

report

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Purpose

To consider the impact on the Code of the new IASB Conceptual Framework for Financial Reporting

1 Introduction

- 1.1 At its March 2018 meeting CIPFA/LASAAC agreed that the next Code revision should reflect new and amended material in the IASB Conceptual Framework for Financial Reporting (IASB Conceptual Framework), IASB March 2018.
- 1.2 The revised framework is effective immediately for the IASB and the IFRS Interpretations Committee. For preparers, the revised Conceptual Framework is effective for annual reporting periods beginning on or after 1 January 2020, with earlier application permitted.
- 1.3 Code amendments could therefore be deferred until 2020-21 while maintaining compliance with IFRS. However, the Secretariat notes that the new material in the revised framework has informed IASB development of several recent standards, including IFRS 9, IFRS 15 and IFRS 16. The revised framework may therefore provide a better guide to understanding these important standards. As far as we are aware, this matter has not yet been discussed by the FRAB.
- 1.4 Currently section 2.1 of the Code includes material on the objectives of the financial statements, accruals accounting concept, the elements of the financial statements and the qualitative characteristics of financial information. Section 2.1 is also informed by the IPSASB Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (the IPSASB Conceptual Framework). Any changes would also need to be informed by the IPSASB Framework.
- 1.5 The frameworks are not in themselves standards to be complied with. The IASB Conceptual Framework is designed to:
 - assist the IASB with the development of IFRS Standards (Standards) based on consistent concepts, resulting in financial information that is useful to the users of financial reporting

- help accounts preparers to develop consistent accounting policies for transactions or other events when no Standard applies or a Standard allows a choice of accounting policies, and
- help all parties to understand and interpret Standards

The IPSASB Conceptual Framework fulfils a similar role for IPSASB and users of IPSASs, and also provides a basis for consideration of how IFRS can be interpreted for public sector preparers.

- 1.6 The frameworks' roles in selection of accounting policies and understanding standards provide the rationale for the inclusion of key elements of both frameworks in the Code. This should help local authority accounts preparers both to comply with applicable standards, and where possible streamline their financial statements.
- 1.7 The IASB began redevelopment of its Conceptual Framework in 2004, and issued a partial update in 2010, which is reflected in the current Code. Some of the recent additions have been discussed for many years, and have informed the development of IFRS during that period, even though they were not formally set out in the Conceptual Framework.
- 1.8 The Secretariat is of the view that the current Code material will need to be updated to reflect the amended framework, but does not need to be significantly expanded. While there are some significant additions to the Conceptual Framework, not all are relevant in the context of local authority financial reporting, and some will be better discussed in standards level Code material.

2 Changes to the Conceptual Framework

- 2.1 The table below sets out the most significant changes in the 2018 Conceptual Framework.

Area/chapter	Changes
Objective, usefulness and limitations of general purpose financial reporting	This chapter was substantially revised in the 2010 update to the Framework. The 2018 update clarifies why information used in assessing stewardship is needed to achieve the objective of financial reporting.
Qualitative characteristics of useful financial information	This chapter was substantially revised in the 2010 update to the Framework. The 2018 update provides additional clarification in relation to the roles of prudence, measurement uncertainty and substance over form in assessing whether information is useful statements.
Financial statements and the reporting entity	This new chapter describes the objective and scope of financial statements and provides a description of the reporting entity.

Area/chapter	Changes
The elements of financial statements	The definitions of an asset and a liability have been refined, with a separate definition of an economic resource as something with the potential to provide benefit, without reference to whether this is 'expected' or probable. The definitions of income and expenses have been updated to reflect this refinement.
Recognition and derecognition	Whether flows of benefits are probable no longer directly affects the recognition of assets or liabilities. Nor is reliable measurement a pre-requisite for recognition. However, low probability or measurement uncertainty may affect qualitative characteristics such as relevance. The revised recognition criteria therefore refer explicitly to the qualitative characteristics of useful information. There are new provisions in relation to derecognition which mainly address difficulties in applying older approaches to financial instruments.
Measurement	The previous version of the Conceptual Framework included limited guidance on measurement. The 2018 Conceptual Framework describes what information measurement bases provide and explains the factors to consider when selecting a measurement basis.
Presentation and disclosure	The 2018 Conceptual Framework sets out objectives and principles for how information should be presented and disclosed in financial statements.

3 Objectives of financial reporting/financial statements

3.1 In setting out local authority relevant material on reporting objectives, it is useful to bring together material from chapter one of the Conceptual Framework, the Objective of General Purpose Financial Reporting and the new chapter three which has more specific material on the objective and scope of financial statements.

3.2 The Code currently includes two parallel objectives of the financial statements. One of these is based on older versions of the Code, taken together with material in the IPSASB Conceptual Framework. The other is based on the 2010 IASB Conceptual Framework;

'...to provide information about the authority's financial performance, financial position and cash flows that is useful to a wide range of users for assessing the stewardship of the authority's management and for making economic decisions.'
(previous Code/IPSASB Conceptual Framework)

'The objective is also to provide financial information about the reporting authority that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to it... '
(2010 IASB Conceptual Framework)

- 3.3 The new chapter three of the IASB Conceptual Framework includes the objective of the financial statements, and this is a better fit for local authority financial statements as it does not refer specifically to investors or lenders:

'The objective of financial statements is to provide financial information about the reporting entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the reporting entity and in assessing management's stewardship of the entity's economic resources'

- 3.4 If a second objective were developed using the new IASB material, then there would be relatively little difference between the two objectives, except that the IASB objective refers to assets, liabilities, etc instead of financial performance and financial position. The Secretariat's view is that the focus on assets and other elements provides additional clarity, and it would be better to merge this with and thereby enhance the first objective. This is the basis of an amended paragraph 2.1.2.2.
- 3.5 The Secretariat has also included material based on the new chapter three which sets out the scope of the financial statements and supports the remainder of the reporting framework under IFRS. To be more useful for local authority financial statements, this has been reframed using the Code's nomenclature for statements, and referring to residual interest as reserves instead of equity.

