New Zealand Equivalent to the IASB *Conceptual Framework forFinancial Reporting 2010* (NZ *Framework*)

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Issued by the Financial Reporting Standards Board of the New Zealand Institute of Chartered Accountants

This New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting 2010* (NZ *Framework*) was issued by the Financial Reporting Standards Board of the New Zealand Institute of Chartered Accountants and approved by the Accounting Standards Review Board in February 2011 as authoritative support under the Financial Reporting Act 1993.

In respect of entities adopting New Zealand equivalents to International Financial Reporting Standards (NZ IFRSs) this NZ *Framework*, on adoption, supersedes the New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements* issued in June 2005.

Entities that have not adopted NZ IFRSs will continue to apply the *Statement of Concepts*.

This NZ *Framework* consists of two parts:

- For profit-oriented entities only, Part A which is the New Zealand equivalent to the IASB *Conceptual Framework for Financial Reporting 2010*; and
- For public benefit entities only, Part B which is the New Zealand equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements* (June 2005)

In the Appendix to this NZ *Framework* the Rationale for the decision to adopt a two-part framework is provided.

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NZ FRAMEWORK

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FOREWORD

The International Accounting Standards Board (IASB) is currently in the process of updating its conceptual framework. This conceptual framework project is conducted in phases.

As a chapter is finalised by the IASB, the relevant paragraphs in Part A of the NZ *Framework* will be replaced. When the IASB's conceptual framework project is completed, the IASB will have a complete, comprehensive and single document called the *Conceptual Framework for Financial Reporting*.

This version of the NZ *Framework* includes the first two chapters the IASB published as a result of its first phase of the conceptual framework project—Chapter 1 *The objective of general purpose 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. Chapter 4 contains the remaining text of the NZ *Framework* based on the IASB *Framework* (1989). The IASB's table of concordance, at the end of Part A of this publication, shows how the contents of the *Framework* (1989) and the IASB's *Conceptual Framework* (2010) correspond.

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The Introduction has been carried forward from the IASB's *Framework* (1989). This will be updated when the IASB considers the purpose of the *Conceptual Framework*. Until then, the purpose and the status of the *Conceptual Framework* are the same as before.

Introduction

Financial statements are prepared and presented for external users by many entities around the world. Although such financial statements may appear similar from country to country, there are differences which have probably been caused by a variety of social, economic and legal circumstances and by different countries having in mind the needs of different users of financial statements when setting national requirements.

These different circumstances have led to the use of a variety of definitions of the elements of financial statements: for example, assets, liabilities, equity, income and expenses. They have also resulted in the use of different criteria for the recognition of items in the financial statements and in a preference for different bases of measurement. The scope of the financial statements and the disclosures made in them have also been affected.

The IASB is committed to narrowing these differences by seeking to harmonise regulations, accounting standards and procedures relating to the preparation and presentation of financial statements. It believes that further harmonisation can best be pursued by focusing on financial statements that are prepared for the purpose of providing information that is useful in making economic decisions.

The IASB believes that financial statements prepared for this purpose meet the common needs of most users. This is because nearly all users are making economic decisions, for example:

(a) to decide when to buy, hold or sell an equity investment.

(b) to assess the stewardship or accountability of management.

(c) to assess the ability of the entity to pay and provide other benefits to its employees.

(d) to assess the security for amounts lent to the entity.

(e) to determine taxation policies.

(f) to determine distributable profits and dividends.

(g) to prepare and use national income statistics.

(h) to regulate the activities of entities.

The IASB recognises, however, that governments, in particular, may specify different or additional requirements for their own purposes. These requirements should not, however, affect financial statements published for the benefit of other users unless they also meet the needs of those other users.

Financial statements are most commonly prepared in accordance with an accounting model based on recoverable historical cost and the nominal financial capital maintenance concept. Other models and concepts may be more appropriate in order to meet the objective of providing information that is useful for making economic decisions although there is at present no consensus for change. The IASB's *Conceptual Framework* has been developed so that it is applicable to a range of accounting models and concepts of capital and capital maintenance.

IASB Purpose and status

The IASB's *Conceptual Framework* sets out the concepts that underlie the preparation and presentation of financial statements for external users. The purpose of the IASB's *Conceptual Framework* is:

(a) to assist the IASB in the development of future IFRSs and in its review of existing IFRSs;

(b) to assist the IASB 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 IFRSs;

(c) to assist national standard-setting bodies in developing national standards;

(d) to assist preparers of financial statements in applying IFRSs and in dealing with topics that have yet to form the subject of an IFRS;

(e) to assist auditors in forming an opinion on whether financial statements comply with IFRSs;

(f) to assist users of financial statements in interpreting the information contained in financial statements prepared in compliance with IFRSs; and

(g) to provide those who are interested in the work of the IASB with information about its approach to the formulation of IFRSs.

The IASB's *Conceptual Framework* is not an IFRS and hence does not define standards for any particular measurement or disclosure issue. Nothing in the IASB's *Conceptual Framework* overrides any specific IFRS.

The IASB recognises that in a limited number of cases there may be a conflict between the IASB's *Conceptual Framework* and an IFRS. In those cases where there is a conflict, the requirements of the IFRS prevail over those of the *Conceptual Framework*. As, however, the Board will be guided by the *Conceptual Framework* in the development of future IFRSs and in its review of existing IFRSs, the number of cases of conflict between the *Conceptual Framework* and IFRSs will diminish through time.

The IASB's *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

Part A of the NZ *Framework* deals with:

(a) the objective of financial reporting;

(b) the qualitative characteristics of useful financial information;

(c) the definition, recognition and measurement of the elements from which financial statements are constructed; and

(d) concepts of capital and capital maintenance.

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CHAPTER 1: *THE OBJECTIVE OF GENERAL PURPOSE FINANCIAL REPORTING*

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Chapter 1: The objective of general purpose financial reporting

Introduction

AOB1 The objective of general purpose financial reporting forms the foundation of Part A of the NZ *Framework*. Other aspects of Part A of the NZ *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

AOB2 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.

AOB3 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.

AOB4 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

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

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

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.

AOB5 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.

AOB6 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.

AOB7 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.

AOB8 Individual primary users have different, and possibly conflicting, information needs and desires. The IASB, 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.

AOB9 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.

AOB10 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.

AOB11 To a large extent, financial reports are based on estimates, judgements and models rather than exact depictions. Part A of the NZ *Framework* establishes the concepts that underlie those estimates, judgements and models. The concepts are the goal towards which the IASB and preparers of financial reports strive. As with most goals, Part A of the NZ *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.

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Information about a reporting entity's economic resources, claims, and changes in resources and claims

AOB12 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

AOB13 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.

AOB14 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

AOB15 Changes in a reporting entity's economic resources and claims result from that entity's financial performance (see paragraphs AOB17–AOB20) and from other events or transactions such as issuing debt or equity instruments (see paragraph AOB21). 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.

AOB16 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.

Financial performance reflected by accrual accounting

AOB17 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.

AOB18 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 AOB21), 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.

AOB19 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

AOB20 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

AOB21 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

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changed and the implications of those changes for its future financial performance.

Chapter 2: The reporting entity

[to be added]

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CHAPTER 3: *QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION*

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Chapter 3: Qualitative characteristics of useful financial information

Introduction

AQC1 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).

AQC2 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 Part A of the NZ *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.

AQC3 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

AQC4 If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.

Fundamental qualitative characteristics

AQC5 The fundamental qualitative characteristics are *relevance* and *faithful representation*.

[*] Throughout Part A of this NZ *Framework*, the terms *qualitative characteristics* and *constraint* refer to the qualitative characteristics of, and the constraint on, useful financial information.

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Relevance

AQC6 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.

AQC7 Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.

AQC8 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.

AQC9 Financial information has confirmatory value if it provides feedback about (confirms or changes) previous evaluations.

AQC10 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

AQC11 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 IASB cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

Faithful representation

AQC12 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 IASB's objective is to maximise those qualities to the extent possible.

AQC13 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.

AQC14 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.

AQC15 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.

AQC16 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

AQC17 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.

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AQC18 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

AQC19 *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

AQC20 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.

AQC21 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.

AQC22 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.

AQC23 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.

AQC24 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.

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AQC25 Although a single economic phenomenon can be faithfully represented in multiple ways, permitting alternative accounting methods for the same economic phenomenon diminishes comparability.

Verifiability

AQC26 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.

AQC27 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).

AQC28 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

AQC29 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

AQC30 Classifying, characterising and presenting information clearly and concisely makes it *understandable*.

AQC31 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.

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AQC32 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

AQC33 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.

AQC34 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

AQC35 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.

AQC36 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.

AQC37 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.

AQC38 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.

AQC39 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.

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Chapter 4: The NZ Framework (June 2005): the remaining text

The remaining text of the NZ Framework for the Preparation and Presentation of Financial Statements *(June 2005) has not been amended to reflect changes made by IAS 1* Presentation of Financial Statements *(as revised in 2007).*

The remaining text will also be updated when the IASB has considered the elements of financial statements and their measurement bases in later phases of its Conceptual Framework Project.

Underlying assumption

Going concern

A4.1 The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis and, if so, the basis used is disclosed.

The elements of financial statements

A4.2 Financial statements portray the financial effects of transactions and other events by grouping them into broad classes according to their economic characteristics. These broad classes are termed the elements of financial statements. The elements directly related to the measurement of financial position in the balance sheet are assets, liabilities and equity. The elements directly related to the measurement of performance in the income statement are income and expenses. The statement of changes in financial position usually reflects income statement elements and changes in balance sheet elements; accordingly, Part A of this NZ *Framework* identifies no elements that are unique to this statement.

A4.3 The presentation of these elements in the balance sheet and the income statement involves a process of sub-classification. For example, assets and liabilities may be classified by their nature or function in the business of the entity in order to display information in the manner most useful to users for purposes of making economic decisions.

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Financial position

A4.4 The elements directly related to the measurement of financial position are assets, liabilities and equity. These are defined as follows:

(a) An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

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

(c) Equity is the residual interest in the assets of the entity after deducting all its liabilities.

A4.5 The definitions of an asset and a liability identify their essential features but do not attempt to specify the criteria that need to be met before they are recognised in the balance sheet. Thus, the definitions embrace items that are not recognised as assets or liabilities in the balance sheet because they do not satisfy the criteria for recognition discussed in paragraphs A4.37–A4.53. In particular, the expectation that future economic benefits will flow to or from an entity must be sufficiently certain to meet the probability criterion in paragraph A4.38 before an asset or liability is recognised.

A4.6 In assessing whether an item meets the definition of an asset, liability or equity, attention needs to be given to its underlying substance and economic reality and not merely its legal form. Thus, for example, in the case of finance leases, the substance and economic reality are that the lessee acquires the economic benefits of the use of the leased asset for the major part of its useful life in return for entering into an obligation to pay for that right an amount approximating to the fair value of the asset and the related finance charge. Hence, the finance lease gives rise to items that satisfy the definition of an asset and a liability and are recognised as such in the lessee's balance sheet.

A4.7 Balance sheets drawn up in accordance with current IFRSs may include items that do not satisfy the definitions of an asset or liability and are not shown as part of equity. The definitions set out in paragraph A4.4 will, however, underlie future reviews of existing IFRSs and the formulation of further IFRSs.

Assets

A4.8 The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.

