CHAPTER 2

CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

Intermediate Accounting
IFRS Edition

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Learning Objectives

1. Describe the usefulness of a conceptual framework.
2. Describe efforts to construct a conceptual framework.
3. Understand the objective of financial reporting.
4. Identify the qualitative characteristics of accounting information.
5. Define the basic elements of financial statements.
6. Describe the basic assumptions of accounting.
7. Explain the application of the basic principles of accounting.
8. Describe the impact that constraints have on reporting accounting information.

Conceptual Framework

Conceptual Framework establishes the concepts that underlie financial reporting.

Need for a Conceptual Framework

- Rule-making should build on and relate to an established body of concepts.
- Enables IASB to issue more useful and consistent pronouncements over time.

ASSUMPTIONS

1. Economic entity
2. Going concern
3. Monetary unit
4. Periodicity
5. Accrual

PRINCIPLES

1. Measurement
2. Revenue recognition
3. Expense recognition
4. Full disclosure

CONSTRAINTS

1. Cost
2. Materiality

Third level

QUALITATIVE CHARACTERISTICS

1. Fundamental qualities
2. Enhancing qualities

ELEMENTS

1. Assets
2. Liabilities
3. Equity
4. Income
5. Expenses

Second level

OBJECTIVE

Provide information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in their capacity as capital Providers.

First level

Illustration 2-7
Framework for Financial Reporting

LO 2 Describe efforts to construct a conceptual framework.

First Level: Basic Objective

OBJECTIVE

"To provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers."

- Provided by issuing general-purpose financial statements.
- Assumption is that users have reasonable knowledge of business and financial accounting matters to understand the information.

LO 3 Understand the objectives of financial reporting.

Second Level: Fundamental Concepts

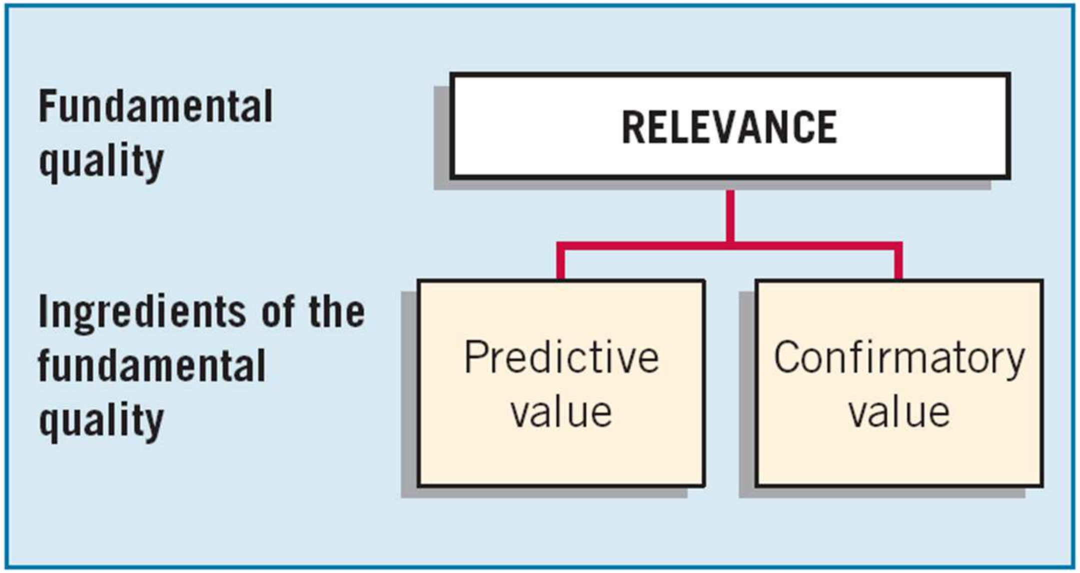
Qualitative Characteristics of Accounting Information

IASB identified the **Qualitative Characteristics** of accounting information that distinguish better (more useful) information from inferior (less useful) information for decision-making purposes.

Second Level: Fundamental Concepts

Fundamental Quality - Relevance

Relevance is one of the two fundamental qualities that make accounting information useful for decision-making.

