measure of protection from the effects of losses. Other reserves may be established if national tax law grants exemptions from, or reductions in, taxation liabilities when transfers to such reserves are made. The existence and size of these legal, statutory and tax reserves is information that can be relevant to the decision-making needs of users. Transfers to such reserves are appropriations of retained earnings rather than expenses.

67 The amount at which equity is shown in the balance sheet is dependent on the measurement of assets and liabilities. Normally, the aggregate amount of equity only by coincidence corresponds with the aggregate market value of the shares of the entity or the sum that could be raised by disposing of either the net assets on a piecemeal basis or the entity as a whole on a going concern basis.

68 Commercial, industrial and business activities are often undertaken by means of entities such as sole proprietorships, partnerships, trusts and various types of government business undertakings. The legal and regulatory framework for such entities is often different from that applying to corporate entities. For example, there may be few, if any, restrictions on the distribution to owners or other beneficiaries of amounts included in equity. Nevertheless, the definition of equity and the other aspects of this *Framework* that deal with equity are appropriate for such entities.

Performance

69 Profit is frequently used as a measure of performance or as the basis for other measures, such as return on investment or earnings per share. The elements directly related to the measurement of profit are income and expenses. The recognition and measurement of income and expenses, and hence profit, depends in part on the concepts of capital and capital maintenance used by the entity in preparing its financial statements. These concepts are discussed in paragraphs 102 to 110.

70 The elements of income and expenses are defined as follows.

(a) 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.

(b) Expenses are 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.

71 The definitions of income and expenses identify their essential features but do not attempt to specify the criteria that would need to be met before they are recognised in the income statement. Criteria for the recognition of income and expenses are discussed in paragraphs 82 to 98.

72 Income and expenses may be presented in the income statement in different ways so as to provide information that is relevant for economic decision-making. For example, it is common practice to distinguish between those items of income and expenses that arise in the course of the ordinary activities of the entity and those that do not. This distinction is made on the basis that the source of an item is relevant in evaluating the ability of the entity to generate cash and cash equivalents in the future[1]. For example, incidental activities such as the disposal of a long-term investment are unlikely to recur on a regular basis. When distinguishing between items in this way, consideration needs to be given to the nature of the entity and its operations. Items that arise from the ordinary activities of one entity may be unusual in respect of another.

73 Distinguishing between items of income and expense and combining them in different ways also permits several measures of entity performance to be displayed. These have differing degrees of

1 For not-for-profit users, also see paragraph AusOB3.1.

inclusiveness. For example, the income statement could display gross margin, profit or loss before taxation, and profit or loss.

Income

74 The definition of income encompasses both revenue and gains. Revenue arises in the course of the ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent.

75 Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an entity. Gains represent increases in economic benefits and as such are no different in nature from revenue. Hence, they are not regarded as constituting a separate element in this *Framework*.

76 Gains include, for example, those arising on the disposal of non-current assets. The definition of income also includes unrealised gains; for example, those arising on the revaluation of marketable securities and those resulting from increases in the carrying amount of long-term assets. When gains are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. Gains are often reported net of related expenses.

77 Various kinds of assets may be received or enhanced by income. Examples include cash, receivables and goods and services received in exchange for goods and services supplied. Income may also result from the settlement of liabilities. For example, an entity may provide goods and services to a lender in settlement of an obligation to repay an outstanding loan.

Expenses

78 The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity. Expenses that arise in the course of the ordinary activities of the entity include, for example, cost of sales, wages and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, property, plant and equipment.

79 Losses represent other items that meet the definition of expenses and may, or may not, arise in the course of the ordinary activities of the entity. Losses represent decreases in economic benefits and as such they are no different in nature from other expenses. Hence, they are not regarded as a separate element in this *Framework*.

80 Losses include, for example, those resulting from disasters such as fire and flood, as well as those arising on the disposal of non-current assets. The definition of expenses also includes unrealised losses, for example, those arising from the effects of increases in the rate of exchange for a foreign currency in respect of the borrowings of an entity in that currency. When losses are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. Losses are often reported net of related income.

Capital Maintenance Adjustments

81 The revaluation or restatement of assets and liabilities gives rise to increases or decreases in equity. While these increases or decreases meet the definition of income and expenses, they are not included in the income statement under certain concepts of capital maintenance. Instead these items are included in equity as capital maintenance adjustments or revaluation reserves. These concepts of capital maintenance are discussed in paragraphs 102 to 110 of this *Framework*.

Recognition of the Elements of Financial Statements

82 Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition set out in paragraph 83. It involves the depiction of the item in words and by a monetary amount and the inclusion of that amount in the balance sheet or income statement totals. Items that satisfy the recognition criteria should be recognised in the balance sheet or income statement. The failure to recognise such items is not rectified by disclosure of the accounting policies used nor by notes or explanatory material.

83 An item that meets the definition of an element should be recognised 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.[2]

2 Information is reliable when it is complete, neutral and free from error.

84 In assessing whether an item meets these criteria, and therefore qualifies for recognition in the financial statements, regard needs to be given to the materiality considerations discussed in Chapter 3 *Qualitative characteristics of useful financial information*. The interrelationship between the elements means that an item that meets the definition and recognition criteria for a particular element, for example, an asset, automatically requires the recognition of another element, for example, income or a liability.