A4.9 An entity usually employs its assets to produce goods or services capable of satisfying the wants or needs of customers; because these goods or services can satisfy these wants or needs, customers are prepared to pay for them and hence contribute to the cash flow of the entity. Cash itself renders a service to the entity because of its command over other resources.

A4.10 The future economic benefits embodied in an asset may flow to the entity in a number of ways. For example, an asset may be:

(a) used singly or in combination with other assets in the production of goods or services to be sold by the entity;

(b) exchanged for other assets;

(c) used to settle a liability; or

(d) distributed to the owners of the entity.

A4.11 Many assets, for example, property, plant and equipment, have a physical form. However, physical form is not essential to the existence of an asset; hence patents and copyrights, for example, are assets if future economic benefits are expected to flow from them to the entity and if they are controlled by the entity.

A4.12 Many assets, for example, receivables and property, are associated with legal rights, including the right of ownership. In determining the existence of an asset, the right of ownership is not essential; thus, for example, property held on a lease is an asset if the entity controls the benefits which are expected to flow from the property. Although the capacity of an entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control. For example, know-how obtained from a development activity may meet the definition of an asset when, by keeping that know-how secret, an entity controls the benefits that are expected to flow from it.

A4.13 The assets of an entity result from past transactions or other past events. Entities normally obtain assets by purchasing or producing them, but other transactions or events may generate assets; examples include property received by an entity from government as part of a programme to encourage economic growth in an area and the discovery of mineral deposits. Transactions or events expected to occur in the future do not in themselves give rise to assets; hence, for example, an intention to purchase inventory does not, of itself, meet the definition of an asset.

A4.14 There is a close association between incurring expenditure and generating assets but the two do not necessarily coincide. Hence, when an entity incurs expenditure, this may provide evidence that future economic benefits were sought but is not conclusive proof that an item satisfying the definition of an asset has been obtained. Similarly the absence of a related expenditure does not preclude an item from satisfying the definition of an asset and thus becoming a candidate for recognition in the balance sheet; for example, items that have been donated to the entity may satisfy the definition of an asset.

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Liabilities

A4.15 An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. If, for example, an entity decides as a matter of policy to rectify faults in its products even when these become apparent after the warranty period has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities.

A4.16 A distinction needs to be drawn between a present obligation and a future commitment. A decision by the management of an entity to acquire assets in the future does not, of itself, give rise to a present obligation. An obligation normally arises only when the asset is delivered or the entity enters into an irrevocable agreement to acquire the asset. In the latter case, the irrevocable nature of the agreement means that the economic consequences of failing to honour the obligation, for example, because of the existence of a substantial penalty, leave the entity with little, if any, discretion to avoid the outflow of resources to another party.

A4.17 The settlement of a present obligation usually involves the entity giving up resources embodying economic benefits in order to satisfy the claim of the other party. Settlement of a present obligation may occur in a number of ways, for example, by:

(a) payment of cash;

(b) transfer of other assets;

(c) provision of services;

(d) replacement of that obligation with another obligation; or

(e) conversion of the obligation to equity.

An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

A4.18 Liabilities result from past transactions or other past events. Thus, for example, the acquisition of goods and the use of services give rise to trade payables (unless paid for in advance or on delivery) and the receipt of a bank loan results in an obligation to repay the loan. An entity may also recognise future rebates based on annual purchases by customers as liabilities; in this case, the sale of the goods in the past is the transaction that gives rise to the liability.

A4.19 Some liabilities can be measured only by using a substantial degree of estimation. Some entities describe these liabilities as provisions. In some countries, such provisions are not regarded as liabilities because the concept of a liability is defined narrowly so as to include only amounts that can be established without

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the need to make estimates. The definition of a liability in paragraph A4.4 follows a broader approach. Thus, when a provision involves a present obligation and satisfies the rest of the definition, it is a liability even if the amount has to be estimated. Examples include provisions for payments to be made under existing warranties and provisions to cover pension obligations.

Equity

A4.20 Although equity is defined in paragraph A4.4 as a residual, it may be sub-classified in the balance sheet. For example, in a corporate entity, funds contributed by shareholders, retained earnings, reserves representing appropriations of retained earnings and reserves representing capital maintenance adjustments may be shown separately. Such classifications can be relevant to the decision-making needs of the users of financial statements when they indicate legal or other restrictions on the ability of the entity to distribute or otherwise apply its equity. They may also reflect the fact that parties with ownership interests in an entity have differing rights in relation to the receipt of dividends or the repayment of contributed equity.

A4.21 The creation of reserves is sometimes required by statute or other law in order to give the entity and its creditors an added measure of protection from the effects of losses. Other reserves may be established if national tax law grants exemptions from, or reductions in, taxation liabilities when transfers to such reserves are made. The existence and size of these legal, statutory and tax reserves is information that can be relevant to the decision-making needs of users. Transfers to such reserves are appropriations of retained earnings rather than expenses.

A4.22 The amount at which equity is shown in the balance sheet is dependent on the measurement of assets and liabilities. Normally, the aggregate amount of equity only by coincidence corresponds with the aggregate market value of the shares of the entity or the sum that could be raised by disposing of either the net assets on a piecemeal basis or the entity as a whole on a going concern basis.

A4.23 Commercial, industrial and business activities are often undertaken by means of entities such as sole proprietorships, partnerships and trusts and various types of government business undertakings. The legal and regulatory framework for such entities is often different from that applying to corporate entities. For example, there may be few, if any, restrictions on the distribution to owners or other beneficiaries of amounts included in equity. Nevertheless, the definition of equity and the other aspects of Part A of this NZ *Framework* that deal with equity are appropriate for such entities.

Performance

A4.24 Profit is frequently used as a measure of performance or as the basis for other measures, such as return on investment or earnings per share. The elements directly related to the measurement of profit are income and expenses. Therecognition and measurement of income and expenses, and hence profit,

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depends in part on the concepts of capital and capital maintenance used by the entity in preparing its financial statements. These concepts are discussed in paragraphs A4.57–A4.65.

A4.25 The elements of income and expenses are defined as follows:

(a) Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

(b) Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

A4.26 The definitions of income and expenses identify their essential features but do not attempt to specify the criteria that would need to be met before they are recognised in the income statement. Criteria for the recognition of income and expenses are discussed in paragraphs A4.37–A4.53.

A4.27 Income and expenses may be presented in the income statement in different ways so as to provide information that is relevant for economic decision-making. For example, it is common practice to distinguish between those items of income and expenses that arise in the course of the ordinary activities of the entity and those that do not. This distinction is made on the basis that the source of an item is relevant in evaluating the ability of the entity to generate cash and cash equivalents in the future; for example, incidental activities such as the disposal of a long-term investment are unlikely to recur on a regular basis. When distinguishing between items in this way consideration needs to be given to the nature of the entity and its operations. Items that arise from the ordinary activities of one entity may be unusual in respect of another.

A4.28 Distinguishing between items of income and expense and combining them in different ways also permits several measures of entity performance to be displayed. These have differing degrees of inclusiveness. For example, the income statement could display gross margin, profit or loss from ordinary activities before taxation, profit or loss from ordinary activities after taxation, and profit or loss.

Income

A4.29 The definition of income encompasses both revenue and gains. Revenue arises in the course of the ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent.

A4.30 Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an entity. Gains represent increases in economic benefits and as such are no different in nature from

revenue. Hence, they are not regarded as constituting a separate element in Part A of this NZ *Framework*.

A4.31 Gains include, for example, those arising on the disposal of non-current assets. The definition of income also includes unrealised gains; for example, those arising on the revaluation of marketable securities and those resulting from increases in the carrying amount of long-term assets. When gains are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. Gains are often reported net of related expenses.

A4.32 Various kinds of assets may be received or enhanced by income; examples include cash, receivables and goods and services received in exchange for goods and services supplied. Income may also result from the settlement of liabilities. For example, an entity may provide goods and services to a lender in settlement of an obligation to repay an outstanding loan.

Expenses

A4.33 The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity. Expenses that arise in the course of the ordinary activities of the entity include, for example, cost of sales, wages and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, property, plant and equipment.

A4.34 Losses represent other items that meet the definition of expenses and may, or may not, arise in the course of the ordinary activities of the entity. Losses represent decreases in economic benefits and as such they are no different in nature from other expenses. Hence, they are not regarded as a separate element in Part A of this NZ *Framework*.

A4.35 Losses include, for example, those resulting from disasters such as fire and flood, as well as those arising on the disposal of non-current assets. The definition of expenses also includes unrealised losses, for example, those arising from the effects of increases in the rate of exchange for a foreign currency in respect of the borrowings of an entity in that currency. When losses are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. Losses are often reported net of related income.

Capital maintenance adjustments

A4.36 The revaluation or restatement of assets and liabilities gives rise to increases or decreases in equity. While these increases or decreases meet the definition of income and expenses, they are not included in the income statement under certain concepts of capital maintenance. Instead these items are included in equity as capital maintenance adjustments or revaluation reserves. These concepts of

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capital maintenance are discussed in paragraphs A4.57–A4.65 of Part A of this NZ *Framework*.

Recognition of the elements of financial statements

A4.37 Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition set out in paragraph A4.38. It involves the depiction of the item in words and by a monetary amount and the inclusion of that amount in the balance sheet or income statement totals. Items that satisfy the recognition criteria should be recognised in the balance sheet or income statement. Thefailure to recognise such items is not rectified by disclosure of the accounting policies used nor by notes or explanatory material.

A4.38 An item that meets the definition of an element should be recognised if:

(a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and

(b) the item has a cost or value that can be measured with reliability.*

A4.39 In assessing whether an item meets these criteria and therefore qualifies for recognition in the financial statements, regard needs to be given to the materiality considerations discussed in Chapter 3 *Qualitative characteristics of useful financial information*. The interrelationship between the elements means that an item that meets the definition and recognition criteria for a particular element, for example, an asset, automatically requires the recognition of another element, for example, income or a liability.

The probability of future economic benefit

A4.40 The concept of probability is used in the recognition criteria to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the entity. The concept is in keeping with the uncertainty that characterises the environment in which an entity operates. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence available when the financial statements are prepared. For example, when it is probable that a receivable owed to an entity will be paid, it is then justifiable, in the absence of any evidence to the contrary, to recognise the receivable as an asset. For a large population of receivables, however, some degree of non-payment is normally considered probable; hence an expense representing the expected reduction in economic benefits is recognised.

* Information is reliable when it is complete, neutral and free from error.

Reliability of measurement

A4.41 The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability. In many cases, cost or value must be estimated; the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When, however, a reasonable estimate cannot be made the item is not recognised in the balance sheet or income statement. Forexample, the expected proceeds from a lawsuit may meet the definitions of both an asset and income as well as the probability criterion for recognition; however, if it is not possible for the claim to be measured reliably, it should not be recognised as an asset or as income; the existence of the claim, however, would be disclosed in the notes, explanatory material or supplementary schedules.

A4.42 An item that, at a particular point in time, fails to meet the recognition criteria in paragraph A4.38 may qualify for recognition at a later date as a result of subsequent circumstances or events.

A4.43 An item that possesses the essential characteristics of an element but fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes, explanatory material or in supplementary schedules. This is appropriate when knowledge of the item is considered to be relevant to the evaluation of the financial position, performance and changes in financial position of an entity by the users of financial statements.

Recognition of assets

A4.44 An asset is recognised in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably.

