

Getting a Better Framework

THE ROLE OF A CONCEPTUAL FRAMEWORK

Bulletin



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This Bulletin is issued by the European Financial Reporting Advisory Group (EFRAG), the French Autorité des Normes Comptables (ANC), the Accounting Standards Committee of Germany (ASCG), the Organismo Italiano di Contabilità (OIC) and the UK Financial Reporting Council (FRC). The publication of Bulletins is part of their strategy to stimulate debate within Europe, and keep European Constituents informed as the IASB develops its Conceptual Framework. Any views expressed are tentative; the issuing bodies will develop their final views after considering responses to this Bulletin and other developments in the debate.

Further information about the work of the project partners, including regular newsletters, is available on the partners' websites.

We welcome views on any of the points addressed in this Bulletin. Specific questions are given at the end of the document. Comments should be sent by e-mail to commentletters@efrag.org or by post to

*EFRAG
35 Square de Meeûs
B-1000 Brussels
Belgium*

So as to arrive no later than 30 September 2013.

All comments will be placed on the public record unless confidentiality is requested.

- 1 In this Bulletin we focus on the rationale for a Conceptual Framework for IFRS (the 'Framework'), rather than discussing the specific accounting concepts and definitions that arise within the Framework. We discuss the following issues that should be considered in the context of the ongoing IASB project:
 - (i) The purpose of the Framework for the IASB;
 - (ii) The completeness of the Framework for setting requirements;
 - (iii) The role of the Framework for preparers;
 - (iv) The decision-making process derived from the Framework; and
 - (v) The consequences of a revised Framework for existing IFRS.

Background

- 2 When the IASB decided to restart the Framework project in 2012 - after the work was paused in 2010 - the Board reconsidered its previous intention to run the project in a number of phases, which were originally envisaged to include a separate phase for the review of the purpose and the status of the Framework. In December 2012, the IASB agreed to a new project plan that no longer divides the project into successive phases, but addresses Framework issues together at once and comprehensively.
- 3 According to the new project plan, the main efforts will especially focus on the elements of financial statements (including recognition and derecognition), measurement, the reporting entity, and presentation and disclosures (including questions about the use of other comprehensive income). Many constituents considered it is also important to discuss the intended role of the Framework because it clearly has a bearing on what kind of Framework is suitable for IFRS. In their view, the proposals for a revised Framework can only be debated sensibly if there is a clear understanding of the purpose and the status of the Framework.
- 4 Recently, the IASB staff published documents for a review and discussion by the IASB on these topics. These staff papers indicated that the purpose and the status of the revised Framework should generally remain the same as outlined in the existing Framework, but with more gradation relating to the purpose of the Framework.
- 5 The existing Framework lists as its purpose:
 - a) To assist the Board in the development of future IFRS and in its review of existing IFRS;
 - b) To assist the Board 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 IFRS;
 - c) To assist national standard-setting bodies in developing national standards;
 - d) To assist preparers of financial statements in applying IFRS and in dealing with topics that have yet to form the subject of an IFRS;
 - e) To assist auditors in forming an opinion on whether financial statements comply with IFRS;
 - f) To assist users of financial statements in interpreting the information contained in financial statements prepared in compliance with IFRS; and
 - g) To provide those who are interested in the work of the IASB with information about its approach to the formulation of IFRS.

The existing Framework states that nothing in the Framework overrides any specific IFRS.

The purpose of the Framework for the IASB

- 6 Many see the primary purpose of the Framework as providing a foundation to develop new IFRS. In this view, the Framework should enhance and ensure the consistency of requirements in IFRS and the continuity of agreed objectives, assumptions, and concepts for financial reporting, despite changes in IASB members and staff.
- 7 Over the last few years, however, some constituents observed inconsistencies between the Framework and requirements in IFRS and consequently questioned the purpose of the Framework as a foundation for developing new requirements. The fact that the IASB currently places its highest prominence on completing major IFRS - with new implications for conceptual approaches in recognition and measurement - before reviewing and amending the existing concepts in the underlying Framework, reinforces, in their view, the concerns that the Framework is not appropriately applied and consistently used for the purpose of developing IFRS.
- 8 Furthermore, the IFRS Foundation *Due Process Handbook* (revised 2013) - and especially the chapter *New or amended Standards* - does not address the Framework as a foundation or binding starting point for the development of new requirements or amendments to existing IFRS. It elucidates that the activities of the Interpretations Committee are constrained by the fact that any Interpretation must not change or conflict with the Framework and IFRS. However, this constraint does not exist for amendments to existing IFRS and the development of new IFRS. Hence, some question the role of the Framework and its nature for developing IFRS, and there are different views about its purpose and the status.
- 9 Many think the Framework should have a kind of long-standing constitutional character for the IASB. In this class of thinking, not only the Interpretations Committee should be constrained by the Framework, but also the IASB in developing new IFRS or amending existing standards. Inconsistencies between the Framework and requirements in individual standards would not be acceptable.
- 10 Other constituents consider the Framework in a less restrictive way. In their view, the Framework is a collection of more or less loose objectives and a pool of (alternative) accounting concepts, reflecting consensus at a certain point in time, but without the implication of being the ultimate driver for the development of new requirements. Hence, consistency between the Framework and individual standards is not considered essential as long as consistency across the individual standard is warranted.