The Probability of Future Economic Benefit

85 The concept of probability is used in the recognition criteria to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the entity. The concept is in keeping with the uncertainty that characterises the environment in which an entity operates. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence available when the financial statements are prepared. For example, when it is probable that a receivable owed by an entity will be paid, it is then justifiable, in the absence of any evidence to the contrary, to recognise the receivable as an asset. For a large population of receivables, however, some degree of non-payment is normally considered probable; hence an expense representing the expected reduction in economic benefits is recognised.

Reliability of Measurement

86 The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability. In many cases, cost or value must be estimated. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When, however, a reasonable estimate cannot be made the item is not recognised in the balance sheet or income statement. For example, the expected proceeds from a lawsuit may meet the definitions of both an asset and income as well as the probability criterion for recognition. However, if it is not possible for the claim to be measured reliably, it should not be recognised as an asset or as income. The existence of the claim, however, would be disclosed in the notes, explanatory material or supplementary schedules.

87 An item that, at a particular point in time, fails to meet the recognition criteria in paragraph 83, may qualify for recognition at a later date as a result of subsequent circumstances or events.

88 An item that possesses the essential characteristics of an element but fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes, explanatory material or in supplementary schedules. This is appropriate when knowledge of the item is considered to be relevant to the evaluation of the financial position, financial performance and cash flows of an entity by the users of financial statements.

Recognition of Assets

89 An asset is recognised in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably.

90 An asset is not recognised in the balance sheet when expenditure has been incurred for which it is considered improbable that economic benefits will flow to the entity beyond the current accounting period. Instead, such a transaction results in the recognition of an expense in the income statement. This treatment does not imply either that the intention of management in incurring expenditure was other than to generate future economic benefits for the entity or that management was misguided. The only implication is that the degree of certainty that economic benefits will flow to the entity beyond the current accounting period is insufficient to warrant the recognition of an asset.

Recognition of Liabilities

91 A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. In practice, obligations under contracts that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements. However, such obligations may meet the definition of liabilities and, provided the recognition criteria are met in the particular circumstances, may qualify for recognition. In such circumstances, recognition of liabilities entails recognition of related assets or expenses.

Recognition of Income

92 Income is recognised in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means, in effect, that recognition of income occurs simultaneously with the

recognition of increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable).

93 The procedures normally adopted in practice for recognising income, for example, the requirement that revenue should be earned, are applications of the recognition criteria in this *Framework*. Such procedures are generally directed at restricting the recognition as income to those items that can be measured reliably and have a sufficient degree of certainty.

Recognition of Expenses

94 Expenses are recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets (for example, the accrual of employee entitlements or the depreciation of equipment).

95 Expenses are recognised in the income statement on the basis of a direct association between the costs incurred and the earning of specific items of income. This process, commonly referred to as the matching of costs with revenues, involves the simultaneous or combined recognition of revenues and expenses that result directly and jointly from the same transactions or other events. For example, the various components of expense making up the cost of goods sold are recognised at the same time as the income derived from the sale of the goods. However, the application of the matching concept under this *Framework* does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.

96 When economic benefits are expected to arise over several accounting periods and the association with income can only be broadly or indirectly determined, expenses are recognised in the income statement on the basis of systematic and rational allocation procedures. This is often necessary in recognising the expenses associated with the using up of assets such as property, plant, equipment, goodwill, patents and trademarks. In such cases, the expense is referred to as depreciation or amortisation. These allocation procedures are intended to recognise expenses in the accounting periods in which the economic benefits associated with these items are consumed or expire.

97 An expense is recognised immediately in the income statement when an expenditure produces no future economic benefits or when, and to

the extent that, future economic benefits do not qualify, or cease to qualify, for recognition in the balance sheet as an asset.

98 An expense is also recognised in the income statement in those cases when a liability is incurred without the recognition of an asset, as when a liability under a product warranty arises.

Measurement of the Elements of Financial Statements

99 Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the balance sheet and income statement. This involves the selection of the particular basis of measurement.

100 A number of different measurement bases are employed to different degrees and in varying combinations in financial statements, including the following.

(a) *Historical cost* Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

(b) *Current cost* Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

(c) *Realisable (settlement) value* Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.

(d) *Present value* Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

101 The measurement basis most commonly adopted by entities in preparing their financial statements is historical cost. This is usually combined with other measurement bases. For example, inventories are usually carried at the lower of cost and net realisable value, marketable securities may be carried at market value and pension liabilities are carried at their present value. Furthermore, some entities use the current cost basis as a response to the inability of the historical cost accounting model to deal with the effects of changing prices of non-monetary assets.

Concepts of Capital and Capital Maintenance

Concepts of Capital

102 A financial concept of capital is adopted by most entities in preparing their financial statements. Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the entity. Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of the entity based on, for example, units of output per day.

103 The selection of the appropriate concept of capital by an entity should be based on the needs of the users of its financial statements. Thus, a financial concept of capital should be adopted if the users of financial statements are primarily concerned with the maintenance of nominal invested capital or the purchasing power of invested capital. If, however, the main concern of users is with the operating capability of the entity, a physical concept of capital should be used. The concept chosen indicates the goal to be attained in determining profit, even though there may be some measurement difficulties in making the concept operational.

