

Third Pre-Ballot Draft of a Revised AASB Conceptual Framework

[limited to changed text (marked up) and other text relating to issues raised on the second pre-ballot draft or raised in the comparison with the draft IPSASB ED]

Comparison with IASB Conceptual Framework

This Conceptual Framework incorporates the Conceptual Framework ~~as chapters~~ issued by the International Accounting Standards Board (IASB) ~~without amendment for application in respect of for-profit entities~~. Paragraphs ~~that~~ have been added to this Conceptual Framework ~~in respect of for its application by in respect of~~ not-for-profit entities (and do not appear in the text of the IASB Conceptual Framework). ~~These added paragraphs~~ are identified with the prefix “Aus”.

Foreword

Approach to revising the AASB Conceptual Framework

The Australian Accounting Standards Board (AASB) is currently in the process of revising its Conceptual Framework, based on the work of the International Accounting Standards Board (IASB) to revise its Conceptual Framework. This Conceptual Framework project is being conducted in phases, resulting in the publication of a series of chapters.

The revised AASB Conceptual Framework supersedes the AASB *Framework for the Preparation and Presentation of Financial Statements*, which was issued in July 2004 for application to periods beginning on or after 1 January 2005 [hereinafter referred to as the ‘AASB Framework (2004)’]. As a chapter is finalised, the relevant paragraphs in the AASB Framework (2004) will be replaced. When the conceptual framework project is completed, the AASB will have a comprehensive document called the *Conceptual Framework for Financial Reporting*.

This version of the AASB Conceptual Framework

This version of the AASB Conceptual Framework includes the first two chapters the AASB published as a result of the first phase of the IASB’s Conceptual Framework project — Chapter 1 *The objective of financial reporting* and Chapter 3 *Qualitative characteristics of useful financial information*. Chapter 2 will deal with the reporting entity concept. The IASB published an exposure draft on this topic in March 2010 with a comment period that ended on 16 July 2010. References to ‘reporting entities’ in this revised AASB Conceptual Framework are to any entities presenting general purpose financial reports. This meaning differs from the meaning of ‘reporting ~~entities entity~~’ in ~~Statement of Accounting Concepts SAC 1 Definition of the Reporting Entity, AASB 1053 Application of Tiers of Australian Accounting Standards~~. Until completion of the next phase of the AASB’s Differential Reporting project, Australian Accounting Standards (Tier 1) and Australian Accounting Standards – Reduced Disclosure Requirements (Tier 2) will be expressed as applying to ‘reporting entities’ ~~as defined using that definition~~ in AASB 1053-~~Application of Tiers of Australian Accounting Standards, using a definition similar to that in SAC 1. Therefore, until then, the guidance on the reporting entity concept in SAC 1 will remain important at a Standards level in Australia.~~

Chapter 4 contains the remaining text of the AASB Framework (2004).

In effect, the AASB Framework (2004) has been retained except for:

- (a) ~~the matters covered by Chapters 1 and 3 of the revised AASB Conceptual Framework; and~~
- (b) ~~the superseding of Statements of Accounting Concepts SAC 1 Definition of the Reporting Entity and SAC 2 Objective of General Purpose Financial Reporting when this Conceptual Framework is applicable. The AASB Framework (2004) presently refers readers to the definition of ‘reporting entity’ in SAC 1 and a more detailed discussion of the objective of financial statements in SAC 2.~~

The table of concordance, at the end of this publication, shows how the contents of the AASB Framework (2004) and the AASB *Conceptual Framework* (2010) correspond.

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~~When this *Conceptual Framework* is applicable, *Statements of Accounting Concepts SAC 1 Definition of the Reporting Entity* and *SAC 2 Objective of General Purpose Financial Reporting* are superseded. The *AASB Framework (2004)* presently refers readers to the definition of 'reporting entity' in SAC 1 and a more detailed discussion of the objective of financial statements in SAC 2.~~