11 Additionally, those who take the view that the IASB should not invariably follow the Framework also advocate that:

- (i) The Framework should be aspirational (i.e. the Framework should aim to improve financial reporting); and
- (ii) Whilst the IASB should consider the Framework in the development of accounting standards, it should also consider economic expediencies not addressed in the Framework - such as the desire to avoid revolutionary change - and it may validly conclude that these outweigh conformity with the Framework.

It would be consistent with this view to insist that all IFRS should clearly explain how they relate to the Framework, and especially whether a departure is made on pragmatic grounds or shows a defect in the Framework that the IASB does not wish to address before issuing the IFRS.



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- 12 In the light of transparency, understandability, and consistency of IFRS development there should be a single and robust conceptual basis. The Framework should serve this purpose in the first place and any new IFRS requirement and guidance developed by the IASB and the Interpretations Committee should be derived from the objectives and concepts of the Framework. The IASB should give clear prominence to the Framework as the primary conceptual source when developing new requirements and guidance.
- 13 Generally inconsistencies between the Framework and individual standards are undesirable. Inconsistencies raise questions about the Framework as a robust conceptual basis for IFRS. Hence, departure from the Framework should be exceptional and requires strong justification. These exceptions should not result in the necessity to revise the Framework, as they are supposed to address very specific and limited cases. In such cases the IASB should give a clear explanation of the reasons and the specific circumstances for departure.
- 14 As the revised Framework will probably include a number of new, untested concepts, standards based on these new ideas need to be monitored closely. Ideally, the IASB should address issues arising from the newly introduced concepts and other deficiencies in the Framework on a timely basis to reduce the risk of inconsistencies and exceptions.

A complete Framework for setting new requirements

- 15 In the past, the IASB has acknowledged that some of its decisions go beyond its Framework. In this context, several IASB members raised concerns that some decisions on accounting issues and corresponding changes in IFRS were based more on expediencies than on conceptual merit.¹ Many constituents think the IASB needs to reconsider the range of concepts and definitions and the level of details in a complete Framework and the timing of future improvements for these concepts and definitions.
- 16 The current Framework states that it will be revised from time to time on the basis of the IASB's experience of working with the Framework. In restarting the project, the IASB already acknowledged that many constituents think that a revised conceptual basis and justification for new requirements in IFRS is overdue.
- 17 The IASB's current consideration for restarting the project with the intention to extend the Framework (e.g. with additional chapters for presentation and disclosures, and on the reporting entity) also indicates the approach of the IASB to broaden the conceptual basis, thus providing a more complete Framework. However, the question remains where the IASB should draw the line between concepts to be included in the Framework and concepts that should only remain on the individual standard level.
- 18 One approach to this question would be to constrain the Framework to a few key concepts. Those key concepts would provide a stable foundation with further requirements anchored in the individual standards. For example, the Framework would not predefine the components of a financial report (i.e. balance sheet, income statement, etc.). In consequence, the Framework would also not include any corresponding recognition and presentation concepts for those components – these concepts would remain on the individual standard level. This kind of approach would allow a degree of flexibility for the standard setter that might be necessary to form new requirements for transactions and events that were not considered in the past. The downside of such an approach could be considered that such Framework would be less helpful as a guide to develop new requirements and potentially result in an increase of inconsistencies of requirements across the individual standards (i.e. an increase of cross-cutting issues).
- 19 An opposite approach would be a complete Framework that includes all necessary concepts and definitions for a financial report. Thus, individual standards would focus on application and implementation guidance. The downside of such an approach could be that such Framework would be too voluminous and may include a variety of alternative concepts as compromises to develop application and implementation guidance. Furthermore, such Framework could be subject to frequent changes, reflecting changes in the environment of financial reporting.

¹ For example, the dissent of IASB member Paul Pacter from Presentation of Items of Other Comprehensive Income (Amendments to IAS 1), 2011.