Concepts of Capital Maintenance and the Determination of Profit

104 The concepts of capital in paragraph 102 give rise to the following concepts of capital maintenance.

(a) *Financial capital maintenance* Under this concept, a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.

(b) *Physical capital maintenance* Under this concept, a profit is earned only if the physical productive capacity (or operating capability) of the entity (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

105 The concept of capital maintenance is concerned with how an entity defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured. It is a prerequisite for distinguishing between an entity's return on capital and its return of capital. Only inflows of assets in excess of amounts needed to maintain capital may be regarded as profit and therefore as a return on capital. Hence, profit is the residual amount that remains after expenses (including capital maintenance adjustments, where appropriate) have been deducted from income. If expenses exceed income, the residual amount is a net loss.

106 The physical capital maintenance concept requires the adoption of the current cost basis of measurement. The financial capital maintenance concept, however, does not require the use of a particular basis of measurement. Selection of the basis under this concept is dependent on the type of financial capital that the entity is seeking to maintain.

107 The principal difference between the two concepts of capital maintenance is the treatment of the effects of changes in the prices of assets and liabilities of the entity. In general terms, an entity has maintained its capital if it has as much capital at the end of the period as it had at the beginning of the period. Any amount over and above that required to maintain the capital at the beginning of the period is profit.

108 Under the concept of financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period. Thus, increases in the prices of assets held over the period, conventionally referred to as holding gains, are, conceptually, profits. They may not be recognised as such, however, until the assets are disposed of in an exchange transaction. When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit. The rest of the increase is treated as a capital maintenance adjustment and, hence, as part of equity.

109 Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the entity are viewed as changes in the measurement of the physical productive capacity of the entity. Hence, they are treated as capital maintenance adjustments that are part of equity and not as profit.

110 The selection of the measurement bases and concept of capital maintenance will determine the accounting model used in the preparation of the financial statements. Different accounting models exhibit different degrees of relevance and reliability and, as in other areas, management must seek a balance between relevance and reliability. This *Framework* is applicable to a range of accounting models and provides guidance on preparing and presenting the financial statements constructed under the chosen model. At the present time, it is not the intention of the AASB to prescribe a particular model other than in exceptional circumstances, such as for those entities reporting in the currency of a hyperinflationary economy. This intention will, however, be reviewed in the light of world developments.

APPENDIX

OBJECTIVE AND QUALITATIVE CHARACTERISTICS

This appendix is an integral part of the Framework for the Preparation and Presentation of Financial Statements *(*Framework*) and has the same status as other parts of the* Framework. *The appendix comprises two chapters – Chapter 1: The objective of general purpose financial reporting and Chapter 3: Qualitative characteristics of useful financial information.*

CHAPTER 1: THE OBJECTIVE OF GENERAL PURPOSE FINANCIAL REPORTING

CONTENTS

CHAPTER 1: THE OBJECTIVE OF GENERAL PURPOSE FINANCIAL REPORTING

Introduction

OB1 The objective of general purpose financial reporting forms the foundation of the *Framework*. Other aspects of the *Framework*—a reporting entity concept, the qualitative characteristics of, and the constraint on, useful financial information, elements of financial statements, recognition, measurement, presentation and disclosure—flow logically from the objective.

Objective, usefulness and limitations of general purpose financial reporting

OB2 The objective of general purpose financial reporting[1] 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.

AusOB2.1 Among the users of financial information about a not-for-profit reporting entity are existing and potential resource providers (such as investors, lenders and other creditors, donors and taxpayers), recipients of goods and services (such as beneficiaries, for example, members of the community) and parties performing a review or oversight function on behalf of other users (such as advisers and members of parliament). Such users may make resource allocation decisions in relation to not-for-profit entities that differ from those identified in paragraph OB2. For example, parliaments decide, on behalf of constituents, whether to fund particular programmes for delivery by an entity, taxpayers decide who should represent them in government, donors decide whether to donate resources to an entity, and recipients decide whether they can continue to rely on the provision of goods and services from the entity or whether to seek alternative suppliers. In relation to not-for-profit entities, where pertinent, all references in this *Framework* to 'existing

1 Throughout this *Framework*, the terms *financial reports* and *financial reporting* refer to *general purpose financial reports* and *general purpose financial reporting* unless specifically indicated otherwise.

and potential investors, lenders and other creditors' (and related terms) should be read as a reference to this broader range of users.

OB3 Decisions by existing and potential investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases. Similarly, decisions by existing and potential lenders and other creditors about providing or settling loans and other forms of credit depend on the principal and interest payments or other returns that they expect. Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity. Consequently, existing and potential investors, lenders and other creditors need information to help them assess the prospects for future net cash inflows to an entity.

AusOB3.1 In respect of not-for-profit entities, users (such as certain existing and potential resource providers) are generally not concerned with obtaining a financial return on an investment in the entity. Rather, they are concerned with the ability of the entity to achieve its objectives (whether financial or non-financial), which in turn may depend, at least in part, on the entity's prospects for future net cash inflows. Users will, for example, be interested in the capability of the entity's resources to provide goods and services in the future. Accordingly, in relation to not-for-profit entities, where pertinent, references in this *Framework* to 'assessing prospects for future net cash inflows' (and related terms) should be read in the context of the common information needs of users of general purpose financial reports of not-for-profit entities described in this paragraph.