A4.45 An asset is not recognised in the balance sheet when expenditure has been incurred for which it is considered improbable that economic benefits will flow to the entity beyond the current accounting period. Instead such a transaction results in the recognition of an expense in the income statement. This treatment does not imply either that the intention of management in incurring expenditure was other than to generate future economic benefits for the entity or that management was misguided. The only implication is that the degree of certainty that economic benefits will flow to the entity beyond the current accounting period is insufficient to warrant the recognition of an asset.

Recognition of liabilities

A4.46 A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. In practice, obligations under contracts that are equally

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proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements. However, such obligations may meet the definition of liabilities and, provided the recognition criteria are met in the particular circumstances, may qualify for recognition. In such circumstances, recognition of liabilities entails recognition of related assets or expenses.

Recognition of income

A4.47 Income is recognised in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means, in effect, that recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable).

A4.48 The procedures normally adopted in practice for recognising income, for example, the requirement that revenue should be earned, are applications of the recognition criteria in Part A of this NZ *Framework*. Such procedures are generally directed at restricting the recognition as income to those items that can be measured reliably and have a sufficient degree of certainty.

Recognition of expenses

A4.49 Expenses are recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets (for example, the accrual of employee entitlements or the depreciation of equipment).

A4.50 Expenses are recognised in the income statement on the basis of a direct association between the costs incurred and the earning of specific items of income. This process, commonly referred to as the matching of costs with revenues, involves the simultaneous or combined recognition of revenues and expenses that result directly and jointly from the same transactions or other events; for example, the various components of expense making up the cost of goods sold are recognised at the same time as the income derived from the sale of the goods. However, the application of the matching concept under Part A of this NZ *Framework* does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.

A4.51 When economic benefits are expected to arise over several accounting periods and the association with income can only be broadly or indirectly determined, expenses are recognised in the income statement on the basis of systematic and rational allocation procedures. This is often necessary in recognising the expenses associated with the using up of assets such as property, plant,

equipment, goodwill, patents and trademarks; in such cases the expense is referred to as depreciation or amortisation. These allocation procedures are intended to recognise expenses in the accounting periods in which the economic benefits associated with these items are consumed or expire.

A4.52 An expense is recognised immediately in the income statement when an expenditure produces no future economic benefits or when, and to the extent that, future economic benefits do not qualify, or cease to qualify, for recognition in the balance sheet as an asset.

A4.53 An expense is also recognised in the income statement in those cases when a liability is incurred without the recognition of an asset, as when a liability under a product warranty arises.

Measurement of the elements of financial statements

A4.54 Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the balance sheet and income statement. This involves the selection of the particular basis of measurement.

A4.55 A number of different measurement bases are employed to different degrees and in varying combinations in financial statements. They include the following:

(a) *Historical cost*. Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

(b) *Current cost*. Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

(c) *Realisable (settlement) value*. Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.

(d) *Present value*. Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

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A4.56 The measurement basis most commonly adopted by entities in preparing their financial statements is historical cost. This is usually combined with other measurement bases. For example, inventories are usually carried at the lower of cost and net realisable value, marketable securities may be carried at market value and pension liabilities are carried at their present value. Furthermore, some entities use the current cost basis as a response to the inability of the historical cost accounting model to deal with the effects of changing prices of non-monetary assets.

Concepts of capital and capital maintenance

Concepts of capital

A4.57 A financial concept of capital is adopted by most entities in preparing their financial statements. Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the entity. Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of the entity based on, for example, units of output per day.

A4.58 The selection of the appropriate concept of capital by an entity should be based on the needs of the users of its financial statements. Thus, a financial concept of capital should be adopted if the users of financial statements are primarily concerned with the maintenance of nominal invested capital or the purchasing power of invested capital. If, however, the main concern of users is with the operating capability of the entity, a physical concept of capital should be used. The concept chosen indicates the goal to be attained in determining profit, even though there may be some measurement difficulties in making the concept operational.

Concepts of capital maintenance and the determination of profit

A4.59 The concepts of capital in paragraph A4.57 give rise to the following concepts of capital maintenance:

(a) *Financial capital maintenance*. Under this concept a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.

(b) *Physical capital maintenance*. Under this concept a profit is earned only if the physical productive capacity (or operating capability) of the entity

(or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

A4.60 The concept of capital maintenance is concerned with how an entity defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured; it is a prerequisite for distinguishing between an entity's return on capital and its return of capital; only inflows of assets in excess of amounts needed to maintain capital may be regarded as profit and therefore as a return on capital. Hence, profit is the residual amount that remains after expenses (including capital maintenance adjustments, where appropriate) have been deducted from income. If expenses exceed income the residual amount is a loss.

A4.61 The physical capital maintenance concept requires the adoption of the current cost basis of measurement. The financial capital maintenance concept, however, does not require the use of a particular basis of measurement. Selection of the basis under this concept is dependent on the type of financial capital that the entity is seeking to maintain.

A4.62 The principal difference between the two concepts of capital maintenance is the treatment of the effects of changes in the prices of assets and liabilities of the entity. In general terms, an entity has maintained its capital if it has as much capital at the end of the period as it had at the beginning of the period. Any amount over and above that required to maintain the capital at the beginning of the period is profit.

A4.63 Under the concept of financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period. Thus, increases in the prices of assets held over the period, conventionally referred to as holding gains, are, conceptually, profits. They may not be recognised as such, however, until the assets are disposed of in an exchange transaction. When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit. The rest of the increase is treated as a capital maintenance adjustment and, hence, as part of equity.

A4.64 Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the entity are viewed as changes in the measurement of the physical productive capacity of the entity; hence, they are treated as capital maintenance adjustments that are part of equity and not as profit.

A4.65 The selection of the measurement bases and concept of capital maintenance will determine the accounting model used in the preparation of the financial

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statements. Different accounting models exhibit different degrees of relevance and reliability and, as in other areas, management must seek a balance between relevance and reliability. Part A of this NZ *Framework* is applicable to a range of accounting models and provides guidance on preparing and presenting the financial statements constructed under the chosen model. At the present time, it is not the intention of the Board to prescribe a particular model other than in exceptional circumstances, such as for those entities reporting in the currency of a hyperinflationary economy. This intention will, however, be reviewed in the light of world developments.

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Approval by the IASB of the *Conceptual Framework for Financial Reporting* issued in September 2010

The *Conceptual Framework for Financial Reporting* was approved for issue by the fifteen members of the International Accounting Standards Board.

Sir David Tweedie	Chairman
Stephen Cooper	
Philippe Danjou	
Jan Engström	
Patrick Finnegan	
Robert P Garnett	
Gilbert Gélard	
Amaro Luiz de Oliveira Gomes	
Prabhakar Kalavacherla	
James J Leisenring	
Patricia McConnell	
Warren J McGregor	
John T Smith	
Tatsumi Yamada	
Wei-Guo Zhang	

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IASB Basis for Conclusions on Chapter 1: *The objective of general purpose financial reporting*

This Basis for Conclusions accompanies, but is not part of, Chapter 1.

Introduction

BC1.1 This Basis for Conclusions summarises considerations of the International Accounting Standards Board in reaching the conclusions in Chapter 1 *The objective of general purpose financial reporting*. It includes reasons for accepting some alternatives and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC1.2 The Board developed this chapter jointly with the US Financial Accounting Standards Board (FASB). Consequently, this Basis for Conclusions also includes some references to the FASB's literature.

Background

BC1.3 The Board began the process of developing the objective of financial reporting by reviewing its own framework and concepts as well as those of other standard-setters. In July 2006 the Board published for public comment a discussion paper on this topic. That same paper was also published by the FASB. The Board and the FASB received 179 responses. In its redeliberations of the issues on this topic, the Board considered all of the comments received and information gained from other outreach initiatives. In May 2008 the Board and the FASB jointly published an exposure draft. The boards received 142 responses. The Board reconsidered all of the issues on this topic. This document is the result of those reconsiderations.

General purpose financial reporting

BC1.4 Consistently with the Board's responsibilities, the *Conceptual Framework* establishes an objective of financial reporting and not just of financial statements. Financial statements are a central part of financial reporting, and most of the issues that the Board addresses involve financial statements. Although the scope of FASB Concepts Statement No. 1 *Objectives of Financial Reporting by Business Enterprises* was financial reporting, the other FASB concepts statements focused on financial statements. The scope of the Board's *Framework for the Preparation and Presentation of Financial Statements*, which was published by the Board's predecessor body in 1989 (hereinafter called *Framework* (1989)), dealt with financial statements only. Therefore, for both boards the scope of the *Conceptual Framework* is broader.

BC1.5 Some constituents suggested that advances in technology may make general purpose financial reporting obsolete. New technologies, for example the use of eXtensible Business Reporting Language (XBRL), may make it practicable in the future for reporting entities either to prepare or to make available the information necessary for different users to assemble different financial reports to meet their individual information needs.

BC1.6 To provide different reports for different users, or to make available all of the information that users would need to assemble their own custom-designed reports, would be expensive. Requiring users of financial information to assemble their own reports might also be unreasonable, because many users would need to have a greater understanding of accounting than they have now. Therefore, the Board concluded that for now a general purpose financial report is still the most efficient and effective way to meet the information needs of a variety of users.

BC1.7 In the discussion paper, the Board used the term *general purpose external financial reporting*. *External* was intended to convey that internal users such as management were not the intended beneficiaries for general purpose financial reporting as established by the Board. During redeliberations, the Board concluded that this term was redundant. Therefore, Chapter 1 uses *general purpose financial reporting*.

Financial reporting of the reporting entity

BC1.8 Some respondents to the exposure draft said that the reporting entity is not separate from its equity investors or a subset of those equity investors. This view has its roots in the days when most businesses were sole proprietorships and partnerships that were managed by their owners who had unlimited liability for the debts incurred in the course of the business. Over time, the separation between businesses and their owners has grown. The vast majority of today's businesses have legal substance separate from their owners by virtue of their legal form of organisation, numerous investors with limited legal liability and professional managers separate from the owners. Consequently, the Board concluded that financial reports should reflect that separation by accounting for the entity (and its economic resources and claims) rather than its primary users and their interests in the reporting entity.

Primary users

BC1.9 The objective of financial reporting in paragraph OB2 refers to existing and potential investors, lenders and other creditors. The description of the primary users in paragraph OB5 refers to existing and potential investors, lenders and other creditors who cannot require reporting entities to provide information directly to them. Paragraph OB10 states that 'regulators and members of the public other than investors, lenders and other creditors' may find information in

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general purpose financial reports useful but clearly states that those are not the parties to whom general purpose financial reports are primarily directed.

BC1.10 Paragraph 9 of the *Framework* (1989) stated that users included 'present and potential investors, employees, lenders, suppliers and other trade creditors' (and later added advisers in the discussion of investors' needs), all of which are intended to be encompassed by the phrase in paragraph OB2. Paragraph 9 of the *Framework* (1989) also included a list of other potential users such as customers, governments and their agencies, and the public, which is similar to the list in paragraph OB10 of those who may be interested in financial reports but are not primary users.

BC1.11 Paragraph 10 of the *Framework* (1989) stated that 'as investors are providers of risk capital to the entity, the provision of financial statements that meet their needs will also meet most of the needs of other users that financial statements can satisfy', which might have been read to narrow the focus to investors only. However, paragraph 12 explicitly stated that the objective of financial statements is to provide information 'that is useful to a wide range of users in making economic decisions.' Thus, the *Framework* (1989) focused on investors' needs as representative of the needs of a wide range of users but did not explicitly identify a group of primary users.