Application by in respect of not-for-profit entities

The AASB decided the two new chapters of its *Conceptual Framework* should be applicable to all entities, with limited guidance added to the extent necessary for their application by in respect of not-for-profit entities. At this stage, therefore, the entire revised AASB *Conceptual Framework* applies to all entities. As an interim step, the AASB is maintaining the status quo, as far as possible, regarding the additional guidance for not-for-profit entities included in the *AASB Framework (2004)*. This position is being taken until the AASB conducts a detailed review of the application of the concepts to not-for-profit entities taking into account the outcome of the IASB's corresponding review later in its *Conceptual Framework* project. The AASB is also monitoring developments in the *Conceptual Framework* project of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants. In this *Conceptual Framework*, the guidance added in respect of not-for-profit entities was developed having regard to the IPSASB's proposals on the objectives of financial reporting and the qualitative characteristics of financial information set out in its December 2010 Exposure Draft for Phase 1 of its *Conceptual Framework* project. For more information, refer to the AASB's Basis for Conclusions on its revised *Conceptual Framework*.

Application

Aus1.1 This *Conceptual Framework* applies to periods beginning on or after 1 July 2011.

Aus1.2 This *Conceptual Framework* may be applied to periods beginning on or after 1 January 2005 but before 1 July 2011.

Aus1.3 When applicable, this *Conceptual Framework* supersedes the *AASB Framework for the Preparation and Presentation of Financial Statements* (July 2004, as amended). This *Conceptual Framework* includes new chapters on two topics, together with unamended text of the *AASB Framework (2004)* on other topics (except for the amendments identified in paragraph Aus1.4).

Aus1.4 When the *AASB Framework (2004)* is superseded, *Statements of Accounting Concepts SAC 1 Definition of the Reporting Entity* and *SAC 2 Objective of General Purpose Financial Reporting* are consequently superseded.

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The Introduction will be updated when the IASB considers the purpose of its *Conceptual Framework*.

Introduction

Purpose and status

1. This *Conceptual Framework* sets out the concepts that underlie the preparation and presentation of financial statements for external users. The purpose of the *Conceptual Framework* is:
 - (a) to assist the AASB (the 'Board') 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) 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 Australian Accounting Standards;
 - (c) [deleted by the Board];
 - (d) to 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) to assist auditors in forming an opinion on whether financial statements comply with Australian Accounting Standards;
 - (f) to assist users of financial statements in interpreting the information contained in financial statements prepared in compliance with Australian Accounting Standards; and
 - (g) to provide those who are interested in the work of the Board with information about its approach to the formulation of Australian Accounting Standards.
2. This *Conceptual Framework* is not an Australian Accounting Standard. Australian Accounting Standard AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* specifies that, in the absence of an Australian Accounting Standard that specifically applies to a transaction, other event or condition, management shall use its judgement in ~~develops and applies~~ developing and applying an accounting policy by referring to, and considering the applicability of, the following sources in descending order:
- (a) the requirements in Australian Accounting Standards dealing with similar and related issues:
and
 - (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in this *Conceptual Framework* ~~(among other sources)~~.
3. The Board recognises that in a limited number of cases there may be a conflict between the *Conceptual 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 *Conceptual Framework*. As, however, the Board will be guided by the *Conceptual Framework* in the development of future Standards and in its review of existing Standards, the number of cases of conflict between the *Conceptual Framework* and Australian Accounting Standards will diminish through time.
4. The *Conceptual Framework* will be revised from time to time on the basis of the Board's experience of working with it.

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Scope

5. The *Conceptual Framework* deals with:
- (a) the objective of financial reporting;
 - (b) the concept of a reporting entity;
 - (c) the qualitative characteristics of useful financial information;
 - (d) the definition, recognition and measurement of the elements from which financial statements are constructed; and
 - (e) concepts of capital and capital maintenance.

Chapter 1: *The objective of general purpose financial reporting*

Introduction

OB1 The objective of general purpose financial reporting forms the foundation of the *Conceptual Framework*. Other aspects of the *Conceptual 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^{*} 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.

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, existing and potential owners and other resource providers ~~may not be as~~ are generally not concerned with obtaining a financial return on an investment in the entity. They are usually more interested in the ability of the entity to achieve its non-financial objectives, which in turn may depend upon the entity's financial position and financial performance. Users of general purpose financial reports of not-for-profit entities (see paragraph AusOB5.1) will, for example, be interested in the capability of the entity's resources to provide goods and services in the future.

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[†] 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. 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.