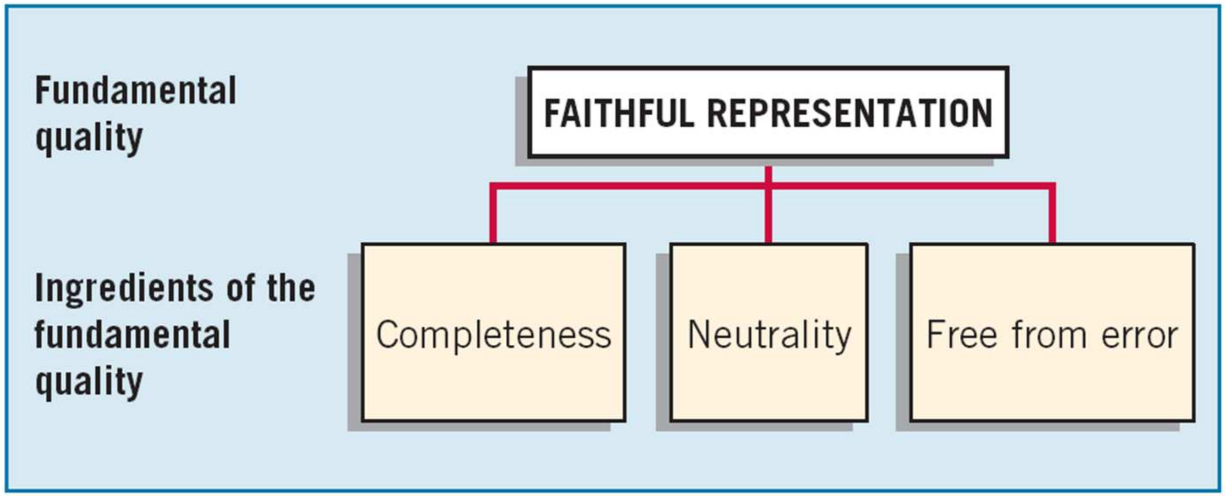


LO 4 Identify the qualitative characteristics of accounting information.

Second Level: Fundamental Concepts

Fundamental Quality – Faithful Representation

Faithful representation means that the numbers and descriptions match what really existed or happened.

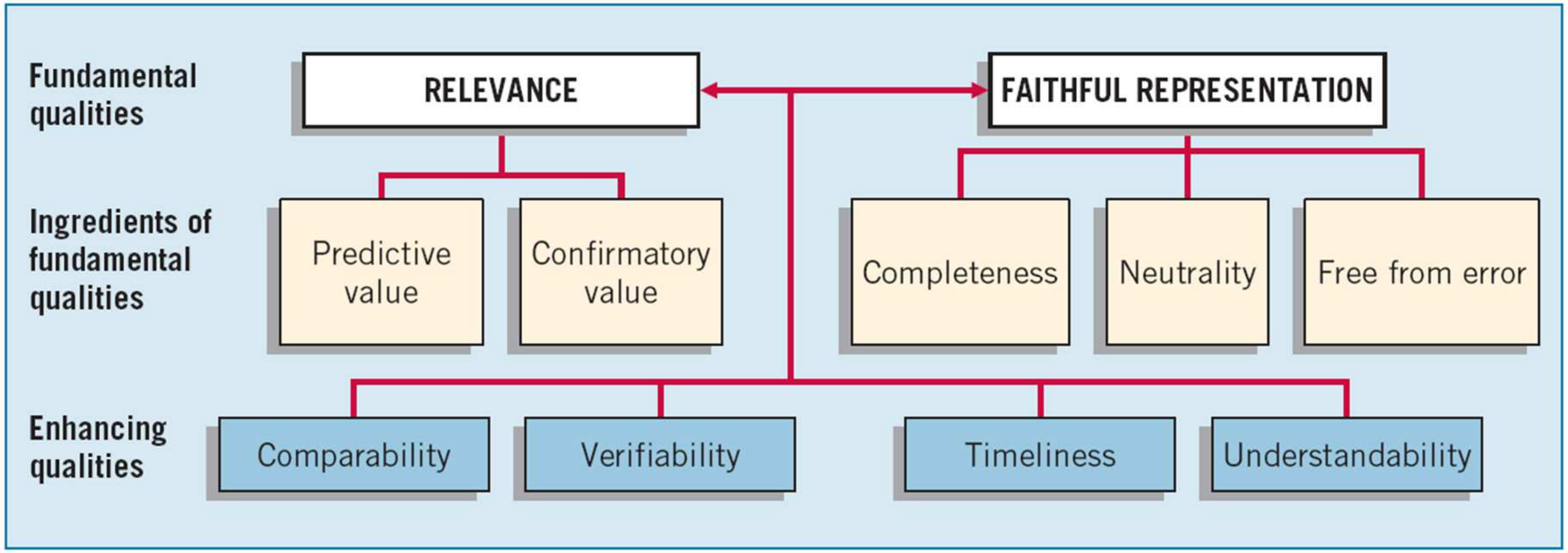


LO 4 Identify the qualitative characteristics of accounting information.

