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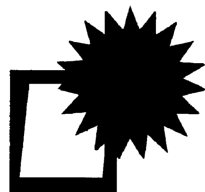

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This edition contains interpretations and application of the IFRS Standards, as approved by the International Accounting Standards Board (Board) for issue up to 31 December 2022, that are required to be applied for accounting periods beginning on 1 January 2023.

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CONTENTS

About the Authors *vii*

1 Introduction To International Financial Reporting Standards 1

2 Conceptual Framework 15

3 Presentation of Financial Statements 41

4 Statement of Financial Position 63

5 Statements of Profit or Loss and Other Comprehensive Income, and Changes In Equity 77

6 Statement of Cash Flows 99

7 Accounting Policies, Changes in Accounting Estimates and Errors 117

8 Inventories 139

9 Property, Plant and Equipment 157

10 Borrowing Costs 187

11 Intangible Assets 195

12 Investment Property 225

13 Impairment of Assets and Non-Current Assets Held for Sale 239

14 Consolidations, Joint Arrangements, Associates and Separate Financial Statements 261

15 Business Combinations 313

16 Shareholders' Equity 365

17 Share-Based Payment 389

18 Current Liabilities, Provisions, Contingencies and Events After the Reporting Period 423

19 Employee Benefits 457

20 Revenue from Contracts with Customers 483

21 Government Grants 523

22 Leases 537

23 Foreign Currency 567

24 Financial Instruments 599

25 Fair Value 729

26 Income Taxes 759

27 Earnings Per Share 797

28 Operating Segments 815

29 Related Party Disclosures 833

30 Accounting and Reporting by Retirement Benefit Plans 847

31 Agriculture 855

32 Extractive Industries 869

33 Accounting for Insurance Contracts 879

34 Interim Financial Reporting 909

35 Hyperinflation 929

36 First-Time Adoption of International Financial Reporting Standards 939

Index *963*

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1 INTRODUCTION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

Introduction 1
The Current Structure 3
Process of IFRS Standard-Setting 4
Appendix A: Current International Financial Reporting Standards (IAS/IFRS) And Interpretations (SIC/IFRIC) 6
Appendix B: IFRS for SMEs 8
Definition of SMEs 8
IFRS for SMEs is a Complete, Self-Contained Set of Requirements 9
Modifications of Full IFRS Made in the IFRS for SMEs 9
Disclosure Requirements Under the IFRS for SMEs 13
Maintenance of the IFRS for SMEs 13
Implications of the IFRS for SMEs 13
Application of the IFRS for SMEs 14

INTRODUCTION

The mission of the IFRS Foundation and the International Accounting Standards Board (IASB) is to develop International Financial Reporting Standards (IFRS) that bring transparency, accountability and efficiency to financial markets around the world. They seek to serve the public interest by fostering trust, growth and long-term stability in the global economy. The IFRS Foundation also created the International Sustainability Standards Board to develop sustainability standards. These standards are outside the scope of this book.

The driver for the convergence of historically dissimilar financial reporting standards has been mainly to facilitate the free flow of capital so that, for example, investors in the US would become more willing to finance business in, say, China or the Czech Republic. Access to financial statements which are written in the same "language" would help to eliminate a major impediment to investor confidence, sometimes referred to as "accounting risk," which adds to the more tangible risks of making such cross-border investments. Additionally, permission to list a company's equity or debt securities on an exchange has generally been conditional on making filings with national regulatory authorities. These regulators tend to insist either on conformity with local Generally Accepted Accounting Principles (GAAP) or on a formal reconciliation to local GAAP. These procedures are tedious and time-consuming, and the human resources and technical knowledge to carry them out are not always widely available, leading many would-be registrants to forgo the opportunity of broadening their investor bases and potentially lowering their costs of capital.

There were once scores of unique sets of financial reporting standards among the more developed nations ("national GAAP"). The year 2005 saw the beginning of a new era in the global conduct of business, and the fulfilment of a 30-year effort to create the financial reporting rules for a worldwide capital market. During that year's financial reporting cycle, the 27 European Union (EU) member states plus many other countries, including Australia, New Zealand and South Africa, adopted IFRS.

This easing of US registration requirements for foreign companies seeking to enjoy the benefits of listing their equity or debt securities in the US led understandably to a call by domestic companies to permit them also to choose freely between financial reporting under US GAAP and IFRS. By late 2008 the SEC appeared to have begun the process of acceptance, first for the largest companies in those industries having (worldwide) the preponderance of IFRS adopters, and later for all publicly held companies. However, a new SEC chair took office in 2009, expressing a concern that the move to IFRS, if it were to occur, should perhaps take place more slowly than had previously been indicated.

It had been highly probable that non-publicly held US entities would have remained restricted to US GAAP for the foreseeable future. However, the American Institute of Certified Public Accountants (AICPA), which oversees the private-sector auditing profession's standards in the US, amended its rules in 2008 to fully recognise IASB as an accounting standard-setting body (giving it equal status with the Financial Accounting Standards Board (FASB)), meaning that auditors and other service providers in the US could now issue opinions (or provide other levels of assurance, as specified under pertinent guidelines). This change, coupled with the promulgation by IASB of a long-sought standard providing simplified financial reporting rules for privately held entities (described later in this chapter), might be seen as increasing the likelihood that a more broadly based move to IFRS will occur in the US over the coming years.

The historic 2002 Norwalk Agreement—embodied in a Memorandum of Understanding (MoU) between the US standard setter, FASB, and the IASB—called for "convergence" of the respective sets of standards, and indeed since that time, a number of revisions of either US GAAP or IFRS have already taken place to implement this commitment.

Despite this commitment by the IASB and the FASB (collectively, the 'Boards') , certain projects such as financial instruments (impairment and hedge accounting), revenue recognition, leases and insurance contracts were deferred due to their complexity and the difficulty in reaching consensus views. The converged standard on revenue recognition, IFRS 15, was finally published in May 2014, although both Boards subsequently deferred its effective date to annual periods beginning on or after January 1, 2018. The standard on leasing, IFRS 16, was published in January 2016, bringing to completion the work of the Boards on the MoU projects. Details of these and other projects of the standard setters are included in a separate section in each relevant chapter of this book.