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

** ~~Except where indicated otherwise, a 'reporting entity' means an entity that presents general purpose financial reports. The narrower meaning of a 'reporting entity' in Statement of Accounting Concepts SAC 1 Definition of the Reporting Entity does not apply to this Conceptual Framework.~~

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

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.

AusOB5.1 The users of general purpose financial reports of not-for-profit entities are existing and potential resource providers (including investors, lenders and other creditors, donors and taxpayers), recipients of goods and services (including beneficiaries, such as members of the community) and parties performing a review or oversight function on behalf of other users (including advisers and, in respect of public sector not-for-profit entities, members of parliament).

AusOB5.2 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 – these decisions may have resource allocation consequences for public sector entities.

AusOB5.23 The Board does not see a need to identify primary users of general purpose financial reports of not-for-profit entities because its focus is on the common information needs of the range of users of those reports. Therefore, in relation to not-for-profit entities, all references in this *Conceptual Framework* to 'primary users' or 'existing and potential investors, lenders and other creditors' should be read as a reference to the users mentioned in paragraph AusOB5.1.

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.*

OB11 To a large extent, financial reports are based on estimates, judgements and models rather than exact depictions. The *Conceptual Framework* establishes the concepts that underlie those

* For not-for-profit entities, also see paragraphs AusOB5.1 and AusOB5.2.

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estimates, judgements and models. The concepts are the goal towards which the Board and preparers of financial reports strive. As with most goals, the *Conceptual 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, 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.

AusOB16.1 In respect of not-for-profit entities, an indication of how well management has discharged its responsibilities to make efficient and effective use of the entity's resources would also, for

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

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

example, be provided by information about the quality, cost and effectiveness of goods and services provided.

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.

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

CHAPTER 2: *THE REPORTING ENTITY**

[to be added]

* This *Conceptual Framework* does not include guidance on the concept of the reporting entity until Chapter 2 is added. ~~However, for the time being, the guidance on the reporting entity concept in Statement of Accounting Concepts SAC 1 Definition of the Reporting Entity is relevant for identifying the characteristics of entities required to prepare general purpose financial reports.~~

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 *Conceptual 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^{*} 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 represents what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

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.

[†] In respect of not-for-profit entities, see the broader range of users identified in Chapter 1, paragraph AusOB5.1 and the comments in paragraph AusOB5.23.

^{*} Throughout this *Conceptual Framework*, the terms *qualitative characteristics* and *constraint* refer to the qualitative characteristics of, and the constraint on, useful financial information.

- 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.

[AusQC20.1 In respect of not-for-profit entities, users may also find it useful to compare the cost of similar goods or services provided by different entities for the same period.](#)

- 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.

AASB Basis for Conclusions on the revised Conceptual Framework, incorporating new Chapter 1: *The objective of general purpose financial reporting* and new Chapter 3: *Qualitative characteristics of useful financial information*

This Basis for Conclusions accompanies, but is not part of, the AASB Conceptual Framework. The IASB's Bases for Conclusions on Chapters 1 and 3 of its revised Conceptual Framework are reproduced separately without amendment.

Introduction [text omitted because unchanged]

Revised AASB Conceptual Framework

1. The AASB's policy regarding its Conceptual Framework is to adopt the current text of the IASB's Conceptual Framework without amendment, for application to for-profit entities. The AASB modifies that text, where appropriate, to address issues particularly affecting not-for-profit entities. As noted below, the AASB also considers, during the staged process for amending the IASB Conceptual Framework, whether to make new chapters of the AASB Conceptual Framework applicable to not-for-profit entities before the IASB completes Phase G of its Conceptual Framework project.

2. The revised AASB Conceptual Framework replaces the AASB *Framework for the Preparation and Presentation of Financial Statements* [AASB *Framework* (2004)]. It represents the first step in the staged amendment of the Conceptual Framework, and incorporates the two chapters resulting from the completion of Phase A of the IASB-FASB Conceptual Framework project. Chapter 4 includes the remainder of the text in the AASB *Framework* (2004) that has not been superseded by new Chapters 1 and 3. [That superseded text includes the references to Statements of Accounting Concepts SAC 1 *Definition of the Reporting Entity* and SAC 2 *Objective of General Purpose Financial Reporting* made in the AASB *Framework* (2004).] The text of Chapter 4, including the Aus paragraphs applicable to not-for-profit entities, is essentially unchanged¹ from the corresponding paragraphs of the AASB *Framework* (2004). In effect, the AASB *Framework* (2004) has been retained except for the matters covered by Chapters 1 and 3 of the revised AASB Conceptual Framework.