OB4 To assess an entity's prospects for future net cash inflows, existing and potential investors, lenders and other creditors need information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity's management and governing board[2] have discharged their responsibilities to use the entity's resources. Examples of such responsibilities include protecting the entity's resources from unfavourable effects of economic factors such as price and technological changes and ensuring that the entity complies with applicable laws, regulations and contractual provisions.

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2 Throughout this *Framework*, the term *management* refers to *management and the governing board of an entity* unless specifically indicated otherwise.

Information about management’s discharge of its responsibilities is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management’s actions.

OB5 Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial reports are directed.

OB6 However, general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks.

OB7 General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity.

OB8 Individual primary users have different, and possibly conflicting, information needs and desires. The Board, in developing financial reporting standards, will seek to provide the information set that will meet the needs of the maximum number of primary users. However, focusing on common information needs does not prevent the reporting entity from including additional information that is most useful to a particular subset of primary users.

OB9 The management of a reporting entity is also interested in financial information about the entity. However, management need not rely on general purpose financial reports because it is able to obtain the financial information it needs internally.

OB10 Other parties, such as regulators and members of the public other than investors, lenders and other creditors, may also find general purpose financial reports useful. However, those reports are not primarily directed to these other groups.[3]

OB11 To a large extent, financial reports are based on estimates, judgements and models rather than exact depictions. The

3 For not-for-profit entities, see paragraph AusOB2.1.

Framework establishes the concepts that underlie those estimates, judgements and models. The concepts are the goal towards which the Board and preparers of financial reports strive. As with most goals, the *Framework*'s vision of ideal financial reporting is unlikely to be achieved in full, at least not in the short term, because it takes time to understand, accept and implement new ways of analysing transactions and other events. Nevertheless, establishing a goal towards which to strive is essential if financial reporting is to evolve so as to improve its usefulness.

Information about a reporting entity's economic resources, claims against the entity and changes in resources and claims

OB12 General purpose financial reports provide information about the financial position of a reporting entity, which is information about the entity's economic resources and the claims against the reporting entity. Financial reports also provide information about the effects of transactions and other events that change a reporting entity's economic resources and claims. Both types of information provide useful input for decisions about providing resources to an entity.

Economic resources and claims

OB13 Information about the nature and amounts of a reporting entity's economic resources and claims can help users to identify the reporting entity's financial strengths and weaknesses. That information can help users to assess the reporting entity's liquidity and solvency, its needs for additional financing and how successful it is likely to be in obtaining that financing. Information about priorities and payment requirements of existing claims helps users to predict how future cash flows will be distributed among those with a claim against the reporting entity.

OB14 Different types of economic resources affect a user's assessment of the reporting entity's prospects for future cash flows differently. Some future cash flows result directly from existing economic resources, such as accounts receivable. Other cash flows result from using several resources in combination to produce and market goods or services to customers. Although those cash flows cannot be identified with individual economic resources (or claims), users of financial reports need to know the nature and amount of the resources available for use in a reporting entity's operations.

Changes in economic resources and claims

OB15 Changes in a reporting entity's economic resources and claims result from that entity's financial performance (see paragraphs OB17–OB20) and from other events or transactions such as issuing debt or equity instruments (see paragraph OB21). To properly assess the prospects for future cash flows from the reporting entity, users need to be able to distinguish between both of these changes.

OB16 Information about a reporting entity's financial performance helps users to understand the return that the entity has produced on its economic resources. Information about the return the entity has produced provides an indication of how well management has discharged its responsibilities to make efficient and effective use of the reporting entity's resources. Information about the variability and components of that return is also important, especially in assessing the uncertainty of future cash flows. Information about a reporting entity's past financial performance and how its management discharged its responsibilities is usually helpful in predicting the entity's future returns on its economic resources.

Financial performance reflected by accrual accounting

OB17 Accrual accounting depicts the effects of transactions and other events and circumstances on a reporting entity's economic resources and claims in the periods in which those effects occur, even if the resulting cash receipts and payments occur in a different period. This is important because information about a reporting entity's economic resources and claims and changes in its economic resources and claims during a period provides a better basis for assessing the entity's past and future performance than information solely about cash receipts and payments during that period.

OB18 Information about a reporting entity's financial performance during a period, reflected by changes in its economic resources and claims other than by obtaining additional resources directly from investors and creditors (see paragraph OB21), is useful in assessing the entity's past and future ability to generate net cash inflows. That information indicates the extent to which the reporting entity has increased its available economic resources, and thus its capacity for generating net cash inflows through its operations rather than by obtaining additional resources directly from investors and creditors.

AusOB18.1 In respect of not-for-profit entities, information useful for assessing an entity's past and future ability to generate net cash inflows through its operations is, in turn, useful for assessing whether income from taxpayers, donors and other sources was sufficient, and is likely to remain sufficient, to meet the cost of a given volume and quality of goods and services the entity provides.

OB19 Information about a reporting entity's financial performance during a period may also indicate the extent to which events such as changes in market prices or interest rates have increased or decreased the entity's economic resources and claims, thereby affecting the entity's ability to generate net cash inflows.