Despite the progress towards convergence described above, the SEC dealt a blow to hopes of future alignment in its strategic plan published in February 2014. The document states that the SEC "will consider, among other things, whether a single set of high-quality global accounting standards is achievable," which is a significant reduction in its previously expressed commitment to a single set of global standards. This leaves IFRS and US GAAP as the two comprehensive financial reporting frameworks in the world, with IFRS gaining more and more momentum.

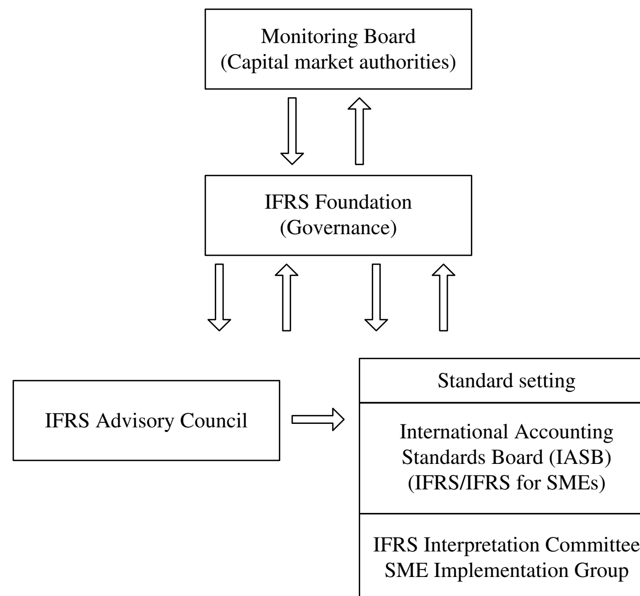
The completed MoU with FASB (and with other international organisations and jurisdictional authorities) has been replaced by a MoU with the Accounting Standards Advisory Forum (ASAF). The ASAF is an advisory group to the IASB, which was set up in 2013. It consists of national standard setters and regional bodies with an interest in financial reporting. Its objective is to provide an advisory forum where members can constructively contribute towards the achievement of the IASB's goal of developing globally accepted high-quality accounting standards. FASB's involvement with the IASB is now through ASAF.

The International Sustainability Standards Board (ISSB) is an independent body that develops and approves IFRS Sustainability Disclosure Standards and was formed in 2021, following various stakeholder consultations on demand for global sustainability standards. The ISSB operates under the oversight of the IFRS Foundation.

The ISSB has complete responsibility for all sustainability-related technical matters of the IFRS Foundation including full discretion in developing and pursuing its technical agenda and the preparation and issuing of exposure drafts, following the due process stipulated in the Constitution.

THE CURRENT STRUCTURE

The formal structure put in place in 2000 has the IFRS Foundation, a Delaware corporation, as its keystone (this was previously known as the IASC Foundation). The Trustees of the IFRS Foundation have both the responsibility to raise funds needed to finance standard setting, and the responsibility of appointing members to the IASB, the IFRS Interpretations Committee (IFRIC) and the IFRS Advisory Council. The structure was amended to incorporate the IFRS Foundation Monitoring Board ("Monitoring Board") in 2009, renaming and incorporating the SME Implementation Group in 2010 as follows:



The Monitoring Board is responsible for ensuring that the Trustees of the IFRS Foundation discharge their duties as defined by the IFRS Foundation Constitution and for approving the appointment or reappointment of Trustees. The Monitoring Board consists of the Boards (as defined above) and the Growth and Emerging Markets Committees of the IOSCO (The International Organization of Securities Commissions—an international body that brings together the world's securities regulators and is recognised as the global standard setter for the securities sector), the Financial Services Agency of Japan (JFSA), the SEC, the Brazilian Securities Commission (CVM), the Financial Services Commission of Korea (FSC) and Ministry of Finance of the People's Republic of China (China MOF). The Basel Committee on Banking Supervision participates as an observer.

The IFRS Foundation is governed by trustees and reports to the Monitoring Board. The IFRS Foundation has fundraising responsibilities and oversees the standard-setting work, the IFRS structure and strategy. It is also responsible for a five-yearly, formal, public review of the Constitution.

The IFRS Advisory Council is the formal advisory body to the IASB and the Trustees of the IFRS Foundation. Members consist of user groups, preparers, financial analysts, academics, auditors, regulators, professional accounting bodies and investor groups.

The IASB is an independent body that is solely responsible for establishing IFRS, including the IFRS for small and medium-sized enterprises (SMEs). The IASB also approves new interpretations.

The IFRS Interpretations Committee (the Interpretations Committee) is a committee comprised partly of technical partners in audit firms but also includes preparers and users. The Interpretations Committee's function is to answer technical queries from constituents about how to interpret IFRS—in effect, filling in the cracks between different requirements. It also proposes modifications to standards to the IASB, in response to perceived operational difficulties or the need to improve consistency. The Interpretations Committee liaises with the US Emerging Issues Task Force and similar bodies and standard setters to preserve convergence at the level of interpretation.

Working relationships are set up with local standard setters who have adopted or converged with IFRS, or are in the process of adopting or converging with IFRS.

PROCESS OF IFRS STANDARD-SETTING

The IASB has a formal due process, which is currently set out in the *IFRS Foundation Due Process Handbook* issued in February 2013 by the Due Process Oversight Committee (DPOC), and updated in June 2016 to include the final IFRS Taxonomy due process.

The DPOC is responsible for:

1. reviewing regularly, and in a timely manner, together with the IASB and the IFRS Foundation staff, the due process activities of the standard-setting activities of the IASB;
2. reviewing, and proposing updates to, the *Due Process Handbook* that relates to the development and review of Standards, Interpretations and the IFRS Taxonomy so as to ensure that the IASB procedures are best practice;
3. reviewing the composition of the IASB's consultative groups to ensure an appropriate balance of perspectives and monitoring the effectiveness of those groups;

4. responding to correspondence from third parties about due process matters, in collaboration with the Director for Trustee Activities and the technical staff;
5. monitoring the effectiveness of the IFRS Advisory Council ("Advisory Council"), the Interpretations Committee and other bodies of the IFRS Foundation relevant to its standard-setting activities; and
6. making recommendations to the Trustees about constitutional changes related to the composition of committees that are integral to due process, as appropriate.