BC1.12 FASB Concepts Statement 1 referred to 'present and potential investors and creditors and other users in making rational investment, credit, and similar decisions' (paragraph 34). It also stated that 'major groups of investors are equity securityholders and debt securityholders' and 'major groups of creditors are suppliers of goods and services who extend credit, customers and employees with claims, lending institutions, individual lenders, and debt securityholders' (paragraph 35). One difference in emphasis from the *Framework* (1989), which emphasised providers of risk capital, is that Concepts Statement 1 referred to 'both those who desire safety of investment and those who are willing to accept risk to obtain high rates of return' (paragraph 35). However, like the *Framework* (1989), Concepts Statement 1 stated that the terms investors and creditors 'also may comprehend security analysts and advisors, brokers, lawyers, regulatory agencies, and others who advise or represent the interests of investors and creditors or who otherwise are interested in how investors and creditors are faring' (paragraph 35).

BC1.13 Paragraphs OB3, OB5 and OB10 differ from the *Framework* (1989) and Concepts Statement 1 for two reasons—to eliminate differences between the *Framework* and Concepts Statement 1 and to be more direct by focusing on users making decisions about providing resources (but not to exclude advisers). The reasons are discussed in paragraphs BC1.15–BC1.24.

Should there be a primary user group?

BC1.14 The discussion paper and the exposure draft proposed identifying a group of primary users of financial reports. Some respondents to the exposure draft said that other users who have not provided, and are not considering providing,

resources to the entity, use financial reports for a variety of reasons. The Board sympathised with their information needs but concluded that without a defined group of primary users, the *Conceptual Framework* would risk becoming unduly abstract or vague.

Why are existing and potential investors, lenders and other creditors considered the primary users?

BC1.15 Some respondents to the discussion paper and the exposure draft suggested that the primary user group should be limited to existing shareholders or the controlling entity's majority shareholders. Others said that the primary users should be existing shareholders and creditors, and that financial reports should focus on their needs.

BC1.16 The reasons why the Board concluded that the primary user group should be the existing and potential investors, lenders and other creditors of a reporting entity are:

(a) Existing and potential investors, lenders and other creditors have the most critical and immediate need for the information in financial reports and many cannot require the entity to provide the information to them directly.

(b) The Board's and the FASB's responsibilities require them to focus on the needs of participants in capital markets, which include not only existing investors but also potential investors and existing and potential lenders and other creditors.

(c) Information that meets the needs of the specified primary users is likely to meet the needs of users both in jurisdictions with a corporate governance model defined in the context of shareholders and those with a corporate governance model defined in the context of all types of stakeholders.

BC1.17 Some respondents expressed the view that the specified primary user group was too broad and that it would result in too much information in the financial reports. However, *too much* is a subjective judgement. In developing financial reporting requirements that meet the objective of financial reporting, the boards will rely on the qualitative characteristics of, and the cost constraint on, useful financial information to provide discipline to avoid providing too much information.

Should there be a hierarchy of users?

BC1.18 Some respondents to the exposure draft who supported the composition of the primary user group also recommended that the Board should establish a hierarchy of primary users because investors, lenders and other creditors have different information needs. However, the Board observed that individual users may have information needs and desires that are different from, and possibly conflict with, those of other users with the same type of interest in the reporting entity. General purpose financial reports are intended to provide common information to users

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and cannot accommodate every request for information. The Board will seek the information set that is intended to meet the needs of the maximum number of users in cost-beneficial ways.

Information needs of other users who are not within the primary user group

Management's information needs

BC1.19 Some constituents questioned the interaction between general purpose financial reporting and management's needs. The Board stated that some of the information directed to the primary users is likely to meet some of management's needs but not all of them. However, management has the ability to access additional financial information, and consequently, general purpose financial reporting need not be explicitly directed to management.

Regulators' information needs

BC1.20 Some constituents said that maintaining financial stability in capital markets (the stability of a country's or region's economy or financial systems) should be an objective of financial reporting. They stated that financial reporting should focus on the needs of regulators and fiscal policy decision-makers who are responsible for maintaining financial stability.

BC1.21 Other constituents opposed establishing an objective to maintain financial stability. They said that financial statements should present the economic reality of the reporting entity with as little bias as possible, but that such a presentation is not necessarily inconsistent with a financial stability objective. By presenting economic reality, financial statements could lead to more informed decision-making and thereby support financial stability even if that is not the primary aim.[*]

BC1.22 However, advocates of a financial stability objective had a different outcome in mind. They did not encourage the Board to require reporting entities to provide information for use by regulators and fiscal policy decision-makers. Instead, they recommended that the Board consider the consequences of new financial reporting standards for the stability of the world's economies and financial systems and, at least at times, assign greater weight to that objective than to the information needs of investors, lenders and other creditors.

[*] One group expressing that view was the Financial Crisis Advisory Group (FCAG). The FCAG comprised approximately 20 senior leaders with broad experience in international financial markets and an interest in the transparency of financial reporting information. The FCAG was formed in 2009 to advise the Board and the FASB about the standard-setting implications of the financial crisis and of potential changes in the global regulatory environment.

BC1.23 The Board acknowledged that the interests of investors, lenders and other creditors often overlap with those of regulators. However, expanding the objective of financial reporting to include maintaining financial stability could at times create conflicts between the objectives that the Board is not well-equipped to resolve. For example, some may take the view that the best way to maintain financial stability is to require entities not to report, or to delay reporting, some changes in asset or liability values. That requirement would almost certainly result in depriving investors, lenders and other creditors of information that they need. The only way to avoid conflicts would be to eliminate or de-emphasise the existing objective of providing information to investors, lenders and other creditors. The Board concluded that eliminating that objective would be inconsistent with its basic mission, which is to serve the information needs of participants in capital markets. The Board also noted that providing relevant and faithfully represented financial information can improve users' confidence in the information, and thus contribute to promoting financial stability.

Usefulness for making decisions

BC1.24 Both the Board's and the FASB's previous frameworks focused on providing information that is useful in making economic decisions as the fundamental objective of financial reporting. Those frameworks also stated that financial information that is useful in making economic decisions would also be helpful in assessing how management has fulfilled its stewardship responsibility.

BC1.25 The discussion paper that led to Chapter 1 stated that the objective of financial reporting should focus on resource allocation decisions. Although most respondents to the discussion paper agreed that providing useful information for decision-making was the appropriate objective, they said that investors, lenders and other creditors make other decisions that are aided by financial reporting information in addition to resource allocation decisions. For example, shareholders who vote on whether to retain directors or replace them, and on how members of management should be remunerated for their services, need information on which to base their decisions. Shareholders' decision-making process may include evaluating how management of the entity performed against management in competing entities in similar circumstances.

BC1.26 The Board agreed with these respondents and noted that, in most cases, information designed for resource allocation decisions would also be useful for assessing management's performance. Therefore, in the exposure draft leading to Chapter 1, the Board proposed that the objective of financial reporting is to provide financial information about the reporting entity that is useful to present and potential investors, lenders and other creditors in making decisions in their capacity as capital providers. The exposure draft also described the role financial statements can have in supporting decisions related to the stewardship of an entity's resources.

BC1.27 The exposure draft discussed the *Objective of Financial Reporting* and *Decision-usefulness* in separate sections. The Board combined those two sections in

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Chapter 1 because usefulness in making decisions is the objective of financial reporting. Consequently, both sections addressed the same points and provided more detail than was necessary. Combining those two sections resulted in eliminating the separate subsections on usefulness in assessing cash flow prospects and usefulness in assessing stewardship. The Board did not intend to imply that assessing prospects for future cash flow or assessing the quality of management's stewardship is more important than the other. Both are important for making decisions about providing resources to an entity, and information about stewardship is also important for resource providers who have the ability to vote on, or otherwise influence, management's actions.

BC1.28 The Board decided not to use the term *stewardship* in the chapter because there would be difficulties in translating it into other languages. Instead, the Board described what stewardship encapsulates. Accordingly, the objective of financial reporting acknowledges that users make resource allocation decisions as well as decisions as to whether management has made efficient and effective use of the resources provided.

The objective of financial reporting for different types of entities

BC1.29 The Board also considered whether the objective of general purpose financial reporting should differ for different types of entities. Possibilities include:

(a) smaller entities versus larger entities;

(b) entities with listed (publicly traded) debt or equity financial instruments versus those without such instruments; and

(c) closely held entities versus those with widely dispersed ownership.

BC1.30 External users of financial reporting have similar objectives, irrespective of the type of entities in which they invest. Therefore, the Board concluded that the objective of general purpose financial reports is the same for all entities. However, cost constraints and differences in activities among entities may sometimes lead the Board to permit or require differences in reporting for different types of entities.

Information about a reporting entity's resources, claims against the entity and changes in resources and claims

The significance of information about financial performance

BC1.31 A long-standing assertion by many constituents is that a reporting entity's financial performance as represented by comprehensive income and its

components is the most important information.[†] Concepts Statement 1 (paragraph 43) stated:

> The primary focus of financial reporting is information about an enterprise's performance provided by measures of comprehensive income and its components. Investors, creditors, and others who are concerned with assessing the prospects for enterprise net cash inflows are especially interested in that information.

In contrast, the *Framework* (1989) considered information on the reporting entity's financial position and financial performance of equal importance.

BC1.32 To be useful for decision-making, financial reports must provide information about a reporting entity's economic resources and claims, and the change during a period in economic resources and claims. A reporting entity cannot provide reasonably complete information about its financial performance (as represented by comprehensive income, profit or loss or other similar terms) without identifying and measuring its economic resources and the claims. Consequently, the Board concluded that to designate one type of information as the primary focus of financial reporting would be inappropriate.

BC1.33 In discussing the financial position of an entity, the exposure draft referred to *economic resources and claims on them*. The chapter uses the phrase *economic resources of the reporting entity and the claims against the reporting entity* (see paragraph OB12). The reason for the change is that in many cases, claims against an entity are not claims on specific resources. In addition, many claims will be satisfied using resources that will result from future net cash inflows. Thus, while all claims are claims against the entity, not all are claims against the entity's existing resources.

Financial position and solvency

BC1.34 Some constituents have suggested that the main purpose of the statement of financial position should be to provide information that helps assess the reporting entity's solvency. The question is not whether information provided in the financial reports should be helpful in assessing solvency; clearly, it should. Assessing solvency is of interest to investors, lenders and other creditors, and the objective of general purpose financial reporting is to provide information that is useful to them for making decisions.

BC1.35 However, some have suggested that the statement of financial position should be directed towards the information needs of lenders, other creditors and regulators, possibly to the detriment of investors and other users. To do so would be inconsistent with the objective of serving the common information needs of the

[†] Concepts Statement 1 referred to *earnings and its components*. However, FASB Concepts Statement No. 6 *Elements of Financial Statements* substituted the term *comprehensive income* for the term *earnings*. The latter term is reserved for a component of comprehensive income.

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primary user group. Therefore, the Board rejected the notion of directing the statement of financial position (or any other particular financial statement) towards the needs of a particular subset of users.

BASIS FOR CONCLUSIONS ON CHAPTER 2: *THE REPORTING ENTITY*

[to be added]

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IASB BASIS FOR CONCLUSIONS ON
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IASB Basis for Conclusions on Chapter 3: *Qualitative characteristics of useful financial information*

This Basis for Conclusions accompanies, but is not part of, Chapter 3.