Not-for-Profit aspects of the Conceptual Framework

3. The AASB *Framework* (2004) applies to all Australian entities that prepare general purpose financial statements. As noted above, the IASB has decided to consider the applicability to not-for-profit entities of the various amendments it makes to the IASB Conceptual Framework in a later phase of its joint project with the FASB. Therefore, there are implications for the AASB Conceptual Framework arising from the IASB's plan to finalise parts of its new Conceptual Framework before it has considered the applicability of any new or revised concepts to other types of entities.

4. The AASB plans to consider, on a case-by-case basis, how to incorporate any amendments to the IASB Conceptual Framework into the AASB Conceptual Framework. The AASB's preliminary view is that, until the IASB considers the applicability of any new or revised concepts to other types of entities, it may be necessary to limit the applicability of some new or revised concepts to for-profit entities. For each amendment of the IASB Conceptual Framework made before completion of Phase G of that project, the AASB's decision on this issue will be affected by whether the revised parts of the IASB's Conceptual Framework are substantially different from the relevant parts of its existing Conceptual Framework, upon which the AASB's Conceptual Framework is closely based.

¹ As a consequence of Chapter 3, paragraph 4.38(b) includes a new footnote stating that information is reliable when it is complete, neutral and free from error (these three characteristics are the components of faithful representation).

Not-for-profit aspects of the two new chapters

5. The AASB decided the two new chapters of its Conceptual Framework should be applicable to all entities, with limited guidance added to the extent necessary for their application by not-for-profit entities. At this stage, therefore, the entire revised AASB Conceptual Framework applies to all entities. The AASB's aim is to maintain the status quo, as far as possible, regarding the additional guidance for not-for-profit entities included in the AASB *Framework* (2004), until its detailed review of the application of the concepts to not-for-profit entities. This detailed review will be undertaken when the IASB conducts Phase G of its Conceptual Framework project. ~~The AASB will also consider whether to amend its Conceptual Framework in relation to not-for-profit entities in the light of the Conceptual Framework of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants after the IPSASB Framework is completed. The AASB is also monitoring developments in the Conceptual Framework project of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants. In this Conceptual Framework, the guidance added in respect of not-for-profit entities was developed having regard to the IPSASB's proposals on the objectives of financial reporting and the qualitative characteristics of financial information set out in its December 2010 Exposure Draft for Phase 1 of its Conceptual Framework project.~~

Application [*text omitted because unchanged*]

Reporting Entity Concept

6. Consistent with the superseded IASB *Framework*, paragraph 8 of the AASB *Framework* (2004) notes that the Conceptual Framework applies to reporting entities and provides guidance on the meaning of a reporting entity. The AASB *Framework* (2004) includes a reference to the definition of a reporting entity in Statement of Accounting Concepts SAC 1 *Definition of the Reporting Entity*.

7. The revised IASB Conceptual Framework did not retain the existing Framework's paragraph on the reporting entity concept. It indicates Chapter 2 on *The Reporting Entity* will be added later. The comment period on the IASB's Exposure Draft of Chapter 2 closed in July 2010, and publication of Chapter 2 is expected in 2011. The revised AASB Conceptual Framework also excludes the paragraph dealing with the reporting entity concept. References to 'reporting entities' in this revised AASB Conceptual Framework are to any entities presenting general purpose financial reports. This meaning differs from the meaning of 'reporting entities' in SAC 1, ~~which is superseded when this version of the AASB Conceptual Framework is first applied. SAC 1 focuses on identifying the characteristics of entities that, in concept, should prepare general purpose financial reports. It defines 'reporting entities' as "all entities (including economic entities) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources".~~