As a minimum, a proposed standard should be exposed for comment, and these comments should be reviewed before issuance of a final standard, with debates open to the public. However, this formal process is rounded out in practice, with wider consultation taking place on an informal basis.

The IASB's agenda is determined in various ways. Suggestions are made by the Trustees, the IFRS Advisory Council, liaison standard setters, the international accounting firms and others. These are debated by IASB and tentative conclusions are discussed with the various consultative bodies. Long-range projects are first put on the research agenda, which means that preliminary work is being done on collecting information about the problem and potential solutions. Projects can also arrive on the current agenda outside that route.

Once a project reaches the current agenda, the formal process is that the staff (a group of about 20 technical staff permanently employed by the IASB) drafts papers which are then discussed by IASB in open meetings. Following that debate, the staff rewrites the paper, or writes a new paper, which is then debated at a subsequent meeting. In theory at least, there is an internal process where the staff proposes solutions, and IASB either accepts or rejects them. In practice, the process is more involved: sometimes (especially for projects such as financial instruments) individual Board members are delegated special responsibility for the project, and they discuss the problems regularly with the relevant staff, helping to build the papers that come to the Board. Equally, Board members may write or speak directly to the staff outside of the formal meeting process to indicate concerns about one matter or another.

The due process comprises six stages: (1) setting the agenda; (2) project planning; (3) developing and publishing a Discussion Paper; (4) developing and publishing an Exposure Draft; (5) developing and publishing the IFRS; and (6) procedures after an IFRS is issued. The process also includes discussion of Staff Papers outlining the principal issues and analysis of comments received on Discussion Papers and Exposure Drafts. A pre-ballot draft is normally subject to external review. A near-final draft is also posted on the limited access website. If all outstanding matters are resolved, the final ballot is applied.

Final ballots on the standard are carried out in secret, but otherwise the process is quite open, with outsiders able to consult project summaries on the IASB website and attend Board meetings if they wish. Of course, the informal exchanges between staff and Board on a day-to-day basis are not visible to the public, nor are the meetings where IASB takes strategic and administrative decisions.

The basic due process can be modified in different circumstances. The Board may decide not to issue Discussion Papers or to reissue Discussion Papers and Exposure Drafts.

The IASB also has regular public meetings with the Capital Markets Advisory Committee (CMAC) and the Global Preparers Forum (GPF), among others. Special groups are set up from time to time. An example was the Financial Crisis Advisory Group, which was

set up to consider how improvements in financial reporting could help enhance investor confidence in financial markets in the wake of the financial crisis of 2008. Formal working groups are established for certain major projects to provide additional practical input and expertise. Apart from these formal consultative processes, IASB also carries out field trials of some standards (examples of this include performance reporting and insurance), where volunteer preparers apply the proposed new standards. The IASB may also hold some form of public consultation during the process, such as roundtable discussions. The IASB engages closely with stakeholders around the world such as investors, analysts, regulators, business leaders, accounting standard setters and the accountancy profession.

The revised *IFRS Foundation Due Process Handbook* has an introduction section dealing with oversight, which identifies the responsibilities of the DPOC. The work of the IASB is divided into development and maintenance projects. Developments are comprehensive projects such as major changes and new IFRS Standards. Maintenance consists of narrow scope amendments. A research programme is also described that should form the development base for comprehensive projects. Each phase of a major project should also include an effects analysis detailing the likely cost and benefits of the project.

Appendix A: Current International Financial Reporting Standards (IAS/IFRS) And Interpretations (SIC/IFRIC)

IFRS 1	First-Time Adoption of IFRS
IFRS 2	Share-Based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations
IFRS 6	Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IFRS 8	Operating Segments
IFRS 9	Financial Instruments (effective for accounting periods commencing on or after January 1, 2018 and will supersede IAS 39 and IFRIC 9)
IFRS 10	Consolidated Financial Statements
IFRS 11	Joint Arrangements
IFRS 12	Disclosure of Interest in Other Entities
IFRS 13	Fair Value Measurement
IFRS 14	Regulatory Deferral Accounts
IFRS 15	Revenue from Contracts with Customers
IFRS 16	Leases
IFRS 17	Insurance Contracts
IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 7	Statement of Cash Flows
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events after the Reporting Period
IAS 11	Construction Contracts (replaced by IFRS 15)
IAS 12	Income Taxes
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 18	Revenue (replaced by IFRS 15)

IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 23	Borrowing Costs
IAS 24	Related-Party Disclosure
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Separate Financial Statements
IAS 28	Investments in Associates and Joint Ventures
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 32	Financial Instruments: Presentation
IAS 33	Earnings per Share
IAS 34	Interim Financial Reporting
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement (replaced by IFRS 9)
IAS 40	Investment Property
IAS 41	Agriculture
IFRIC 1	Changes in Existing Decommissioning, Restoration and Similar Liabilities
IFRIC 2	Members' Shares in Co-operative Entities and Similar Instruments
IFRIC 4	Determining Whether an Arrangement Contains a Lease
IFRIC 5	Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
IFRIC 6	Liabilities Arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment
IFRIC 7	Applying the Restatement Approach under IAS 29, *Financial Reporting in Hyperinflationary Economies*
IFRIC 9	Reassessment of Embedded Derivatives (replaced by IFRS 9)
IFRIC 10	Interim Financial Reporting and Impairment
IFRIC 12	Service Concession Arrangements
IFRIC 13	Customer Loyalty Programmes (replaced by IFRS 15)
IFRIC 14	IAS 19—*The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*
IFRIC 15	Agreements for the Construction of Real Estate (replaced by IFRS 15)
IFRIC 16	Hedges of a Net Investment in a Foreign Operation
IFRIC 17	Distributions of Non-cash Assets to Owners
IFRIC 18	Transfer of Assets from Customers (replaced by IFRS 15)
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments
IFRIC 20	Stripping Costs in the Production Phase of a Surface Mine
IFRIC 21	Levies
IFRIC 22	Foreign Currency Transactions and Advance Consideration
IFRIC 23	Uncertainty over Income Tax Treatments
SIC 7	Introduction of the Euro
SIC 10	Government Assistance—No Specific Relation to Operating Activities
SIC 25	Income Taxes—Changes in the Tax Status of an Enterprise or its Shareholders
SIC 29	Disclosure—Service Concession Arrangements
SIC 32	Intangible Assets—Website Costs