Financial performance reflected by past cash flows

OB20 Information about a reporting entity's cash flows during a period also helps users to assess the entity's ability to generate future net cash inflows. It indicates how the reporting entity obtains and spends cash, including information about its borrowing and repayment of debt, cash dividends or other cash distributions to investors, and other factors that may affect the entity's liquidity or solvency. Information about cash flows helps users understand a reporting entity's operations, evaluate its financing and investing activities, assess its liquidity or solvency and interpret other information about financial performance.

Changes in economic resources and claims not resulting from financial performance

OB21 A reporting entity's economic resources and claims may also change for reasons other than financial performance, such as issuing additional ownership shares. Information about this type of change is necessary to give users a complete understanding of why the reporting entity's economic resources and claims changed and the implications of those changes for its future financial performance.

CHAPTER 3: QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION

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CHAPTER 3: QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION

Introduction

QC1 The qualitative characteristics of useful financial information discussed in this chapter identify the types of information that are likely to be most useful to the existing and potential investors, lenders and other creditors for making decisions about the reporting entity on the basis of information in its financial report (financial information).

QC2 Financial reports provide information about the reporting entity's economic resources, claims against the reporting entity and the effects of transactions and other events and conditions that change those resources and claims. (This information is referred to in the *Framework* as information about the economic phenomena.) Some financial reports also include explanatory material about management's expectations and strategies for the reporting entity, and other types of forward-looking information.

QC3 The qualitative characteristics of useful financial information[4] apply to financial information provided in financial statements, as well as to financial information provided in other ways. Cost, which is a pervasive constraint on the reporting entity's ability to provide useful financial information, applies similarly. However, the considerations in applying the qualitative characteristics and the cost constraint may be different for different types of information. For example, applying them to forward-looking information may be different from applying them to information about existing economic resources and claims and to changes in those resources and claims.

Qualitative characteristics of useful financial information

QC4 If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

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4 Throughout this *Framework*, the terms *qualitative characteristics* and *constraint* refer to the qualitative characteristics of, and the constraint on, useful financial information.

Fundamental qualitative characteristics

QC5 The fundamental qualitative characteristics are *relevance* and *faithful representation*.

Relevance

QC6 Relevant financial information is capable of making a difference in the decisions made by users. Information may be capable of making a difference in a decision even if some users choose not to take advantage of it or are already aware of it from other sources.

QC7 Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.

QC8 Financial information has predictive value if it can be used as an input to processes employed by users to predict future outcomes. Financial information need not be a prediction or forecast to have predictive value. Financial information with predictive value is employed by users in making their own predictions.

QC9 Financial information has confirmatory value if it provides feedback about (confirms or changes) previous evaluations.

QC10 The predictive value and confirmatory value of financial information are interrelated. Information that has predictive value often also has confirmatory value. For example, revenue information for the current year, which can be used as the basis for predicting revenues in future years, can also be compared with revenue predictions for the current year that were made in past years. The results of those comparisons can help a user to correct and improve the processes that were used to make those previous predictions.

Materiality

QC11 Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

Faithful representation

QC12 Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent. To be a perfectly faithful representation, a depiction would have three characteristics. It would be *complete*, *neutral* and *free from error*. Of course, perfection is seldom, if ever, achievable. The Board's objective is to maximise those qualities to the extent possible.

QC13 A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations. For example, a complete depiction of a group of assets would include, at a minimum, a description of the nature of the assets in the group, a numerical depiction of all of the assets in the group, and a description of what the numerical depiction represents (for example, original cost, adjusted cost or fair value). For some items, a complete depiction may also entail explanations of significant facts about the quality and nature of the items, factors and circumstances that might affect their quality and nature, and the process used to determine the numerical depiction.

QC14 A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users. Neutral information does not mean information with no purpose or no influence on behaviour. On the contrary, relevant financial information is, by definition, capable of making a difference in users' decisions.

QC15 Faithful representation does not mean accurate in all respects. Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.

QC16 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.

Applying the fundamental qualitative characteristics

QC17 Information must be both relevant and faithfully represented if it is to be useful. Neither a faithful representation of an irrelevant phenomenon nor an unfaithful representation of a relevant phenomenon helps users make good decisions.

QC18 The most efficient and effective process for applying the fundamental qualitative characteristics would usually be as follows (subject to the effects of enhancing characteristics and the cost constraint, which are not considered in this example). First, identify an economic phenomenon that has the potential to be useful to users of the reporting entity's financial information. Second, identify the type of information about that phenomenon that would be most relevant if it is available and can be faithfully represented. Third, determine whether that information is available and can be faithfully represented. If so, the process of satisfying the fundamental qualitative characteristics ends at that point. If not, the process is repeated with the next most relevant type of information.

Enhancing qualitative characteristics

QC19 *Comparability*, *verifiability*, *timeliness* and *understandability* are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully represented. The enhancing qualitative characteristics may also help determine which of two ways should be used to depict a phenomenon if both are considered equally relevant and faithfully represented.

Comparability

QC20 Users' decisions involve choosing between alternatives, for example, selling or holding an investment, or investing in one reporting entity or another. Consequently, information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date.

QC21 Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. Unlike the other qualitative characteristics, comparability does not relate to a single item. A comparison requires at least two items.

QC22 Consistency, although related to comparability, is not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Comparability is the goal; consistency helps to achieve that goal.