Introduction

BC3.1 This Basis for Conclusions summarises considerations of the Board in reaching the conclusions in Chapter 3 *Qualitative characteristics of useful financial information*. It includes reasons for accepting some alternatives and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC3.2 The Board developed the chapter jointly with the US Financial Accounting Standards Board (FASB). Consequently, this Basis for Conclusions also includes some references to the FASB's literature.

Background

BC3.3 The Board began the process of developing the qualitative characteristics of useful financial information by reviewing its own framework and concepts as well as those of other standard-setters. In July 2006 the Board published for public comment a discussion paper on this topic. That same paper was also published by the FASB. The Board and the FASB received 179 responses. In its redeliberations of the issues on this topic, the Board considered all of the comments received and information gained from other outreach initiatives. In May 2008 the Board and the FASB jointly published an exposure draft. The boards received 142 responses. The Board reconsidered all of the issues. This document is the result of those reconsiderations.

The objective of financial reporting and the qualitative characteristics of useful financial information

BC3.4 Alternatives are available for all aspects of financial reporting, including recognition, derecognition, measurement, classification, presentation and disclosure. When developing financial reporting standards, the Board will choose the alternative that goes furthest towards achieving the objective of financial reporting. Providers of financial information will also have to choose among the alternatives if there are no applicable standards available, or if application of a particular standard requires judgements or options, to achieve the objective of financial reporting.

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BC3.5 Chapter 1 specifies that 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. The decision-makers on which this *Conceptual Framework* focuses are existing and potential investors, lenders and other creditors.

BC3.6 That objective by itself leaves a great deal to judgement and provides little guidance on how to exercise that judgement. Chapter 3 describes the first step in making the judgements needed to apply that objective. It identifies and describes the qualitative characteristics that financial information should have if it is to meet the objective of financial reporting. It also discusses cost, which is a pervasive constraint on financial reporting.

BC3.7 Subsequent chapters will use the qualitative characteristics to help guide choices about recognition, measurement and the other aspects of financial reporting.

Fundamental and enhancing qualitative characteristics

BC3.8 Chapter 3 distinguishes between the fundamental qualitative characteristics that are the most critical and the enhancing qualitative characteristics that are less critical but still highly desirable. The discussion paper did not explicitly distinguish between those qualitative characteristics. The Board made the distinction later because of confusion among respondents to the discussion paper about how the qualitative characteristics relate to each other.

BC3.9 Some respondents to the exposure draft stated that all of the qualitative characteristics should be considered equal, and that the distinction between fundamental and enhancing qualitative characteristics was arbitrary. Others said that the most important qualitative characteristic differs depending on the circumstances; therefore, differentiating qualitative characteristics was not appropriate.

BC3.10 The Board does not agree that the distinction is arbitrary. Financial information without the two fundamental qualitative characteristics of relevance and faithful representation is not useful, and it cannot be made useful by being more comparable, verifiable, timely or understandable. However, financial information that is relevant and faithfully represented may still be useful even if it does not have any of the enhancing qualitative characteristics.

Fundamental qualitative characteristics

Relevance

BC3.11 It is self-evident that financial information is useful for making a decision only if it is capable of making a difference in that decision. *Relevance* is the term used

in the *Conceptual Framework* to describe that capability. It is a fundamental qualitative characteristic of useful financial information.

BC3.12 The definition of relevance in the *Conceptual Framework* is consistent with the definition in FASB Concepts Statement No. 2 *Qualitative Characteristics of Accounting Information*. The *Framework* (1989) definition of relevance was that information is relevant only if it actually makes a difference in users' decisions. However, users consider a variety of information from many sources, and the extent to which a decision is affected by information about a particular economic phenomenon is difficult, if not impossible, to determine, even after the fact.

BC3.13 In contrast, whether information is *capable* of making a difference in a decision (relevance as defined in the *Conceptual Framework*) can be determined. One of the primary purposes of publishing exposure drafts and other due process documents is to seek the views of users on whether information that would be required by proposed financial reporting standards is capable of making a difference in their decisions. The Board also assesses relevance by meeting users to discuss proposed standards, potential agenda decisions, effects on reported information of applying recently implemented standards and other matters.

Predictive and confirmatory value

BC3.14 Many decisions by investors, lenders and other creditors are based on implicit or explicit predictions about the amount and timing of the return on an equity investment, loan or other credit instrument. Consequently, information is capable of making a difference in one of those decisions only if it will help users to make new predictions, confirm or correct prior predictions or both (which is the definition of predictive or confirmatory value).

BC3.15 The *Framework* (1989) identified predictive value and confirmatory value as components of relevance, and Concepts Statement 2 referred to predictive value and feedback value. The Board concluded that confirmatory value and feedback value were intended to have the same meaning. The Board and the FASB agreed that both boards would use the same term (confirmatory value) to avoid giving the impression that the two frameworks were intended to be different.

The difference between predictive value and related statistical terms

BC3.16 Predictive value, as used in the *Conceptual Framework*, is not the same as predictability and persistence as used in statistics. Information has predictive value if it can be used in making predictions about the eventual outcomes of past or current events. In contrast, statisticians use predictability to refer to the accuracy with which it is possible to foretell the next number in a series and persistence to refer to the tendency of a series of numbers to continue to change as it has changed in the past.

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Materiality

BC3.17 Concepts Statement 2 and the *Framework* (1989) discussed materiality and defined it similarly. Concepts Statement 2 described materiality as a constraint on financial reporting that can be considered only together with the qualitative characteristics, especially relevance and faithful representation. The *Framework* (1989), on the other hand, discussed materiality as an aspect of relevance and did not indicate that materiality has a role in relation to the other qualitative characteristics.

BC3.18 The discussion paper and the exposure draft proposed that materiality is a pervasive constraint in financial reporting because it is pertinent to all of the qualitative characteristics. However, some respondents to the exposure draft agreed that although materiality is pervasive, it is not a constraint on a reporting entity's ability to report information. Rather, materiality is an aspect of relevance, because immaterial information does not affect a user's decision. Furthermore, a standard-setter does not consider materiality when developing standards because it is an entity-specific consideration. The boards agreed with those views and concluded that materiality is an aspect of relevance that applies at the individual entity level.

Faithful representation

BC3.19 The discussion of faithful representation in Chapter 3 differs from that in the previous frameworks in two significant ways. First, it uses the term *faithful representation* instead of the term *reliability*. Second, substance over form, prudence (conservatism) and verifiability, which were aspects of reliability in Concepts Statement 2 or the *Framework* (1989), are not considered aspects of faithful representation. Substance over form and prudence were removed for the reasons described in paragraphs BC3.26–BC3.29. Verifiability is now described as an enhancing qualitative characteristic rather than as part of this fundamental qualitative characteristic (see paragraphs 3.34–3.36).

Replacement of the term reliability

BC3.20 Concepts Statement 2 and the *Framework* (1989) used the term *reliability* to describe what is now called faithful representation.

BC3.21 Concepts Statement 2 listed representational faithfulness, verifiability and neutrality as aspects of reliability and discussed completeness as part of representational faithfulness.

BC3.22 The *Framework* (1989) said:

> Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.

The *Framework* (1989) also discussed substance over form, neutrality, prudence and completeness as aspects of faithful representation.

BC3.23 Unfortunately, neither framework clearly conveyed the meaning of reliability. The comments of respondents to numerous proposed standards indicated a lack of a common understanding of the term *reliability*. Some focused on *verifiability* or *free from material error* to the virtual exclusion of faithful representation. Others focused more on faithful representation, perhaps combined with neutrality. Some apparently think that reliability refers primarily to precision.

BC3.24 Because attempts to explain what reliability was intended to mean in this context have proved unsuccessful, the Board sought a different term that would more clearly convey the intended meaning. The term *faithful representation*, the faithful depiction in financial reports of economic phenomena, was the result of that search. That term encompasses the main characteristics that the previous frameworks included as aspects of reliability.

BC3.25 Many respondents to the discussion paper and the exposure draft opposed the Board's preliminary decision to replace *reliability* with *faithful representation*. Some said that the Board could have better explained what reliable means rather than replacing the term. However, many respondents who made those comments assigned a different meaning to reliability from what the Board meant. In particular, many respondents' descriptions of reliability more closely resembled the Board's notion of verifiability than its notion of reliability. Those comments led the Board to affirm its decision to replace the term *reliability* with *faithful representation*.

Substance over form

BC3.26 Substance over form is not considered a separate component of faithful representation because it would be redundant. Faithful representation means that financial information represents the substance of an economic phenomenon rather than merely representing its legal form. Representing a legal form that differs from the economic substance of the underlying economic phenomenon could not result in a faithful representation.

Prudence (conservatism) and neutrality

BC3.27 Chapter 3 does not include prudence or conservatism as an aspect of faithful representation because including either would be inconsistent with neutrality. Some respondents to the discussion paper and exposure draft disagreed with that view. They said that the framework should include conservatism, prudence or both. They said that bias should not always be assumed to be undesirable, especially in circumstances when bias, in their view, produces information that is more relevant to some users.

BC3.28 Deliberately reflecting conservative estimates of assets, liabilities, income or equity has sometimes been considered desirable to counteract the effects of some management estimates that have been perceived as excessively optimistic.

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However, even with the prohibitions against deliberate misstatement that appear in the existing frameworks, an admonition to be prudent is likely to lead to a bias. Understating assets or overstating liabilities in one period frequently leads to overstating financial performance in later periods—a result that cannot be described as prudent or neutral.

BC3.29 Other respondents to the exposure draft said that neutrality is impossible to achieve. In their view, relevant information must have purpose, and information with a purpose is not neutral. In other words, because financial reporting is a tool to influence decision-making, it cannot be neutral. Obviously, reported financial information is expected to influence the actions of users of that information, and the mere fact that many users take similar actions on the basis of reported information does not demonstrate a lack of neutrality. The Board does not attempt to encourage or predict specific actions of users. If financial information is biased in a way that encourages users to take or avoid predetermined actions, that information is not neutral.

Can faithful representation be empirically measured?

BC3.30 Empirical accounting researchers have accumulated considerable evidence supporting relevant and faithfully represented financial information through correlation with changes in the market prices of entities' equity or debt instruments. However, such studies have not provided techniques for empirically measuring faithful representation apart from relevance.

BC3.31 Both previous frameworks discussed the desirability of providing statistical information about how faithfully a financial measure is represented. That would not be unprecedented. Other statistical information is sometimes reflected in financial reports. For example, some entities disclose value at risk from derivative financial instruments and similar positions. The Board expects that the use of statistical concepts for financial reporting in some situations will continue to be important. Unfortunately, the boards have not identified any way to quantify the faithfulness of the representations in a financial report.

Enhancing qualitative characteristics

Comparability

BC3.32 Comparability was an important concept in both the *Framework* (1989) and Concepts Statement 2, but the two previous frameworks disagreed on its importance. The *Framework* (1989) stated that comparability is as important as relevance and faithful representation.[*] Concepts Statement 2 described

[*] The term *reliability* was used instead of *faithful representation*, but the meaning was intended to be similar.

comparability as a quality of the relationship between two or more pieces of information that, although important, is secondary to relevance and faithful representation.