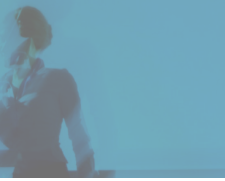
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- 20 It is obviously not easy to say where a complete Framework should start and where it should end. However, struggling with technical decisions without a sound conceptual basis, as has happened in the past in the IASB's considerations, is a clear indication that the Framework cannot be considered complete.
- 21 Achieving a complete Framework will remain an evolutionary process, as described in the current Framework. The necessity and timing to amend the Framework should be based on the IASB's experiences of developing standards but should also reflect the requests from constituents for conceptual clarification on a Framework level.
- 22 The IASB should also allocate more timely work in addressing cross-cutting issues, including an appropriate evaluation process whether an identified issue should be addressed on a Framework level. For instance, the recent discussion about the different types of discount rates in IFRS and the linked discussion about the reflection of time value of money in IFRS could be considered in this context. If such conceptual issues and inconsistencies between individual standards are identified and the IASB does not consider those issues as resolvable on a timely basis, this fact needs to be documented prominently by the IASB together with a strategy for how the issues will be solved.

The role of the Framework for preparers

- 23 As is highlighted in paragraph 5 of this Bulletin, the current Framework also has the purpose of assisting preparers of financial statements in applying IFRS and in dealing with topics that have yet to form the subject of an IFRS. Thus, the Framework may serve preparers as a “fallback provision” for necessary judgement in developing and applying an accounting policy. This issue is explicitly addressed in IAS 8, which mandates the Framework as authoritative guidance for preparers to consider the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework if other IFRS with similar or related issues do not provide guidance.
- 24 In the light of the current intention of the IASB to extend the Framework with chapters about presentation, disclosures, and the reporting entity, the IASB would need to consider whether those new chapters and concepts should be incorporated in IAS 8, or whether those additions should be placed into individual standards as amendments to existing IFRS.
- 25 Some constituents question the current role of the Framework for preparers, especially the usefulness of the linkage to the Framework in IAS 8. One argument for this view points to the fact that relevant concepts of the current Framework for IFRS are already replicated in individual standards, especially in IAS 1. More importantly, the fundamental qualitative characteristics in the current Framework are overruled by IAS 8 with criteria reflecting the pre-2010 Framework. For example, IAS 8 refers to *reliability*, *prudence* and *substance over form* that were replaced, removed or reconsidered in 2010.²
- 26 Furthermore, it has been argued that the current Framework is not particularly helpful in developing accounting policies for transactions or events not covered by existing standards, especially in the context of measurement, presentation and disclosures. Additionally, perceived inconsistencies or explicit departures from the Framework in IFRS raise the question whether preparers should follow the Framework in any circumstances or may also depart from the Framework concepts to provide the most useful information to the users of financial statements.
- 27 There is also the point that, if preparers are to be required to consider the Framework, this will limit the degree of innovation or aspiration that can be reflected in the Framework. The result might be a Framework that is less useful for the development of accounting standards that improve financial reporting.
- 28 Last, but not least, another argument in the context of European preparer’s points to the fact that, unlike individual IFRS, any changes to the Framework - and the Framework itself - are not included in the European endorsement process.

² See also the Bulletin Reliability of financial information and the Bulletin Prudence, published by EFRAG, ANC, ASCG, OIC, and FRC in April 2013.



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- 29 Generally, the Framework is considered to be useful for the preparation of financial reports, especially by providing a better understanding of the underlying objectives, assumptions, and concepts of financial reporting. It is even more essential for developing necessary judgements by the reporting entity in a more principle-based accounting environment compared to rules-driven accounting standards. The Framework provides preparers and other IFRS constituents a comprehensive conceptual depiction of financial reporting in accordance with IFRS.

- 30 The mandate in IAS 8 for preparers to consider the Framework as authoritative guidance in absence of a relevant IFRS is expected to be even more applicable and important for preparers if the conceptual guidance will be developed in more detail compared to the current Framework (especially better guidance on measurement, disclosures and presentation). Nevertheless, the IASB should also address the existing questions in the context of current IAS 8 and especially align the requirements for developing and applying an accounting policy with the underlying concepts in the Framework.