QC23 Comparability is not uniformity. For information to be comparable, like things must look alike and different things must look different. Comparability of financial information is not enhanced by making unlike things look alike any more than it is enhanced by making like things look different.

QC24 Some degree of comparability is likely to be attained by satisfying the fundamental qualitative characteristics. A faithful representation of a relevant economic phenomenon should naturally possess some degree of comparability with a faithful representation of a similar relevant economic phenomenon by another reporting entity.

QC25 Although a single economic phenomenon can be faithfully represented in multiple ways, permitting alternative accounting methods for the same economic phenomenon diminishes comparability.

Verifiability

QC26 Verifiability helps assure users that information faithfully represents the economic phenomena it purports to represent.

Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Quantified information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified.

QC27 Verification can be direct or indirect. Direct verification means verifying an amount or other representation through direct observation, for example, by counting cash. Indirect verification means checking the inputs to a model, formula or other technique and recalculating the outputs using the same methodology. An example is verifying the carrying amount of inventory by checking the inputs (quantities and costs) and recalculating the ending inventory using the same cost flow assumption (for example, using the first-in, first-out method).

QC28 It may not be possible to verify some explanations and forward-looking financial information until a future period, if at all. To help users decide whether they want to use that information, it would normally be necessary to disclose the underlying assumptions, the methods of compiling the information and other factors and circumstances that support the information.

Timeliness

QC29 Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is. However, some information may continue to be timely long after the end of a reporting period because, for example, some users may need to identify and assess trends.

Understandability

QC30 Classifying, characterising and presenting information clearly and concisely makes it *understandable*.

QC31 Some phenomena are inherently complex and cannot be made easy to understand. Excluding information about those phenomena from financial reports might make the information in those financial reports easier to understand. However, those reports would be incomplete and therefore potentially misleading.

QC32 Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

Applying the enhancing qualitative characteristics

QC33 Enhancing qualitative characteristics should be maximised to the extent possible. However, the enhancing qualitative characteristics, either individually or as a group, cannot make information useful if that information is irrelevant or not faithfully represented.

QC34 Applying the enhancing qualitative characteristics is an iterative process that does not follow a prescribed order. Sometimes, one enhancing qualitative characteristic may have to be diminished to maximise another qualitative characteristic. For example, a temporary reduction in comparability as a result of prospectively applying a new financial reporting standard may be worthwhile to improve relevance or faithful representation in the longer term. Appropriate disclosures may partially compensate for non-comparability.

The cost constraint on useful financial reporting

QC35 Cost is a pervasive constraint on the information that can be provided by financial reporting. Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information. There are several types of costs and benefits to consider.

QC36 Providers of financial information expend most of the effort involved in collecting, processing, verifying and disseminating financial information, but users ultimately bear those costs in the form of reduced returns. Users of financial information also incur costs of analysing and interpreting the information provided. If needed information is not provided, users incur additional costs to obtain that information elsewhere or to estimate it.

QC37 Reporting financial information that is relevant and faithfully represents what it purports to represent helps users to make decisions with more confidence. This results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole. An individual investor, lender or other creditor also receives benefits by making more informed decisions. However, it is not possible for general purpose financial reports to provide all the information that every user finds relevant.

QC38 In applying the cost constraint, the Board assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information. When applying the cost constraint in developing a proposed financial reporting standard, the Board seeks information from providers of financial information, users, auditors, academics and others about the expected nature and quantity of the benefits and costs of that standard. In most situations, assessments are based on a combination of quantitative and qualitative information.

QC39 Because of the inherent subjectivity, different individuals' assessments of the costs and benefits of reporting particular items of financial information will vary. Therefore, the Board seeks to consider costs and benefits in relation to financial reporting generally, and not just in relation to individual reporting entities. That does not mean that assessments of costs and benefits always justify the same reporting requirements for all entities. Differences may be appropriate because of different sizes of entities, different ways of raising capital (publicly or privately), different users' needs or other factors.

BASIS FOR CONCLUSIONS ON AASB CF 2013-1

This Basis for Conclusions accompanies, but is not part of, the Framework. *The Basis for Conclusions was originally published with Accounting Framework AASB CF 2013-1* Amendments to the Australian Conceptual Framework *(December 2013).*

Background to the Amendments Introduced Through AASB CF 2013-1

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's (AASB) considerations in developing AASB CF 2013-1. Individual Board members gave greater weight to some factors than to others.

BC2 The amendments to the *Framework for the Preparation and Presentation of Financial Statements* (*Framework*) result from proposals that were included in AASB Exposure Draft ED 164 *An improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information* (AASB ED 164) published in June 2008. AASB ED 164 incorporated the International Accounting Standards Board's (IASB) May 2008 Exposure Draft of the same name.

BC3 The IASB has been undertaking a review of its conceptual framework for several years. Consistent with the AASB's policy of IFRS adoption, the AASB has been closely monitoring the work of the IASB. In September 2010, the IASB issued a revised IASB *Conceptual Framework for Financial Reporting* (IASB *Conceptual Framework*) containing two new chapters – Chapter 1: *The objective of general purpose financial reporting* and Chapter 3: *Qualitative characteristics of useful financial information*. The revised IASB *Conceptual Framework* includes a 'placeholder' for Chapter 2: *The reporting entity* and Chapter 4, which carries over the text of the IASB's *Framework for the Preparation and Presentation of Financial Statements*[1] (IASB *Framework* 2001) that was not superseded by Chapters 1 and 3 and therefore deals with concepts not yet reconsidered by the IASB. Further revised chapters are planned – see paragraph BC4 below.