BC3.33 Relevant and faithfully represented information is most useful if it can be readily compared with similar information reported by other entities and by the same entity in other periods. One of the most important reasons that financial reporting standards are needed is to increase the comparability of reported financial information. However, even if it is not readily comparable, relevant and faithfully represented information is still useful. Comparable information, however, is not useful if it is not relevant and may mislead if it is not faithfully represented. Therefore, *comparability* is considered an enhancing qualitative characteristic instead of a fundamental qualitative characteristic.

Verifiability

BC3.34 Verifiable information can be used with confidence. Lack of verifiability does not necessarily render information useless, but users are likely to be more cautious because there is a greater risk that the information does not faithfully represent what it purports to represent.

BC3.35 The *Framework* (1989) did not explicitly include verifiability as an aspect of reliability, but Concepts Statement 2 did. However, the two frameworks are not as different as it might appear because the definition of reliability in the *Framework* (1989) contained the phrase *and can be depended upon by users*, which implies that users need assurance on the information.

BC3.36 The discussion paper stated that reported financial information should be verifiable to assure users that it is free from material error and bias and can be depended on to represent what it purports to represent. Therefore, verifiability was considered an aspect of faithful representation. Some respondents pointed out that including verifiability as an aspect of faithful representation could result in excluding information that is not readily verifiable. Those respondents recognised that many forward-looking estimates that are very important in providing relevant financial information (for example, expected cash flows, useful lives and salvage values) cannot be directly verified. However, excluding information about those estimates would make the financial reports much less useful. The Board agreed and repositioned verifiability as an enhancing qualitative characteristic, very desirable but not necessarily required.

Timeliness

BC3.37 The *Framework* (1989) discussed timeliness as a constraint that could rob information of relevance. Concepts Statement 2 described timeliness as an aspect of relevance. However, the substance of timeliness as discussed in the two previous frameworks was essentially the same.

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BC3.38 The discussion paper described timeliness as an aspect of relevance. However, some respondents pointed out that timeliness is not part of relevance in the same sense that predictive and confirmatory value are. The Board was persuaded that timeliness is different from the other components of relevance.

BC3.39 Timeliness is very desirable, but it is not as critical as relevance and faithful representation. Timely information is useful only if it is relevant and faithfully represented. In contrast, relevant and faithfully represented information may still be useful (especially for confirmatory purposes) even if it is not reported in as timely a manner as would be desirable.

Understandability

BC3.40 Both the *Framework* (1989) and Concepts Statement 2 included understandability, a qualitative characteristic that enables users to comprehend the information and therefore make it useful for making decisions. Both frameworks also similarly described that for financial information to be understandable, users should have a reasonable degree of financial knowledge and a willingness to study the information with reasonable diligence.

BC3.41 Despite those discussions of understandability and users' responsibilities for understanding financial reports, misunderstanding persists. For example, some have expressed the view that a new accounting method should not be implemented because some users might not understand it, even though the new accounting method would result in reporting financial information that is useful for decision-making. They imply that understandability is more important than relevance.

BC3.42 If understandability considerations were fundamental, it might be appropriate to avoid reporting information about very complicated things even if the information is relevant and faithfully represented. Classifying understandability as an enhancing qualitative characteristic is intended to indicate that information that is difficult to understand should be presented and explained as clearly as possible.

BC3.43 To clarify another frequently misunderstood point, the *Conceptual Framework* explains that users are responsible for *actually* studying reported financial information with reasonable diligence rather than only being *willing* to do so (which was the statement in the previous frameworks). In addition, the *Conceptual Framework* states that users may need to seek the aid of advisers to understand economic phenomena that are particularly complex.

Qualitative characteristics not included

BC3.44 *Transparency, high quality, internal consistency, true and fair view or fair presentation* and *credibility* have been suggested as desirable qualitative characteristics of financial information. However, transparency, high quality, internal consistency, true and fair view or fair presentation are different words to describe information that has the qualitative characteristics of relevance and

representational faithfulness enhanced by comparability, verifiability, timeliness and understandability. Credibility is similar but also implies trustworthiness of a reporting entity's management.

BC3.45 Interested parties sometimes suggested other criteria for standard-setting decisions, and the Board has at times cited some of those criteria as part of the rationale for some decisions. Those criteria include simplicity, operationality, practicability or practicality, and acceptability.

BC3.46 Those criteria are not qualitative characteristics. Instead, they are part of the overall weighing of benefits and costs of providing useful financial information. For example, a simpler method may be less costly to apply than a more complex method. In some circumstances, a simpler method may result in information that is essentially the same as, but somewhat less precise than, information produced by a more complex method. In that situation, a standard-setter would include the decrease in faithful representation and the decrease in implementation cost in weighing benefits against costs.

The cost constraint on useful financial reporting

BC3.47 Cost is a pervasive constraint that standard-setters, as well as providers and users of financial information, should keep in mind when considering the benefits of a possible new financial reporting requirement. Cost is not a qualitative characteristic of information. It is a characteristic of the process used to provide the information.

BC3.48 The Board has attempted and continues to attempt to develop more structured methods of obtaining information about the cost of gathering and processing the information that proposed standards would require entities to provide. The primary method used is to request interested parties, sometimes formally (such as by field tests and questionnaires), to submit cost and benefit information for a specific proposal that is quantified to the extent feasible. Those requests have resulted in helpful information and have led directly to changes to proposed requirements to reduce the costs without significantly reducing the related benefits.

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IASB Table of Concordance

This table shows how the contents of the *Framework* (1989) and the *Conceptual Framework* 2010 correspond.

***Framework* (1989) paragraphs**	***Conceptual Framework* 2010 paragraphs**
Preface and Introduction paragraphs 15	Introduction
6–21	superseded by Chapter 1
22	Not carried forward
23	4.1
24–46	superseded by Chapter 3
47–110	Chapter 4
47, 48	4.2, 4.3
49–52	4.4–4.7
53–59	4.8–4.14
60–64	4.15–4.19
65–68	4.20–4.23
69–73	4.24–4.28
74–77	4.29–4.32
78–80	4.33–4.35
81	4.36
8284	4.37–4.39
85	4.40
86–88	4.41–4.43
89, 90	4.44, 4.45
91	4.46
92, 93	4.47, 4.48
94–98	4.49–4.53
99–101	4.54–4.56
102, 103	4.57, 4.58
104–110	4.59–4.65

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Part B of the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting2010* is set out in paragraphs B1–B110. Part B of the NZ *Framework* is based on the IASB *Framework for the Preparation and Presentation of Financial Statements* (1989) (IASB *Framework* (1989)) initially issued by the International Accounting Standards Committee (IASC) and subsequently adopted by the International Accounting Standards Board (IASB).

Part B of this NZ *Framework* has not been amended to reflect the changes made by NZ IAS 1 *Presentation of Financial Statements* (as revised in 2007).

Any additional material is shown with grey shading. The paragraphs are denoted with "NZ" and identify the types of entities to which the paragraphs apply.

Part B of this NZ *Framework* uses the terminology adopted in International Financial Reporting Standards[*] (IFRSs) to describe the financial statements and other elements. New Zealand Equivalent to IAS 1 *Presentation of Financial Statements* (as revised in 2007) paragraph 5 explains that entities seeking to apply this NZ *Framework* may need to amend the descriptions used for particular line items in the financial statements and for the financial statements themselves. For example, profit/loss may be referred to as surplus/deficit and capital or share capital may be referred to as equity.

[*] The term IFRSs is defined in New Zealand Equivalent to IFRS 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards* (NZ IFRS 1).

Introduction to Part B of the NZ *Framework*

Part B of this NZ *Framework* is based on the IASB *Framework* (1989). Part B of this NZ *Framework* is an essential component of New Zealand financial reporting pronouncements as it establishes definitions and recognition criteria that are applied in other pronouncements.

The IASB *Framework* (1989) was developed for application by profit-oriented entities. Part B of this NZ *Framework* includes material additional to that in the IASB *Framework* (1989) to ensure that it can be applied by public benefit entities required to prepare general purpose financial statements that comply with generally accepted accounting practice in New Zealand. In order to preserve the integrity of the IASB *Framework* (1989) and to enable Part B of this NZ *Framework* to be readily updated for future revisions of the IASB *Framework* (1989), changes to the text of the IASB *Framework* (1989) have been minimised.

In adopting the IASB *Framework* (1989) for application as Part B of the NZ *Framework*, the following changes have been made.

(a) The discussion in paragraphs B1–B4 has been revised to reflect the purpose of Part B of the NZ *Framework* and the role of the FRSB (paragraphs NZ B4.1 to NZ B4.4).

(b) The description of a complete set of financial statements has been amended for consistency with NZ IAS 1 *Presentation of Financial Statements* (paragraph B7).

(c) A discussion acknowledging the role of non-financial and supplementary information has been included (paragraph NZ B7.1).

(d) Additional paragraphs have been inserted to acknowledge the range of entities that are required to prepare general purpose financial statements (paragraphs NZ B8.1 to NZ B8.3).

(e) A discussion of two additional users of financial statements (funders or financial supporters, and elected or appointed representatives) has been inserted (paragraph NZ B9.1).

(f) A discussion of the role of financial statements in demonstrating accountability has been included (paragraphs NZ B14.1 and NZ B14.2).

(g) A discussion of various types of non-financial and supplementary information has been included (paragraphs NZ B20.1 to NZ B20.8).

(h) Additional guidance for public benefit entities in respect of materiality has been inserted (paragraph NZ B30.1).

(i) An additional paragraph discussing "future economic benefits" and "service potential" has been inserted (paragraph NZ B49.1).

(j) Additional guidance has been inserted stating that in the context of public benefit entities, references to contributions from (or distributions to) equity participants

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should be read as contributions from (or distributions to) equity holders acting in their capacity as equity holders (paragraph NZ B70.1).

(k) A brief discussion of the elements of non-financial statements has been included. Part B of the NZ *Framework* requires that the quality of the information presented in non-financial and supplementary information should be considered with regard to the qualitative characteristics and constraints on those qualitative characteristics discussed in paragraphs B24 to B45 of Part B of the NZ *Framework* (paragraphs NZ B101.1 to NZ B101.3).

(l) A brief rationale for the New Zealand specific sections has been included as an Appendix to Part B of the NZ *Framework*.

Introduction to Part B

Purpose and status

B1-B4 [Paragraphs 1 to 4 of the IASB *Framework* (1989) are not reproduced—they have been replaced by paragraphs NZ B4.1 to NZ B4.4 which explain the purpose of Part B of this NZ *Framework*.]

NZ B4.1 Part B of this NZ *Framework* sets out the concepts that underlie the preparation and presentation of financial statements by public benefit entities required to prepare general purpose financial statements that comply with Generally Accepted Accounting Practice in New Zealand (NZ GAAP).[*],[†] The IASB *Framework* (1989), on which Part B of this NZ *Framework* is based, focuses on financial statements. However, financial statements are often presented in conjunction with other information. A financial report may include financial statements, non-financial statements and supplementary information. In adopting Part B of this NZ *Framework* for application to New Zealand public benefit entities, and particularly to ensure the relevance of Part B of the NZ *Framework* for public benefit entities, certain aspects have been extended to acknowledge the role of non-financial and supplementary information. These paragraphs are clearly marked. The purpose of Part B of this NZ *Framework* is to:

(a) assist the New Zealand National Standard Setter in its role as a national standard setter with formal liaison status with the IASB:
   (i) in the development of future International Financial Reporting Standards (IFRSs);
   (ii) in the review of existing IFRSs; and
   (iii) in promoting harmonisation of 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 IFRSs;

(b) assist the New Zealand National Standard Setter in developing New Zealand equivalents to IFRSs;

[*] The New Zealand *Preface* (NZ *Preface*), paragraph 17, contains an explanation of the term general purpose financial statements.