4 Qualitative Characteristics of Useful Financial Information

- 4.1 The material in the current Code reflects the 2010 Conceptual Framework and relatively few changes have been made in the 2018 revision. The Secretariat is of the view that the qualitative characteristics taken together with the definition of materiality are important tools to support the streamlining of local authority financial statements.
- 4.2 Changes have been made to chapter two of IASB Conceptual Framework in relation to the role of prudence, measurement uncertainty and substance over form in assessing whether information is useful. Each of these are relevant to local authorities. Some of these were already anticipated in the Code, which included material from the 2010 Framework basis of conclusions on substance over form. Proposed amendments to paragraphs 2.1.2.14 and 2.1.2.15 are included in the Exposure Draft (see Appendix A).

5 Financial Statements and the Reporting Entity

- 5.1 Material in the new chapter 3 on the objective of financial statements and the scope of the financial statements is dealt with in Section 3 of this paper.
- 5.2 Chapter three also covers the concepts relating to the reporting entity and the reporting period. For local authorities these matters are substantially determined by statute. The Secretariat does not consider that conceptual material relating to these needs to be included in the Code.

6 Elements of the Financial Statements

6.1 Chapter four of the IASB Conceptual Framework covers the elements of the financial statements. The five elements were already considered in the Code. There have been substantial changes to the definitions of asset and liability and consequential changes to the definitions of income and expenses.

6.2 The revised definition of an asset has been included in the Exposure Draft of the Code: a present economic resource controlled by the entity as a result of past events. Key aspects of the revised definition are:

- the reference to economic resource – to clarify that an asset is the economic resource, not the ultimate inflow of economic benefits
- removal of references to 'expected flow'- it does not need to be certain, or even likely, that economic benefits will arise
- a low probability of economic benefits may nevertheless affect recognition decisions and the measurement of the asset, but having regard only to the effect on usefulness of this information

6.3 The revised definition of a liability has been included in the Exposure Draft: a present obligation of the entity to transfer an economic resource as a result of past events. Key aspects of the revised definition are::

- the reference to economic resource – to clarify that a liability is the obligation to transfer the resource, not the ultimate outflow of economic benefits
- deletion of 'expected flow'—with the same implications as set out above for an asset, and the
- introduction of a 'no practical ability to avoid' criterion

6.4 The Secretariat does not propose to add substantially more additional detail to the definitions of the asset or the liability. The proposed revisions to the Code include references to the relevant IASB material. They also include a definition of economic resources to be clear that this includes service potential. The Exposure Draft also includes references to rights and obligations as both are relevant factors in determining when particular local authority assets or liabilities should be recognised.

6.5 The Secretariat has also amended the definitions of income and expenses in the Code Exposure Draft in accordance with the revised IASB Conceptual Framework. The definition of income is:

'Increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.'

The Secretariat has replaced the 'equity' residual interest with 'reserves' and removed the reference to 'those relating to contributions from holders of equity claims' as this is not relevant to local authority single entity financial statements. It has also used this approach to the definition of expenses. The IASB definitions may of course be relevant to companies consolidated in Group accounts. The definition of equity has not been changed in the IASB Conceptual Framework.

- 6.6 The Secretariat notes that the revised definitions underpin recent standards development including IFRS 9 Financial Instruments, IFRS 15 Revenue from Contracts with Customers and IFRS 16 Leases. While the new framework will help preparers understand the standards, it is not anticipated that the new aspects of the definitions will raise issues in areas that will not be covered by specific standards.
- 6.7 Chapter four of the IASB Conceptual Framework also includes consideration of 'units of account', 'executory contract', and 'substance of contractual rights and contractual obligations' – these are not substantial issues for local authorities and inasmuch as they are applicable we would expect sufficient guidance to be covered in standards and relevant Code guidance on those standards.

7 Recognition and Derecognition

- 7.1 Chapter five of the Conceptual Framework discusses criteria for including assets and liabilities in financial statements (recognition) and guidance on when to remove them (derecognition). The previous recognition criteria were that an entity should recognise an item that met the definition of an element if it was probable that economic benefits would flow to the entity and if the item had a cost or value that could be determined reliably. The revised recognition criteria refer explicitly to the qualitative characteristics of useful information. The Secretariat has therefore updated the text in the Code in relation to the recognition process and also the recognition criteria. Discussion of the more difficult aspects of achieving faithful representation has not been included as these issues are dealt with in individual standards.
- 7.2 The Secretariat has also included the new description of the concept of derecognition in the Code but has provided no further detail as this issue is dealt with in standards. To date this is rarely an issue for local authorities.

8 Measurement

- 8.1 Chapter six of the IASB Conceptual Framework describes various measurement bases and discusses factors to be considered when selecting a measurement basis. The Secretariat has included the general description of the measurement process but again has not included any further detail as this is covered by the individual standards in the Code.

9 Presentation and Disclosure

- 9.1 Chapter seven of the IASB Conceptual Framework includes concepts relating to presentation and disclosure and guidance on including income and expenses in the statement of profit or loss and other comprehensive income. The Secretariat has not included any specific provisions in the Code on these issues as the Code specifies the presentation of items in the main local authority financial statements.
- 9.2 The Secretariat considers that this chapter of the IASB Conceptual Framework may assist CIPFA/LASAAC in its standard setting processes, and particularly in its outreach work in relation to the effectiveness of the Telling the Story changes to the Code.

CIPFA/LASAAC is invited to consider the above approach to the inclusion of the principles in the Conceptual Framework in the Code.