Second Level: Fundamental Concepts

Enhancing Qualities

Distinguish more-useful information from less-useful information.



LO 4 Identify the qualitative characteristics of accounting information.

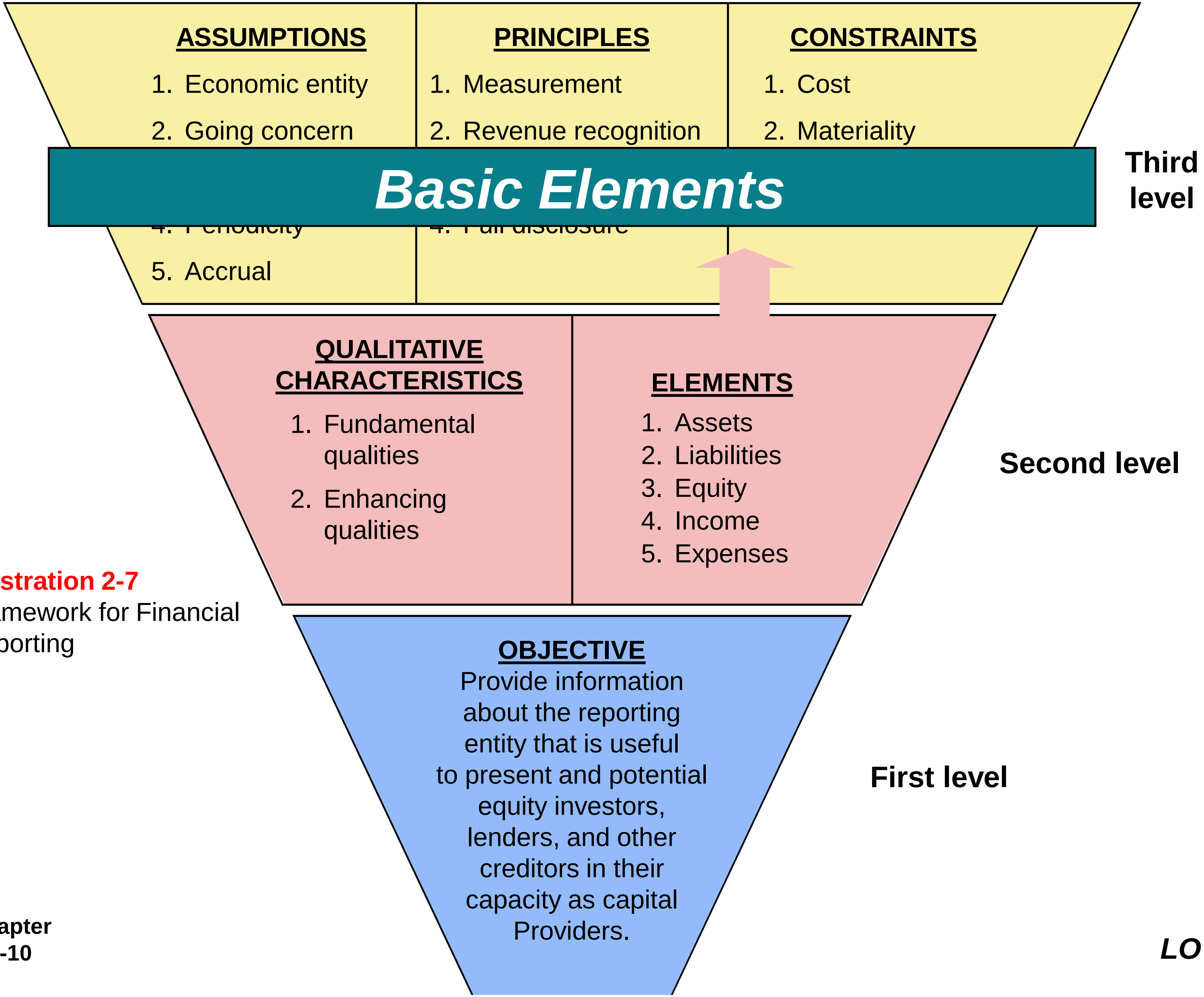


Illustration 2-7
Framework for Financial Reporting

Second Level: Basic Elements

ELEMENTS OF FINANCIAL STATEMENTS

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

ASSET. A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

LIABILITY. A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

EQUITY. The residual interest in the assets of the entity after deducting all its liabilities.

The elements of income and expenses are defined as follows:

INCOME. 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.

EXPENSES. 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.

LO 5 Define the basic elements of financial statements.