8. Until completion of the next phase of the AASB's Differential Reporting project, Australian Accounting Standards (Tier 1) and Australian Accounting Standards – Reduced Disclosure Requirements (Tier 2) will be expressed as applying to 'reporting entities' as defined in AASB 1053 *Application of Tiers of Australian Accounting Standards*, using a definition similar to that in ~~superseded~~ SAC 1. ~~Therefore, until then, the guidance on the reporting entity concept in SAC 1 will remain important for the purpose of applying AASB 1053. The IASB's Exposure Draft of Chapter 2 does not propose a reporting entity concept that includes criteria for identifying the characteristics of entities that should prepare general purpose financial reports.~~

SAC 2 Objective of General Purpose Financial Reporting

9. Paragraph Aus14.1 of the AASB *Framework* (2004) notes that a more detailed discussion of the objective of financial statements is provided in Statement of Accounting Concepts SAC 2 *Objective of General Purpose Financial Reporting*. With the addition of extensive discussion of the objective of

general purpose financial reporting in Chapter 1 of the revised AASB Conceptual Framework, SAC 2 is superseded. Therefore, the revised AASB Conceptual Framework does not refer to SAC 2.

Additional Guidance for Application of the AASB Conceptual Framework to Not-for-Profit Entities

10. The IASB's Basis for Conclusions on Chapters 1 and 3 of the IASB's revised Conceptual Framework reflect that the IASB's concepts have been developed, at this stage, with only private sector business entities in mind. They do not incorporate the not-for-profit entity guidance added in Chapters 1 and 3 of the revised AASB Conceptual Framework. Because the AASB's revised Conceptual Framework applies to all entities, this Basis for Conclusions provides background on the additional guidance for not-for-profit entities provided in the revised AASB Conceptual Framework.

11. As noted above, the AASB's aim at this stage is to maintain the status quo, as far as possible, regarding the additional guidance for not-for-profit entities presently included in the AASB *Framework* (2004). For example, the additional guidance included in Chapter 4 of the revised AASB Conceptual Framework is unchanged from the additional guidance on those parts of the AASB *Framework* (2004). However, due to differences between the new chapters and corresponding existing text of the IASB's Conceptual Framework, some changes to the existing additional guidance are necessary. In developing that guidance, the AASB had regard to developments in the IPSASB's Conceptual Framework project.

12. In this regard, the revised IASB Conceptual Framework limits the primary users of general purpose financial reports to particular resource providers. However, the AASB regards recipients of goods and services as important users of general purpose financial reports of not-for-profit entities, whose information needs should be considered in development of Accounting Standards. In addition, whilst paragraph BC1.10 of the IASB's Basis for Conclusions on Chapter 1 notes that 'existing and potential investors, lenders and other creditors' include advisers of those parties, that phrase could be interpreted to exclude other parties performing a review or oversight function, such as members of parliament. Therefore, the AASB decided to specifically refer to parties performing a review or oversight function as users. Moreover, the AASB does not see a need to identify primary users of general purpose financial reports of not-for-profit entities because its focus is on the common information needs of the range of users of those reports. Therefore, in relation to not-for-profit entities, guidance is added to emphasise that all references in this *Conceptual Framework* to 'primary users' or 'existing and potential investors, lenders and other creditors' should be read as a reference to the range of users identified by the AASB. These perspectives of the AASB are reflected in paragraphs AusOB5.1 and AusOB5.23 of Chapter 1.

13. Paragraph AusOB5.2 of Chapter 1 provides guidance on how broadly references to making decisions about providing resources to an entity should be interpreted in relation to decisions taxpayers may make on the basis of information provided in general purpose financial reports.

14. Paragraph OB16 of Chapter 1 notes that providing information about an entity's return (which is useful for making decisions about providing resources to the entity) provides an indication of how well management has discharged its responsibilities to make efficient and effective use of the entity's resources. Paragraph AusOB16.1 notes that, for not-for-profit entities, information about the quality, cost and effectiveness of goods and services provided would also be useful for assessing management's performance. This reflects the comment in paragraph AusOB3.1 that providers of resources to not-for-profit entities ~~may not be as~~ are generally not concerned with obtaining a financial return on an investment in the entity.

New Zealand Financial Reporting Standards Board (FRSB) [text omitted because unchanged]

[Other components of the draft Framework and supporting materials are unchanged]