[†] A range of entities are required by legislation (for example, Financial Reporting Act 1993, Public Finance Act 1989, Local Government Act 2002, to prepare financial statements in accordance with GAAP (as defined in the Finncial Reporting Act or a modified version of that definition).

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(c) in the absence of a New Zealand equivalent to an IFRS, assist the New Zealand National Standard Setter in developing a Financial Reporting Standard;

(d) assist preparers of financial statements in applying Standards[*] and in dealing with topics that have yet to form the subject of a Standard;

(e) assist auditors in forming an opinion as to whether financial statements conform with Standards; and

(f) assist users of financial statements in interpreting the information contained in financial statements.

NZ B4.2 Part B of this NZ *Framework* is not a Standard and hence does not define standards for any particular definition, recognition, measurement or disclosure issue. Nothing in Part B of this NZ *Framework* overrides any specific Standard. The NZ *Preface* outlines the requirements of New Zealand Equivalent to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (NZ IAS 8) in relation to developing accounting policies in the absence of a specific Standard or an interpretation of a Standard that specifically applies to a transaction, other event or condition.

NZ B4.3 The New Zealand National Standard Setter recognises that in a limited number of cases there may be a conflict between Part B of this NZ *Framework* and a specific Standard. In those cases where there is a conflict, the requirements of the Standard prevail over those of Part B of this NZ *Framework*. As, however, the IASB and the New Zealand National Standard Setter will be guided by their respective *Frameworks* in the development of future Standards and in their review of existing Standards, the number of cases of conflict between Part B of this NZ *Framework* and Standards will diminish through time.

NZ B4.4 Part B of this NZ *Framework* will be revised from time to time.

Scope

B5 Part B of this NZ *Framework* deals with:

(a) the objective of financial statements;

(b) the qualitative characteristics that determine the usefulness of information in financial statements;

(c) the definition, recognition and measurement of the elements from which financial statements are constructed; and

(d) concepts of capital and capital maintenance.

[*] Unless otherwise stated, references to Standards in this document should be read as references to both New Zealand equivalents to IFRSs (as defined in New Zealand equivalent to IFRS 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards*) and other Financial Reporting Standards applicable to entities that have adopted New Zealand equivalents to IFRSs.

B6 Part B of this NZ *Framework* is concerned with general purpose financial statements (hereafter referred to as "financial statements"), including consolidated financial statements. Such financial statements are prepared and presented at least annually and are directed toward the common information needs of a wide range of users. Some of these users may require, and have the power to obtain, information in addition to that contained in the financial statements. Many users, however, have to rely on the financial statements as their major source of financial information and such financial statements should, therefore, be prepared and presented with their needs in view. Special purpose financial reports, for example, prospectuses and computations prepared for taxation purposes, are outside the scope of Part B of this NZ *Framework*. Nevertheless, Part B of this NZ *Framework* may be applied in the preparation of such special purpose reports where their requirements permit.

B7 Financial statements form part of the process of financial reporting. A complete set of financial statements normally includes a balance sheet, an income statement, a statement of cash flows and a statement of changes in equity, and those notes and other statements and explanatory material that are an integral part of the financial statements. They may also include supplementary schedules and information based on or derived from, and expected to be read with, such statements. Such schedules and supplementary information may deal, for example, with financial information about industrial and geographical segments and disclosures about the effects of changing prices. Financial statements do not, however, include such items as reports by directors, statements by the chairman, discussion and analysis by management and similar items that may be included in an annual or interim report. [Amended in Part B of NZ *Framework* for consistency with the explanation of a complete set of financial statements in NZ IAS 1 *Presentation of Financial Statements*.]

NZ B7.1 A financial report may include financial statements, non-financial statements such as statements of service performance and supplementary information which is additional to the information in financial statements.

B8 Part B of this NZ *Framework* applies to the financial statements of public benefit entities. A reporting entity* is an entity for which there are users who rely on the financial statements as their major source of financial information about the entity. [Amended in Part B NZ *Framework*—first sentence adapted to remove reference to commercial entities.]

* This definition of a reporting entity differs to that used in the Financial Reporting Act 1993. The Financial Reporting Act 1993 defines a reporting entity as:
(a) An issuer; or
(b) A company, other than an exempt company; or
(c) A person that is required by any Act, other than this Act, to comply with this Act as if it were a reporting entity. The definition in the Financial Reporting Act is used to establish a legal requirement for certain entities to report in accordance with NZ GAAP.

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NZ B8.1 An obligation to prepare general purpose financial statements often derives from legislation, regulations, common law, an entity's constitution or contractual arrangements.

NZ B8.2 Types of reporting entities include companies, government departments, Crown entities, local authorities, and other not-for-profit entities including trusts and charities. New Zealand Standards contain requirements in relation to all entities. Certain requirements within Standards apply to some entities only (for example, public benefit entities).[*]

NZ B8.3 The application of Part B of this NZ *Framework* is outlined in paragraph NZ B4.1.

Users and their information needs

B9 The users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They use financial statements in order to satisfy some of their different needs for information. These needs include the following:

(a) *Investors.* The providers of risk capital and their advisers are concerned with the risk inherent in, and return provided by, their investments. They need information to help them determine whether they should buy, hold or sell. Shareholders are also interested in information which enables them to assess the ability of the entity to pay dividends.

(b) *Employees.* Employees and their representative groups are interested in information about the stability and profitability of their employers. They are also interested in information which enables them to assess the ability of the entity to provide remuneration, retirement benefits and employment opportunities.

(c) *Lenders.* Lenders are interested in information that enables them to determine whether their loans, and the interest attaching to them, will be paid when due.

(d) *Suppliers and other trade creditors.* Suppliers and other creditors are interested in information that enables them to determine whether amounts owing to them will be paid when due. Trade creditors are likely to be interested in an entity over a shorter period than lenders unless they are dependent upon the continuation of the entity as a major customer.

(e) *Customers.* Customers have an interest in information about the continuance of an entity, especially when they have a long-term involvement with, or are dependent on, the entity.

(f) *Governments and their agencies.* Governments and their agencies are interested in the allocation of resources and, therefore, the activities of

[*] The NZ *Preface* contains an explanation of the term public benefit entities.

entities. They also require information in order to regulate the activities of entities, determine taxation policies and as the basis for national income and similar statistics.

(g) *Public.* Entities affect members of the public in a variety of ways. For example, entities may make a substantial contribution to the local economy in many ways, including the number of people they employ and their patronage of local suppliers. Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the entity and the range of its activities.

NZ B9.1 The users of financial statements in the New Zealand context also include funders and financial supporters (for example, taxpayers and donors), and elected or appointed representatives. Their needs include the following:

(a) Funders or financial supporters. Funders or financial supporters provide a source of cash and/or resources that does not generate a direct return (unlike a loan) and is not provided in exchange for direct benefits (goods or services) for themselves. The funder or financial supporter generally provides taxation, grants or donations to the entity. This class of users includes the past, present and potential funders and financial supporters of the entity. When funders and financial supporters provide resources that are used to supply goods and services to third parties they are interested in the quality of the goods and services produced and whether the goods and services were produced in accordance with relevant contracts or agreements. As with customers that purchase goods and services directly from an entity, funders and financial supporters are interested in information about the continuance of an entity, such as its sustainability, flexibility and vulnerability.

(b) Elected or appointed representatives. Members of Parliament and local authority councillors represent their respective electorates. Members of a governing body represent the interests of specific groups or entities. Elected or appointed representatives use financial statements to assess an entity's actual achievement against its formal objectives and targets and hold an entity accountable for its performance. Such users are likely to use financial statements in conjunction with non-financial information. Where the elected or appointed representatives have responsibility for the long-term financial performance of an entity they may also be interested in its sustainability, flexibility and vulnerability.

B10 While all of the information needs of these users cannot be met by financial statements, there are needs which are common to all users. As investors are providers of risk capital to the entity, the provision of financial statements that meet their needs will also meet most of the needs of other users that financial statements can satisfy.

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B11 The management[*] of an entity has the primary responsibility for the preparation and presentation of the financial statements of the entity. Management is also interested in the information contained in the financial statements even though it has access to additional management and financial information that helps it carry out its planning, decision-making and control responsibilities. Management has the ability to determine the form and content of such additional information in order to meet its own needs. The reporting of such information, however, is beyond the scope of Part B of this NZ *Framework*. Nevertheless, published financial statements are based on the information used by management about the financial position, performance and changes in financial position of the entity. [Footnote on definitions of management inserted in Part B of NZ *Framework*.]

The objective of financial statements

B12 The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

B13 Financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non-financial information.

B14 Financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they may make economic decisions; these decisions may include, for example, whether to hold or sell their investment in the entity or whether to reappoint or replace the management.

[*] New Zealand Equivalent to IAS 24 *Related Party Disclosures* (NZ IAS 24) defines “key management personnel” as those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

NZ B14.1 In addition to making economic decisions, as discussed in paragraphs B12 to B14, users of financial statements of New Zealand entities may also be interested in how well an entity has demonstrated its accountability in relation to a range of obligations including the entity's compliance with legislation, regulations, common law and contractual arrangements.

NZ B14.2 An entity may demonstrate its accountability in relation to its obligations in its financial statements or in non-financial statements and other supplementary information. Accountability requires that an entity reflect the nature and dimensions of performance that are relevant to the entity by:

(a) identifying the objectives and targets (financial or non-financial) normally established by formal process; and

(b) recognising, measuring and disclosing actual achievements in relation to those objectives and targets.

Financial position, performance and changes in financial position

B15 The economic decisions that are taken by users of financial statements require an evaluation of the ability of an entity to generate cash and cash equivalents and of the timing and certainty of their generation. This ability ultimately determines, for example, the capacity of an entity to pay its employees and suppliers, meet interest payments, repay loans and make distributions to its owners. Users are better able to evaluate this ability to generate cash and cash equivalents if they are provided with information that focuses on the financial position, performance and changes in financial position of an entity.

B16 The financial position of an entity is affected by the economic resources it controls, its financial structure, its liquidity and solvency, and its capacity to adapt to changes in the environment in which it operates. Information about the economic resources controlled by the entity and its capacity in the past to modify these resources is useful in predicting the ability of the entity to generate cash and cash equivalents in the future. Information about financial structure is useful in predicting future borrowing needs and how future profits and cash flows will be distributed among those with an interest in the entity; it is also useful in predicting how successful the entity is likely to be in raising further finance. Information about liquidity and solvency is useful in predicting the ability of the entity to meet its financial commitments as they fall due. Liquidity refers to the availability of cash in the near future after taking account of financial commitments over this period. Solvency refers to the availability of cash over the longer term to meet financial commitments as they fall due.

B17 Information about the performance of an entity, in particular its profitability, is required in order to assess potential changes in the economic resources that it is likely to control in the future. Information about variability of performance is important in this respect. Information about performance is useful in predicting

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the capacity of the entity to generate cash flows from its existing resource base. It is also useful in forming judgements about the effectiveness with which the entity might employ additional resources.