APPENDIX B: IFRS FOR SMEs

A long-standing debate among professional accountants, users and preparers—between those advocating some form of simplified financial reporting standards for smaller or non-publicly responsible entities (however they are defined), and those arguing that all reporting entities purporting to adhere to officially mandated accounting standards should do so with absolute faithfulness—was resolved on July 9, 2009 with the publication of the *International Financial Reporting Standard (IFRS) for Small and Medium-Sized Entities (IFRS for SMEs)*. Notwithstanding the name, it is actually intended as an optional, somewhat simplified and choice-limited comprehensive financial reporting standard for enterprises not having public accountability. Many of the recognition and measurement principles in full IFRS have been simplified, disclosures significantly reduced and topics not relevant to SMEs omitted from the IFRS for SMEs. The IASB carried out a comprehensive review of the *IFRS for SMEs* which it completed in May 2015 resulting in limited amendments to the standard. A complete revised version of the standard was issued in December 2015 and is effective from January 1, 2017. The IASB expects that revisions to the standard will be limited to once every three years.

The *IFRS for SMEs* is not immediately updated for any changes to full IFRS but, as noted above, the IASB issued amendments in the first half of 2015 and then anticipates updating the standard every three years thereafter.

The IASB has published a Request for information for commentary at 27 October 2020 to seeks views on how to align the IFRS for SMEs with full IFRS. The next step is to considers when the second comprehensive review should be done.

Definition of SMEs

The *IFRS for SMEs* is intended for entities that do not have public accountability. An entity has public accountability—and therefore would not be permitted to use the *IFRS for SMEs*—if it meets either of the following conditions: (1) it has issued debt or equity securities in a public market; or (2) it holds assets in a fiduciary capacity, as one of its primary businesses, for a broad group of outsiders. The latter category of entity would include most banks, insurance companies, securities brokers/dealers, pension funds, mutual funds and investment banks. The standard does not impose a size test in defining SMEs, notwithstanding its name.

The standard also states that it is intended for entities which publish financial statements for external users, as with IFRS and US GAAP. In other words, the standard is not intended to govern internal or managerial reporting, although there is nothing to prevent such reporting from fully conforming to such standards.

A subsidiary of an entity that employs full IFRS, or an entity that is part of a consolidated entity that reports in compliance with IFRS, may report, on a stand-alone basis, in accordance with the *IFRS for SMEs*, if the financial statements are so identified, and if the subsidiary does not have public accountability itself. If this is done, the standard must be fully complied with, which could mean that the subsidiary's stand-alone financial statements would differ from how they are presented within the parent's consolidated financial statements; for example, in the subsidiary's financial statements prepared in accordance with the *IFRS for SMEs*, borrowing costs incurred in connection with the construction of long-lived assets would be expensed as incurred, but those same borrowing costs would be capitalised in the consolidated financial statements, since IAS 23 as most recently revised no longer

provides the option of immediate expensing. In the authors' view, this would not be optimal financial reporting, and the goals of consistency and comparability would be better served if the stand-alone financial statements of the subsidiary were also based on full IFRS.

IFRS for SMEs is a Complete, Self-Contained Set of Requirements

The *IFRS for SMEs* is a complete and comprehensive standard, and accordingly contains much or most of the vital guidance provided by full IFRS. For example, it defines the qualities that are needed for IFRS-compliant financial reporting (reliability, understandability, et al.), the elements of financial statements (assets, liabilities, et al.), the required minimum captions in the required full set of financial statements, the mandate for comparative reporting and so on. There is no need for an entity reporting under this standard to refer elsewhere (other than for guidance in IAS 39, discussed below), and indeed it would be improper to do so.

An entity having no public accountability, which elects to report in conformity with the *IFRS for SMEs*, must make an "explicit and unreserved" declaration to that effect in the notes to the financial statements. As with a representation that the financial statements comply with full IFRS, if this representation is made, the entity must comply fully with all relevant requirements in the standard(s).

Many options under full IFRS remain under the *IFRS for SMEs*. For example, a single statement of comprehensive income may be presented, with profit or loss being an intermediate step in the derivation of the period's comprehensive income or loss, or alternatively a separate statement of income can be displayed, with profit or loss (the "bottom line" in that statement) then being the opening item in the separate statement of comprehensive income. Likewise, most of the mandates under full IFRS, such as the requirement to consolidate special-purpose entities that are controlled by the reporting entity, also exist under the *IFRS for SMEs*.

Modifications of Full IFRS Made in the IFRS for SMEs

Compared to full IFRS, the aggregate length of the standard, in terms of number of words, has been reduced by more than 90%. This was achieved by removing topics deemed not to be generally relevant to SMEs, by eliminating certain choices of accounting treatments and by simplifying methods for recognition and measurement. These three sets of modifications to the content of full IFRS, which are discussed below, respond both to the perceived needs of users of SMEs' financial statements and to cost-benefit concerns. According to the IASB, the set of standards in the *IFRS for SMEs* will be suitable for a typical enterprise having 50 employees and will also be valid for so-called micro-entities having only a single or a few employees. However, no size limits are stipulated in the standard, and thus even very large entities could conceivably elect to apply the *IFRS for SMEs*, assuming they have no public accountability as defined in the standard, and that no objections are raised by their various other stakeholders, such as lenders, customers, vendors or joint venture partners.