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1 The IASC's *Framework for the Preparation and Presentation of Financial Statements* (1989) was adopted by the IASB in April 2001.

BC4 As part of its review, the IASB has also issued:

(a) in March 2010, IASB Exposure Draft ED/2010/2 *Conceptual Framework for Financial Reporting: The Reporting Entity* (incorporated into AASB Exposure Draft ED 193 of the same name, also issued in March 2010); and

(b) in July 2013, IASB Discussion Paper DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting* (incorporated into AASB Invitation to Comment ITC 29 *A Review of the IASB's Conceptual Framework for Financial Reporting*, also issued in July 2013). The Discussion Paper sets out the IASB's preliminary views on concepts relating to the elements of financial statements, recognition and derecognition, measurement, presentation and disclosure, and the IASB's plan to progress its reporting entity proposals.

BC5 In addition to the aspects of a conceptual framework noted in paragraph BC4(b) above, the IASB Discussion Paper DP/2013/1 also notes that while the IASB does not intend to fundamentally reconsider Chapter 1 and Chapter 3 as issued in September 2010, changes to these chapters may be necessary if work on the other aspects highlights areas in these chapters that require clarification or amendment. The IASB has also invited comment where respondents believe that changes are necessary to the existing chapters.

Application of the Amendments to For-Profit Entities

BC6 The Board decided to make Chapters 1 and 3 of the September 2010 IASB *Conceptual Framework* applicable to for-profit entities, consistent with its IFRS-adoption policy. The Board decided to do this pragmatically by amending the *Framework* for the revised guidance rather than issuing a new framework document, pending completion of the IASB project.

BC7 The Board considered whether to introduce additional guidance in respect of for-profit entities in the public sector and decided that additional guidance is not necessary at this time.

Application of the Amendments to Not-for-Profit Entities

BC8 As part of its due process, through AASB ED 164, the AASB invited constituents to comment on the issues that would need to be considered if the proposed concepts relating to the objective of financial reporting and the qualitative characteristics of useful financial information were also to be applied to not-for-profit entities. Consistent with comments made in the joint report *A Report on the application to not-for-profit entities in the private and public sectors* (July 2008)[2] on the not-for-profit implications of the IASB Exposure Draft on these concepts, some respondents to AASB ED 164 commented that more emphasis would need to be given to accountability or stewardship, and less to reporting information for assessing cash flows, for the concepts to be suitable for such entities. Respondents were also concerned that a user group focussed on capital providers was too narrow to be a proxy for the common information needs of users of general purpose financial reports of not-for-profit entities.

BC9 The Board noted that the current focus of the IASB is on business entities in the private sector and that the IASB appears to no longer intend to consider, in the manner it initially proposed, the applicability of its revised concepts to not-for-profit entities in the private sector. In light of this, the Board decided to make Chapters 1 and 3 of the September 2010 IASB *Conceptual Framework* applicable to not-for-profit entities at the same time as for-profit entities, to be consistent with its IFRS-adoption and transaction-neutral policies. However, having regard to the feedback received on AASB ED 164 (see paragraph BC8), the Board decided to include additional guidance in respect of not-for-profit entities to the extent that matters are not adequately addressed by the IASB in Chapters 1 and 3 (see paragraphs BC11–BC15 below).

BC10 After the IASB has completed its review of its conceptual framework, the AASB intends reviewing the not-for-profit guidance included in its conceptual framework. As part of this process, the AASB will have further regard to the International Public Sector Accounting Standards Board's (IPSASB) decisions about its conceptual framework, particularly where the IPSASB's decisions are complementary to the IASB's decisions.[3]

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2 The Report was prepared by the Chairs and senior staff of the Australian Accounting Standards Board, Canadian Accounting Standards Board, New Zealand Financial Reporting Standards Board and the United Kingdom Accounting Standards Board.

3 In January 2013, the IPSASB issued *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* addressing some aspects of its conceptual framework: the role and authority of the conceptual framework, the objective and users of general purpose financial reports, qualitative characteristics, and the reporting entity. Chapters addressing other concepts, including the definition and recognition of elements of financial statements, measurement, and presentation, are being developed by the IPSASB.

Additional Guidance for Not-for-Profit Entities

BC11 The Board noted comments about the importance of accountability of management in respect of not-for-profit entities, and considered whether to make specific reference to the accountability (or stewardship) of management for the resources entrusted to it, similar to statements made in superseded paragraph 14 of the *Framework* and in Statement of Accounting Concepts SAC 2 *Objective of General Purpose Financial Reporting* (e.g. paragraphs 14, 27 and 44). The Board noted the IASB's acknowledgement of the role of stewardship and its rationale for not using the term 'stewardship' within Chapter 1. Paragraphs BC1.27 and BC1.28 of the IASB's Basis for Conclusions on Chapter 1 of the IASB *Conceptual Framework* (September 2010) state:

> BC1.27 … 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.
>
> BC1.28 The Board decided not to use the term *stewardship* in the chapter because there would be difficulties in translating it into other languages. Instead, the Board 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.