Decision-making process derived from the Framework

- 31 Many constituents question how the IASB is approaching and using the Framework when developing new standards. It appears that many IFRS projects are processed in isolation and on a stand-alone basis without being based on a common structure and format of decision-making process derived from the Framework. Some constituents think this could be one reason that caused cross-cutting issues in the past. Thus, they argue the IASB may need to rethink the structure and format of the decision-making process derived from the Framework, especially demonstrating more clearly the use of the Framework.
- 32 Recently the FASB published Framework-related documents that indicated new ideas for the Board's decision-making process. In the Discussion Paper *Disclosure Framework*³ (published in 2012) and the recently published Invitation to Comment *Private Company Decision-Making Framework - A Framework for Evaluating Financial Accounting and Reporting Guidance for Private Companies*⁴, the FASB indicated to establish a new format of Framework documents that would include a set of questions and illustrations of related decision trees in the form of process flowcharts. In binding the due process to a step-by-step decision-making process that is anchored in a Framework document, the process for developing new standards is considered to enhance the consistency in new requirements and these developments would be more transparent for constituents. Furthermore, it may also help preparers to use these questions when developing an accounting policy in the absence of any standard and guidance that specifically applies to a transaction, other event or condition. So far, there is no indication from IASB members and its staff to discuss or consider changes in the format of the revised Framework.

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- 33 As is highlighted above, the IASB should demonstrate more clearly the application of the Framework in the decision-making process relating to the development of new requirements in IFRS. The use of decision trees and related questions could be useful. However, rigid application of such process flowcharts for making decisions could also imply a too mechanical process.
- 34 We do not see the necessity to enrich the Framework itself with decisions trees and questions as long as the implication of the conceptual guidance in the Framework is clear and consistently applied in the decision-making process.

³ FASB, Discussion paper - Disclosure Frameworks, 2012.

⁴ FASB, Invitation to Comment - Private Company Decision-Making Framework—A Framework for Evaluating Financial Accounting and Reporting Guidance for Private Companies, April 2013.



Consequences of a revised Framework for existing IFRS

- 35 The current project plan suggests that the revised Framework will be published in September 2015. At the moment, it is too early to foresee all the conceptual changes and clarifications that will result from the project. However, the general consequences of the changes to the Framework on existing IFRS may be considered. Specifically, the question arises whether the revised conceptual foundation should only apply to the development of new IFRS or whether the Framework project would also trigger an automatic review of existing IFRS.
- 36 On one hand, a full review and immediate alignment of all existing IFRS with the revised Framework to secure consistency seems to be a good approach. On the other hand, such an approach might undermine the endeavour of having IFRS as a stable platform for preparers and users. There is already criticism from constituents, especially preparers, on the volume and pace of changes to individual IFRS.
- 37 The current *Due Process Handbook* states that the IASB might need to consider whether any standards should be amended to reflect revisions to the Framework. However, amending a standard is not an automatic consequence of such revisions. Changes to standards are made to address deficiencies in financial reporting. Any changes to the Framework that highlight inconsistencies in the standards must be considered by the IASB in the light of other priorities when developing its work program.



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- 38 We think it is important that the IASB's Framework project results in a robust revised Framework that better reflects the conceptual underlying of IFRS and is widely accepted and supported by constituents. Thus, the ongoing project should not be distracted from the introduction of potential inconsistencies with existing IFRS. However, the project should also clearly expose the potential consequences arising from proposed changes in the Framework to avoid second-guessing by constituents.
- 39 Immediate changes for existing IFRS are not desirable in the light of potential instability instead of having a stable platform for financial reporting. Thus, changing the Framework should not automatically trigger changes to existing IFRS. Nevertheless, there should be a timely evaluation process with a thorough assessment by the IASB whether and when some changes from the revised Framework should be incorporated in existing IFRS requirements. Furthermore, the outcome of this evaluation process for each existing IFRS should be documented.

**We would welcome views on any of the points addressed in this Bulletin.
In particular:**

- (i) Do you think the IASB should invariably follow the Framework? (Paragraphs 6-11)?**
- (ii) What do you think is an appropriate approach to achieve a complete Framework? (Paragraphs 15-19)**
- (iii) Do you think the current reference in IAS 8 to the Framework as authoritative guidance is useful? (Paragraphs 23-28)**
- (iv) Do you think the Framework project should develop questions and decision trees or process flowcharts for developing IFRS requirements? (Paragraphs 31-32)**
- (v) How should the IASB proceed with existing IFRS in the context of a revised Framework? (Paragraphs 35-37)**
- (vi) The Framework is not an IFRS (according to the IASB's own terminology) and it is, therefore, outside the scope of endorsement. Has this caused any issues for you in practice and, if so, how do you believe they might be addressed?**
- (vii) Do you have any other comments on this Bulletin?**

Comments should be addressed to: commentletters@efrag.org, so as to be received before 30 September 2013.





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