Omitted topics. Certain topics covered in the full IFRS were viewed as not being relevant to typical SMEs (e.g., rules pertaining to transactions that were thought to be unlikely to occur in an SME context), and have accordingly been omitted from the standard. This leaves open the question of whether SMEs could optionally seek expanded guidance in the full IFRS. Originally, when the Exposure Draft of the *IFRS for SMEs* was released, cross-references to the full IFRS were retained, so that SMEs would not be precluded from applying any of the financial reporting standards and methods found in IFRS, essentially making

the *IFRS for SMEs* standard entirely optional on a component-by-component basis. However, in the final *IFRS for SMEs* standard all of these cross-references have been removed, with the exception of a reference to IAS 39, *Financial Instruments: Recognition and Measurement*, thus making the *IFRS for SMEs* a fully stand-alone document, not to be used in conjunction with the full IFRS. An entity that would qualify for use of the *IFRS for SMEs* must therefore make a decision to use full IFRS or the *IFRS for SMEs* exclusively.

Topics addressed in full IFRS, which are entirely omitted from the *IFRS for SMEs*, are as follows:

- Earnings per share;
- Interim reporting;
- Segment reporting;
- Special accounting for assets held for sale;
- Insurance (since, because of public accountability, such entities would be precluded from using *IFRS for SMEs* in any event).

Thus, for example, if a reporting entity concluded that its stakeholders wanted presentation of segment reporting information, and the entity's management wished to provide that to them, it would elect to prepare financial statements in conformity with the full set of IFRS, rather than under the *IFRS for SMEs*.

Only the simpler option included. Where full IFRS provides an accounting policy choice, generally only the simpler option is included in *IFRS for SMEs*. SMEs will not be permitted to employ the other option(s) provided by the full IFRS, as had been envisioned by the Exposure Draft that preceded the standard, as all cross-references to the full IFRS have been eliminated.

The simpler options selected for inclusion in *IFRS for SMEs* are as follows, with the excluded alternatives noted:

- For investment property, measurement is driven by circumstances rather than a choice between the cost and fair value models, both of which are permitted under IAS 40, *Investment Property*. Under the provisions of the *IFRS for SMEs*, if the fair value of investment property can be measured reliably without undue cost or effort, the fair value model must be used. Otherwise, the cost method is required.
- Use of the cost-amortisation-impairment model for intangible assets is required; the revaluation model set out in IAS 38, *Intangible Assets*, is not allowed.
- Immediate expensing of borrowing costs is required; the capitalisation model stipulated under revised IAS 23 is not deemed appropriate for SMEs.
- Jointly controlled entities cannot be accounted for under the proportionate consolidation method under the *IFRS for SMEs* but can be under full IFRS as they presently exist. The *IFRS for SMEs* does permit the use of the fair value-through-earnings method as well as the equity method, and even the cost method can be used when it is not possible to obtain price or value data.
- Entities electing to employ the *IFRS for SMEs* are required to expense development costs as they are incurred, together with all research costs. Full IFRS necessitates making a distinction between research and development costs, with the former expensed and the latter capitalised and then amortised over an appropriate period receiving economic benefits.

It should be noted that the Exposure Draft that preceded the original version of the *IFRS for SMEs* would have required that the direct method for the presentation of operating

cash flows be used, to the exclusion of the less desirable, but vastly more popular, indirect method. The final standard has retreated from this position and permits both methods, so it includes necessary guidance on application of the indirect method, which was absent from the draft.

All references to full IFRS found in the original draft of the standard have been eliminated, except for the reference to IAS 39, which may be used, optionally, by entities reporting under the *IFRS for SMEs*. The general expectation is that few reporting entities will opt to do this, since the enormous complexity of that standard was a primary impetus to the development of the streamlined *IFRS for SMEs*.

It is inevitable that some financial accounting or reporting situations will arise for which the *IFRS for SMEs* itself will not provide complete guidance. The standard provides a hierarchy, of sorts, of additional literature upon which reliance could be placed, in the absence of definitive rules contained in the *IFRS for SMEs*. First, the requirements and guidance that are set out for highly similar or closely related circumstances would be consulted within the *IFRS for SMEs*. Secondly, the *Concepts and Pervasive Principles* section (Section 1.2) of the standard would be consulted, in the hope that definitions, recognition criteria and measurement concepts (e.g., for assets, revenues) would provide the preparer with sufficient guidance to reason out a valid solution. Thirdly, and lastly, full IFRS is identified explicitly as a source of instruction. Although reference to US (or other) GAAP is not suggested as an alternate, (since full IFRS permits preparers to consider the requirements of another GAAP, if based on a framework similar to full IFRS, where an item is not covered under IFRS such as the concept of merger accounting) this does not permit departure from IFRS.

Recognition and measurement simplifications. For the purposes of the *IFRS for SMEs*, IASB has made significant simplifications to the recognition and measurement principles included in full IFRS. Examples of the simplifications to the recognition and measurement principles found in full IFRS are as follows:

1. *Financial instruments*:

   a. *Classification of financial instruments*. Only two categories for financial assets (cost or amortised cost, and fair value through profit or loss) are provided. The fair value through other comprehensive income is not available.

      (1) The *IFRS for SMEs* requires an amortised cost model for most debt instruments, using the effective interest rate as at initial recognition. The effective rate should consider all contractual terms, such as prepayment options. Investments in non-convertible and non-puttable preference shares and non-puttable ordinary shares that are publicly traded or whose fair value can otherwise be measured reliably are to be measured at fair value with changes in value reported in current earnings. Most other basic financial instruments are to be reported at cost less any impairment recognised. Impairment or uncollectability must always be assessed, and, if identified, recognised immediately in profit or loss; recoveries to the extent of losses previously taken are also recognised in profit or loss.

      (2) For more complex financial instruments (such as derivatives), fair value through profit or loss is generally the applicable measurement method, with cost less impairment being prescribed for those instruments (such as equity instruments lacking an objectively determinable fair value) for which fair value cannot be ascertained.