BC12 The Board noted that while the provision of information for accountability purposes is an important function of general purpose financial reporting, including in relation to not-for-profit entities, the rendering of accountability by reporting entities through general purpose financial reporting can be regarded as encompassed by the broader objective of providing information useful for making decisions about the allocation of resources. This is on the basis that users ultimately require accountability-related information for resource allocation decisions. Accordingly, in response to constituent feedback on AASB ED 164 in relation to accountability (see paragraph BC8), the Board concluded that the additional guidance it has included in respect of not-for-profit entities is consistent with the view that management accountability is encompassed within the objective of general purpose financial reporting of not-for-profit entities as described in the *Framework*.

BC13 In particular, the Board decided to develop additional guidance for not-for-profit entities that would:

(a) identify the broad range of users of general purpose financial reports of not-for-profit entities (see paragraph AusOB2.1); and

(b) adequately acknowledge that such users of general purpose financial reports of not-for-profit entities have common information needs relating to:

 (i) how well the entity is meeting its objectives that are not primarily related to cash generation (see paragraphs AusOB3.1 and AusOB18.1); and

 (ii) the ability of the entity's available resources to deliver future goods and services (see paragraph AusOB3.1).

In developing this not-for-profit specific guidance, the Board gave consideration to guidance included in the IPSASB conceptual framework chapters published in January 2013.

BC14 With regard to paragraph BC13(a), consistent with the IPSASB's *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (and superseded paragraph 17 of SAC 2), the Board decided to particularly identify taxpayers as one of the users of general purpose financial reports of not-for-profit entities in paragraph AusOB2.1. As noted by the IPSASB, taxpayers usually provide resources to governments and other public sector entities involuntarily. In addition, as recipients of goods or services from public sector entities, taxpayers often do not have the discretion to choose an alternative supplier of those goods and services. Consequently, they have little direct or immediate capacity to make decisions about whether to provide resources to the government, the resources to be allocated for the provision of goods or services by a public sector entity or whether to purchase or consume the goods or services provided. However, they can make decisions about their voting preferences and representations they make to elected officials or other representative bodies based on information contained in general purpose financial reports – these decisions may have resource allocation consequences for certain not-for-profit entities.

BC15 With regard to paragraph BC13(b), the Board concluded that the common information needs of users of general purpose financial reports of not-for-profit entities include the entity's ability to achieve both its financial and non-financial objectives. For example, taxpayers may be interested in whether a not-for-profit entity in the public sector is delivering the services expected of it, that is, whether it is achieving its objectives and doing so economically and efficiently. Other resource providers, such as creditors, may principally be interested in the entity's ability to generate future cash inflows for timely payment of the entity's obligations to them; however, they may be indirectly concerned about the extent to which the entity is achieving its non-financial objectives, since the ability of the entity to generate future cash inflows will depend on its performance in this regard. The Board decided that it was important for such common user needs to be explicitly acknowledged in the amended chapters.

Other Significant Issues

Status of the *Framework*

BC16 The Board decided to take this opportunity to amend paragraph Aus1.1 of the *Framework* to remove the references to superseded or withdrawn pronouncements. Policy Statement 5 *The Nature and Purpose of Statements of Accounting Concepts* was withdrawn with effect for reporting periods beginning on or after 1 January 2005. Professional Statement APS 1 *Conformity with Accounting Standards and UIG Consensus Views* (which superseded APS 1 *Conformity of Accounting Standards*) has been superseded by Professional Standard APES 205 *Conformity with Accounting Standards* (December 2007), which does not make explicit reference to the non-mandatory status of the *Framework* or the Statements of Accounting Concepts.

Consequences for SAC 2

BC17 Superseded paragraph Aus14.1 of the *Framework* noted that a more detailed discussion of the objective of financial statements is provided in SAC 2. The Board decided that SAC 2 should be superseded as it is no longer necessary in light of the extensive discussion of the objective of general purpose financial reporting in paragraphs OB1 to OB21.

Status of SAC 1

BC18 The Board decided that the reporting entity concept expressed in Statement of Accounting Concepts SAC 1 *Definition of the Reporting Entity* still has its place in Australia. The concept is currently used to help identify those entities that must apply Australian Accounting

Standards. Accordingly, the status of SAC 1 is retained (at least for now) in the Australian conceptual framework. The AASB intends to consider the manner in which to incorporate the IASB's forthcoming chapter on Reporting Entity (see paragraph BC4(a)) into the Australian conceptual framework in due course. This consideration would have regard to the interaction with other aspects of the IASB's Conceptual Framework project, other AASB projects (including reconsideration of the application of the reporting entity concept in Australia), and the AASB's approach to adopting IASB content for application by not-for-profit entities.

Effective Date of the Amendments

BC19 The Board decided that the amendments introduced by AASB CF 2013-1 should be applicable to general purpose financial statements of periods ending on or after the date of approval of the pronouncement, with allowance for earlier application.

BC20 The Board would not expect the incorporation of Chapters 1 and 3 of the IASB *Conceptual Framework* into the *Framework* to cause entities to change their accounting policies adopted under the existing *Framework*. Therefore, the application date provisions of these amendments would not be expected to have any practical significance. Nevertheless, the Board decided to identify an application date for these amendments and allow for earlier application, to avoid doubt about these aspects and for consistency with the application provisions of Accounting Standards.