(3) Assets which would generally not meet the criteria as being basic financial instruments include: (a) asset-backed securities, such as collateralised mortgage obligations, repurchase agreements and securitised packages of receivables; (b) options, rights, warrants, futures contracts, forward contracts and interest rate swaps that can be settled in cash or by exchanging another financial instrument; (c) financial instruments that qualify and are designated as hedging instruments in accordance with the requirements in the standard; (d) commitments to make a loan to another entity; and, (e) commitments to receive a loan if the commitment can be net settled in cash. Such instruments would include: (a) an investment in another entity's equity instruments other than non-convertible preference shares and non-puttable ordinary and preference shares; (b) an interest rate swap, which returns a cash flow that is positive or negative, or a forward commitment to purchase a commodity or financial instrument, which is capable of being cash settled and which, on settlement, could have positive or negative cash flow; (c) options and forward contracts, because returns to the holder are not fixed; (d) investments in convertible debt, because the return to the holder can vary with the price of the issuer's equity shares rather than just with market interest rates; and, (e) a loan receivable from a third party that gives the third party the right or obligation to prepay if the applicable taxation or accounting requirements change.

b. *Derecognition*. In general, the principle to be applied is that, if the transferor retains any significant risks or rewards of ownership, derecognition is not permitted, although if full control over the asset is transferred, derecognition is valid even if some very limited risks or rewards are retained. The complex "passthrough testing" and "control retention testing" of IAS 39 can thus be omitted, unless full IAS 39 is elected for by the reporting entity. For financial liabilities, derecognition is permitted only when the obligation is discharged, canceled or expires.
c. *Simplified hedge accounting*. Much more simplified hedge accounting and less strict requirements for periodic recognition and measurement of hedge effectiveness are specified than those set out in IAS 39.
d. *Embedded derivatives*. No separate accounting for embedded derivatives is required.

2. *Goodwill impairment*: An indicator approach has been adopted to supersede the mandatory annual impairment calculations in IFRS 3, *Business Combinations*. Additionally, goodwill and other indefinite-lived assets are considered to have finite lives, thus reducing the difficulty of assessing impairment.
3. *All research and development costs are expensed as incurred* (IAS 38 requires capitalisation after commercial viability has been assessed).
4. *The cost method or fair value through profit or loss of accounting for associates and joint ventures may be used* (rather than the equity method or proportionate consolidation).
5. *Simplified accounting for deferred taxes*: The "temporary difference approach" for recognition of deferred taxes under IAS 12, *Income Taxes*, is allowed with a minor

modification. Current and deferred taxes are required to be measured initially at the rate applicable to undistributed profits, with adjustment in subsequent periods if the profits are distributed.

6. *Less use of fair value for agriculture* (being required only if fair value is readily determinable without undue cost or effort).
7. *Share-based payment*: Equity-settled share-based payments should always be recognised as an expense and the expense should be measured on the basis of observable market prices, if available. When there is a choice of settlement, the entity should account for the transaction as a cash-settled transaction, except under certain circumstances.
8. *Finance leases*: A simplified measurement of a lessee's rights and obligations is prescribed.
9. *First-time adoption*: Less prior period data would have to be restated than under IFRS 1, *First-time Adoption of International Financial Reporting Standards*. An impracticability exemption has also been included.

Because the default measurement of financial instruments would be fair value through profit and loss under the *IFRS for SMEs*, some SMEs may actually be required to apply more fair value measurements than do entities reporting under full IFRS.

Disclosure Requirements Under the IFRS for SMEs

There are certain reductions in disclosure requirements under the *IFRS for SMEs* compared to full IFRS, but these are relatively minor and alone would not drive a decision to adopt the standard. Furthermore, key stakeholders, such as banks, often prescribe supplemental disclosures (e.g., major contracts, compensation agreements), which exceed what is required under IFRS, and this would be likely to continue to be true under the *IFRS for SMEs*.

Maintenance of the IFRS for SMEs

SMEs have expressed concerns not only over the complexity of IFRS, but also about the frequency of changes to standards. To respond to these issues, IASB intends to update the *IFRS for SMEs* approximately once every three years via an "omnibus" standard, with the expectation that any new requirements would not have mandatory application dates sooner than one year from issuance. Users are thus assured of having a moderately stable platform of requirements.

Implications of the IFRS for SMEs

The *IFRS for SMEs* is a significant development, which appears to be having a real impact on the future accounting and auditing standards issued by organisations participating in the standard-setting process.

On March 6, 2007, the FASB and the AICPA announced that the newly established Private Company Financial Reporting Committee (PCFRC) will address the financial reporting needs of private companies and of the users of their financial statements. In addition, on May 23, 2012, the Financial Accounting Foundation announced its decision to make process and structural improvements in private company financial reporting by creating the Private Company Council (PCC). The primary objective of PCFRC and PCC is to help the

FASB determine whether and where there should be specific differences in prospective and existing accounting standards for private companies.

In many continental European countries, a close link exists between the statutory financial statements and the results reported for income tax purposes. The successful implementation of SME Standards will require breaking the traditional bond between the financial statements and the income tax return, and may well trigger a need to amend company laws.

Since it is imperative that international convergence of accounting standards be accompanied by convergence of audit standards, differential accounting for SMEs will affect regulators such as the Public Company Accounting Oversight Board (PCAOB) and the SEC. The *IFRS for SMEs* may be a welcome relief for auditors as it will decrease the inherent risk that results from the numerous choices and wide-ranging judgement required by management when utilising the full version of IFRS. The ultimate success of the *IFRS for SMEs* will depend on the extent to which users, preparers and their auditors believe the standard meets their needs.

Application of the IFRS for SMEs

The application of the *IFRS for SMEs* is not covered in this publication. However, there is a detailed accounting manual available, which addresses the requirements, application and interpretation of the standard—*Applying IFRS for SMEs* (available from Wiley).

2 CONCEPTUAL FRAMEWORK

Introduction 15
Conceptual Framework for Financial Reporting 2018 15
Structure 15
Status and Purpose 16
1. The Objective of General-Purpose Financial Reporting 16
2. Qualitative Characteristics of Useful Financial Information 17
3. Financial Statements and the Reporting Entity 19
4. The Elements of Financial Statements 20
5. Recognition and Derecognition 24
6. Measurement 27
7. Presentation and Disclosure 34
8. Concepts of Capital and Capital Maintenance 35
Hierarchy of Standards 36
IFRS Practice Statement 1—Management Commentary 37
Nature and Scope 37
Principles 37
Qualitative Characteristics 38
Presentation 38
Elements 38
Future Developments 39
US GAAP Comparison 39

INTRODUCTION

In March 2018 the IASB completed the project with the issue of its revised *Conceptual Framework for Financial Reporting* (the 2018 framework).

The IASB and IFRS Interpretations Committee are using the 2018 framework in developing and revising standards and interpretations.

CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING 2018

Structure

The 2018 framework consists of an introduction setting the status and purpose of the framework, and eight chapters as follows:

1. **The Objective of General-Purpose Financial Reporting:** this chapter is largely unchanged from the 2010 framework, although the IASB has clarified why information used in assessing stewardship is needed to achieve the objective of financial reporting;
2. **Qualitative Characteristics of Useful Financial Information:** this chapter is largely unchanged from the 2010 framework, although the IASB has clarified the roles of prudence, measurement uncertainty and substance over form in assessing whether information is useful;
3. **Financial Statements and the Reporting Entity:** this is a new chapter, which provides guidance on determining the appropriate boundary of a reporting entity;

4. **The Elements of Financial Statements:** the definitions of assets and liabilities have been refined and, following on from this, the definitions of income and expenses have been updated;
5. **Recognition and Derecognition:** the previous recognition criteria have been revised to refer explicitly to the qualitative characteristics of useful information. New guidance on derecognition has been provided;
6. **Measurement:** this chapter has been expanded significantly to describe the information which measurement bases provide and explanations of the factors to be considered when selecting a measurement basis;
7. **Presentation and Disclosure:** this is a new chapter, which sets out concepts that describe how information should be presented and disclosed in financial statements; and
8. **Concepts of Capital and Capital Maintenance:** the material in this chapter has been carried forward unchanged from the 2010 framework, into which it was transferred unchanged from the IASC's 1989 framework.

Status and Purpose

The 2018 framework describes the objective of, and the concepts for, general-purpose financial reporting.

The purpose of the 2018 framework is to:

a. assist the IASB to develop standards which are based on consistent concepts;
b. assist preparers to develop consistent accounting policies when no standard applies to a particular transaction or other event; and
c. assist all parties to understand and interpret the standards.

The 2018 framework is not a standard, and nothing in the framework overrides any standard or any requirement which the standards contain.

The main aim is therefore to help the IASB in preparing new standards and reviewing existing standards. The conceptual framework also helps national standard setters, preparers, auditors, users and others interested in IFRS in achieving their objectives. The conceptual framework is, however, not itself regarded as an IFRS and therefore cannot override any IFRS although there might be potential conflicts. The IASB believes that over time any such conflicts will be eliminated.

1. The Objective of General-Purpose Financial Reporting

The objective of general-purpose financial reporting is defined in the 2018 framework as follows:

> To provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.

The decisions to be made concern:

a. buying, selling or holding equity and debt instruments;
b. providing or settling loans and other forms of credit; or
c. exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.

Since investors, lenders and other creditors are generally not in a position to have the necessary information issued directly to them they have to rely on general-purpose financial reports to make decisions. They are therefore identified as the primary users of general-purpose financial reports.

The framework recognises that users need to evaluate the prospects for future net cash inflows to an entity. To assess these net inflows, information is needed of an entity's resources, claims to those resources and the ability of management and the governing board to discharge their responsibility to use the resources. Assessing stewardship is thus included in the ability of users to assess the net cash flows of an entity.

It is noted that general-purpose financial reports do not provide information regarding the value of a reporting entity but assist in making such valuations.

General-purpose financial reports provide information about the financial position of an entity, its resources and claims against those resources. The entity's financial position is affected by the economic resources which the entity controls, its financial structure, its liquidity and solvency and its capacity to adapt to changes in the environment in which it operates. Information is provided about the strengths and weaknesses of an entity and its ability to acquire finance.

Changes in an entity's economic resources and claims are a result of an entity's financial performance and are derived from other transactions such as issuing debt and equity instruments.

Financial performance is assessed both through the process of accrual accounting and changes in cash flows. Accrual accounting depicts the effects of transactions and other events and circumstances on a reporting entity's economic resources and claims in the period in which those effects occur, even if the resultant cash payments and receipts arise in a different period. Information about the cash flows which occur during a period assists users in assessing the entity's ability to generate future net cash flows. Accrual accounting and reporting of cash flows both help users to understand the return on the resources of an entity and how well management has discharged its stewardship responsibilities.

Changes in economic resources and claims may also occur for reasons other than financial performance. For example, debt or equity instruments may be issued, resulting in cash inflows. Information about these types of changes is necessary to provide users with a complete understanding of why economic resources and claims have changed, and the implications of those changes for future financial performance.

Information about how efficiently and effectively the reporting entity's management has discharged its responsibilities in relation to the entity's economic resources helps users to assess management's stewardship of those resources. This can assist users in assessing management's future stewardship of the entity's resources.

2. Qualitative Characteristics of Useful Financial Information

The qualitative characteristics identify the information which is most useful in financial reporting. Financial reporting includes information in financial statements and financial information that is provided by other means. The qualitative characteristics are divided into fundamental qualitative characteristics and enhancing qualitative characteristics.

The fundamental qualitative characteristics are relevance and faithful representation. Financial information is useful if it possesses these characteristics.

The enhancing qualitative characteristics are comparability, verifiability, timeliness and understandability. The usefulness of financial information is enhanced if it possesses these characteristics.

No hierarchy of applying the qualitative characteristics is determined. The application is, however, a process. The fundamental characteristics are applied by following a three-step process. First, it is necessary to identify the economic phenomenon which has a potential to be useful. Secondly, the type of information regarding the phenomenon that is most relevant that could be faithfully represented should be identified. Finally, it should be determined whether the information is available and could be faithfully represented.

It may be necessary to make a trade-off between relevance and faithful representation to meet the objective of financial reporting, which is to provide useful information about economic phenomena. It is possible that the most relevant information about an economic phenomenon could be a highly uncertain estimate. Measurement uncertainty can sometimes be so high that it may be questionable whether the estimate would provide a sufficiently faithful representation of the economic phenomenon. In such a case, it would be necessary to determine whether the most useful information would be provided by that estimate accompanied by a detailed description of the estimate and an explanation of the uncertainties which accompany it, or whether it would be more useful to provide a less relevant estimate which nonetheless was subject to lower measurement uncertainty.

Once the process described above has been followed, the enhancing characteristics are applied to confirm or enhance the quality of the information.

The fundamental qualitative characteristics are explained as follows:

- *Relevant* financial information can make a difference in decision making. Information can make a difference if it has predictive value, confirmatory value or both. Financial information has predictive value if it can be used as an input in the process to predict future outcomes and has confirmatory value if it confirms or changes previous evaluations. Materiality is included in relevance. Information is material if omitting it or misstating it could influence the decisions of users.
- *Faithful representation* is achieved when information is complete, neutral and free from error. A complete depiction includes all information needed to understand the economic phenomena under consideration, including any necessary descriptions and explanations. A neutral depiction is one which is without bias in the selection or presentation of financial information. Neutrality is supported by the exercise of prudence, which means that assets and income are not overstated, and liabilities and expenses are not understated. (Equally, prudence does not allow for the understatement of assets or income, or the overstatement of liabilities or expenses.) "Free from error" means that there are no errors or omissions in the description of the phenomena and in the process applied (although this does not require that information be perfectly accurate in all respects). The framework acknowledges that in many instances it may be necessary to include estimates in financial information.

The enhancing qualitative characteristics are explained as follows:

- *Comparability* enables users to identify similarities in, and differences between, items. 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. *Consistency* (the use of the same methods for the same items, either from period to period within the same entity or in a single period across entities) aids comparability, although it is not the same as comparability.

- *Verifiability* helps to assure users that information represents faithfully the economic phenomena which it purports to represent. It implies that knowledgeable and independent observers could reach a consensus (but not necessarily absolute agreement) that the information does represent faithfully the economic phenomena it purports to represent without material error or bias, or that an appropriate recognition or measurement method has been applied without material error or bias. It means that independent observations would yield essentially the same measure or conclusions.
- *Timeliness* means that the information is provided to users in time to be capable of influencing their decisions. Generally, the older the information is, the less useful it may be to the users.
- *Understandability* is classifying, characterising and presenting information clearly and concisely. Understandability enables users who have a reasonable knowledge of business, economic and financial activities and financial reporting, and who apply reasonable diligence to comprehend the information, to gain insights into the reporting entity's financial position and results of operations, as intended.

The cost constraint is the only constraint included regarding the information provided in useful financial reports. At issue is whether the benefits of providing information exceed the cost of providing and using the information. In developing standards, the IASB considers information about the expected benefits and costs of those benefits which will result. Presumably this would constrain the imposition of certain new requirements, although this is a relative concept, and as information technology continues to evolve and the cost of preparing and distributing financial and other information declines, this constraint conceivably may be relaxed.

3. Financial Statements and the Reporting Entity

This chapter discusses the role of general-purpose financial statements (which are a particular form of general-purpose financial report) and the concept of the reporting entity.

The chapter sets out that general-purpose financial statements consist of a statement of financial position (recognising assets, liabilities and equity), a statement of financial performance which may be a single statement or two statements (recognising income and expenses), and other statements and notes which present information about recognised elements (assets, liabilities, equity, income and expenses), unrecognised elements, cash flows, contributions from and distributions to equity holders, and methods, assumptions and judgements used in estimating the amounts presented or disclosed.

Financial statements are prepared for a specified period of time (the reporting period) and provide information about assets and liabilities (whether recognised or unrecognised) which existed at the end of the reporting period or during it, and income and expenses for the reporting period. Comparative information for at least one preceding reporting period should also be provided.

Information about possible future transactions and other events should be provided if it is useful to users of the financial statements, although information about management's expectations and strategies for the entity is not typically included in the financial statements.

Financial statements are usually prepared on the assumption that the entity is a going concern and will continue to operate for the foreseeable future, although where a decision has been made that the entity will cease trading or enter liquidation, or there is no alternative to such a course of action, a different basis may need to be applied.

In describing the role of financial statements, the 2018 framework states that financial statements are prepared from the perspective of the entity as a whole, instead of from the viewpoint of any particular group of investors, lenders or other creditors.

The framework describes a reporting entity as an entity which is required, or chooses, to prepare general-purpose financial statements. It notes that a reporting entity is not necessarily a legal entity, and could comprise a portion of an entity, or two or more entities.

The framework discusses the boundary of a reporting entity and notes that, in situations where one entity (a parent) has control of another entity (a subsidiary), the boundary of the reporting entity could encompass the parent and any subsidiaries (resulting in consolidated financial statements) or the parent alone (resulting in unconsolidated financial statements). If the reporting entity comprises two or more entities which are not linked by a parent–subsidiary relationship, the reporting entity's financial statements are referred to as "combined financial statements."

Where a reporting entity is not a legal entity and does not comprise only legal entities linked by a parent–subsidiary relationship, determining the appropriate boundary may be difficult. In such cases, the boundary needs to be set in such a way that the financial statements provide the relevant financial information needed by users, and faithfully represent the economic activities of the entity. The boundary should not contain an arbitrary or incomplete set of economic activities, and a description should be provided of how the boundary has been determined.

Where a parent–subsidiary relationship exists, the framework suggests that consolidated financial statements are usually more likely than unconsolidated financial statements to provide useful information to users, but that unconsolidated financial statements may also provide useful information because claims against the parent are typically not enforceable against subsidiaries and in some jurisdictions (for instance, under the UK's Companies Act 2006) the amounts that can legally be distributed to the parent's equity holders depend on the distributable reserves of the parent.

4. The Elements of Financial Statements

This chapter deals with the elements of financial statements, including assets, liabilities, equity, income and expenses. The 2018 framework notes that financial statements provide information about the financial effects of transactions and other events by grouping them into broad classes—the elements of financial statements. The elements are linked to the economic resources and claims, and changes in those economic resources and claims. The related definitions are:

- An *asset* is defined as a present economic resource controlled by the entity as a result of past events. An economic resource is defined as a right that has the potential to produce economic benefits.