B18 Information concerning changes in the financial position of an entity is useful in order to assess its investing, financing and operating activities during the reporting period. This information is useful in providing the user with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows. In constructing a statement of changes in financial position, funds can be defined in various ways, such as all financial resources, working capital, liquid assets or cash. No attempt is made in Part B of this NZ *Framework* to specify a definition of funds.

B19 Information about financial position is primarily provided in a balance sheet. Information about performance is primarily provided in an income statement. Information about changes in financial position is provided in the financial statements by means of a separate statement.

B20 The component parts of the financial statements interrelate because they reflect different aspects of the same transactions or other events. Although each statement provides information that is different from the others, none is likely to serve only a single purpose or provide all the information necessary for particular needs of users. For example, an income statement provides an incomplete picture of performance unless it is used in conjunction with the balance sheet and the statement of changes in financial position.

Non-financial and supplementary information

NZ B20.1 In order to assist users of financial statements in making economic decisions and in forming assessments of an entity's accountability for its obligations, an entity may provide a range of non-financial and supplementary information including:

(a) historical information;

(b) interpretive comment;

(c) prospective information;

(d) service performance information;

(e) information on compliance with legislation; and

(f) key value driver information.

NZ B20.2 Historical information reports on past transactions and events.

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NZ B20.3 Interpretive comment reports on reported results. For example, narrative comment could explain the relationship between material changes in financial elements and the entity's history, objectives, current activities and changes in the external environment (including the economic, physical and social environment) or objectives.

NZ B20.4 Prospective information reports on the potential effects of past transactions and events and the likely effects of proposed transactions and events. It is commonly disclosed in narrative and/or quantitative form. For example, narrative information could provide an assessment of the entity's future impacts and prospects, focusing on how anticipated changes in the external environment (including the economic, physical and social environment) might affect results, liquidity and risk. In contrast, quantitative information could take the form of predictive results for anticipated economic, social or environmental effects based on proposed courses of action.

NZ B20.5 Service performance is the term used to describe an entity's performance in meeting its objectives of supplying goods and services. An entity's service performance is assessed by comparing the entity's service performance results with its service performance objectives. Service performance objectives and results are reported in non-financial terms, such as quantities of goods and services provided.

NZ B20.6 An entity may have an obligation to report service performance when it receives funding from one party (the ratepayer, the donor etc) but delivers (or arranges to deliver) outputs (goods and services) to third parties (the general public, the disabled etc). This relationship occurs when the entity has the coercive power to tax, rate or levy to obtain public funds, or the entity receives donations from the public. For example, this relationship exists where the entity reporting is a charity that receives donations from the public but provides services to third parties such as the disabled. Similarly, a local authority may charge rates to property owners but provide a park and other services to the general public as third parties.

NZ B20.7 Entities have a range of legal obligations, including compliance with legislation governing health and safety, human resources and protection of the environment. Such obligations may impact upon financial performance, or information from the financial statements may be used to demonstrate an entity's commitment to these obligations. In addition, some entities have legal obligations to operate in accordance with approved budgets.

NZ B20.8 Non-financial information might also focus on identifying and describing the key business, operational and strategic factors facing an entity. Key value driver information can encompass a broad range of measures including sales growth, profit, client satisfaction, measures of the quality of goods and services, and supplier relationships.

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Notes and supplementary schedules

B21 The financial statements also contain notes and supplementary schedules and other information. For example, they may contain additional information that is relevant to the needs of users about the items in the balance sheet and income statement. They may include disclosures about the risks and uncertainties affecting the entity and any resources and obligations not recognised in the balance sheet (such as mineral reserves). Information about geographical and industry segments and the effect on the entity of changing prices may also be provided in the form of supplementary information.

Underlying assumptions

Accrual basis

B22 In order to meet their objectives, financial statements are prepared on the accrual basis of accounting. Under this basis, the effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Financial statements prepared on the accrual basis inform users not only of past transactions involving the payment and receipt of cash but also of obligations to pay cash in the future and of resources that represent cash to be received in the future. Hence, they provide the type of information about past transactions and other events that is most useful to users in making economic decisions.

Going concern

B23 The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis and, if so, the basis used is disclosed.

Qualitative characteristics of financial statements

B24 Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

Understandability

B25 An essential quality of the information provided in financial statements is that it is readily understandable by users. For this purpose, users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand.

Relevance

B26 To be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

B27 The predictive and confirmatory roles of information are interrelated. For example, information about the current level and structure of asset holdings has value to users when they endeavour to predict the ability of the entity to take advantage of opportunities and its ability to react to adverse situations. The same information plays a confirmatory role in respect of past predictions about, for example, the way in which the entity would be structured or the outcome of planned operations.

B28 Information about financial position and past performance is frequently used as the basis for predicting future financial position and performance and other matters in which users are directly interested, such as dividend and wage payments, security price movements and the ability of the entity to meet its commitments as they fall due. To have predictive value, information need not be in the form of an explicit forecast. The ability to make predictions from financial statements is enhanced, however, by the manner in which information on past transactions and events is displayed. For example, the predictive value of the income statement is enhanced if unusual, abnormal and infrequent items of income or expense are separately disclosed.

Materiality

B29 The relevance of information is affected by its nature and materiality. In some cases, the nature of information alone is sufficient to determine its relevance. For example, the reporting of a new segment may affect the assessment of the risks and opportunities facing the entity irrespective of the materiality of the results achieved by the new segment in the reporting period. In other cases, both the nature and materiality are important, for example, the amounts of inventories held in each of the main categories that are appropriate to the business.

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B30 Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.

NZ B30.1 In addition to the guidance in paragraph B30, omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements.

Reliability

B31 To be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.

B32 Information may be relevant but so unreliable in nature or representation that its recognition may be potentially misleading. For example, if the validity and amount of a claim for damages under a legal action are disputed, it may be inappropriate for the entity to recognise the full amount of the claim in the balance sheet, although it may be appropriate to disclose the amount and circumstances of the claim.

Faithful representation

B33 To be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent. Thus, for example, a balance sheet should represent faithfully the transactions and other events that result in assets, liabilities and equity of the entity at the reporting date which meet the recognition criteria.

B34 Most financial information is subject to some risk of being less than a faithful representation of that which it purports to portray. This is not due to bias, but rather to inherent difficulties either in identifying the transactions and other events to be measured or in devising and applying measurement and presentation techniques that can convey messages that correspond with those transactions and events. In certain cases, the measurement of the financial effects of items could be so uncertain that entities generally would not recognise them in the financial statements; for example, although most entities generate goodwill internally over time, it is usually difficult to identify or measure that goodwill reliably. In other cases, however, it may be relevant to recognise items and to disclose the risk of error surrounding their recognition and measurement.

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Substance over form

B35 If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form. For example, an entity may dispose of an asset to another party in such a way that the documentation purports to pass legal ownership to that party; nevertheless, agreements may exist that ensure that the entity continues to enjoy the future economic benefits embodied in the asset. In such circumstances, the reporting of a sale would not represent faithfully the transaction entered into (if indeed there was a transaction).

Neutrality

B36 To be reliable, the information contained in financial statements must be neutral, that is, free from bias. Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

Prudence

B37 The preparers of financial statements do, however, have to contend with the uncertainties that inevitably surround many events and circumstances, such as the collectability of doubtful receivables, the probable useful life of plant and equipment and the number of warranty claims that may occur. Such uncertainties are recognised by the disclosure of their nature and extent and by the exercise of prudence in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses, because the financial statements would not be neutral and, therefore, not have the quality of reliability.

Completeness

B38 To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

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Comparability

B39 Users must be able to compare the financial statements of an entity through time in order to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different entities in order to evaluate their relative financial position, performance and changes in financial position. Hence, the measurement and display of the financial effect of like transactions and other events must be carried out in a consistent way throughout an entity and over time for that entity and in a consistent way for different entities.

B40 An important implication of the qualitative characteristic of comparability is that users be informed of the accounting policies employed in the preparation of the financial statements, any changes in those policies and the effects of such changes. Users need to be able to identify differences between the accounting policies for like transactions and other events used by the same entity from period to period and by different entities. Compliance with NZ GAAP, including the disclosure of the accounting policies used by the entity, helps to achieve comparability. [Amended in Part B of NZ *Framework* - final sentence, reference to NZ GAAP inserted.]

B41 The need for comparability should not be confused with mere uniformity and accounting standards. It is not appropriate for an entity to continue accounting in the same manner for a transaction or other event if the policy adopted is not in keeping with the qualitative characteristics of relevance and reliability. It is also inappropriate for an entity to leave its accounting policies unchanged when more relevant and reliable alternatives exist.

B42 Because users wish to compare the financial position, performance and changes in financial position of an entity over time, it is important that the financial statements show corresponding information for the preceding periods.

Constraints on relevant and reliable information

Timeliness

B43 If there is undue delay in the reporting of information it may lose its relevance. Management may need to balance the relative merits of timely reporting and the provision of reliable information. To provide information on a timely basis it may often be necessary to report before all aspects of a transaction or other event are known, thus impairing reliability. Conversely, if reporting is delayed until all aspects are known, the information may be highly reliable but of little use to users who have had to make decisions in the interim. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the economic decision-making needs of users.

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Balance between benefit and cost

B44 The balance between benefit and cost is a pervasive constraint rather than a qualitative characteristic. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a judgmental process. Furthermore, the costs do not necessarily fall on those users who enjoy the benefits. Benefits may also be enjoyed by users other than those for whom the information is prepared; for example, the provision of further information to lenders may reduce the borrowing costs of an entity. For these reasons, it is difficult to apply a cost-benefit test in any particular case. Nevertheless, standard-setters in particular, as well as the preparers and users of financial statements, should be aware of this constraint.

Balance between qualitative characteristics

B45 In practice a balancing, or trade-off, between qualitative characteristics is often necessary. Generally the aim is to achieve an appropriate balance among the characteristics in order to meet the objective of financial statements. The relative importance of the characteristics in different cases is a matter of professional judgment.

True and fair view/fair presentation

B46 Financial statements are frequently described as showing a true and fair view of, or as presenting fairly, the financial position, performance and changes in financial position of an entity. Although Part B of this NZ *Framework* does not deal directly with such concepts, the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements that convey what is generally understood as a true and fair view of, or as presenting fairly such information.[*]

The elements of financial statements

B47 Financial statements portray the financial effects of transactions and other events by grouping them into broad classes according to their economic characteristics. These broad classes are termed the elements of financial statements. The elements directly related to the measurement of financial position in the balance sheet are assets, liabilities and equity. The elements directly related to the measurement of performance in the income statement are income and expenses. The statement of changes in financial position usually reflects income statement elements and changes in balance sheet elements; accordingly, Part B of this NZ *Framework* identifies no elements that are unique to this statement.

[*] For details of regulatory requirements in New Zealand, refer to the Financial Reporting Act 1993, the Public Finance Act 1989 and the Local Government Act 2002. Refer also to NZ IAS 1, paragraph 21.

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B48 The presentation of these elements in the balance sheet and the income statement involves a process of sub-classification. For example, assets and liabilities may be classified by their nature or function in the business of the entity in order to display information in the manner most useful to users for purposes of making economic decisions.

Financial Position

B49 The elements directly related to the measurement of financial position are assets, liabilities and equity. These are defined as follows:

(a) An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

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

(c) Equity is the residual interest in the assets of the entity after deducting all its liabilities.

NZ B49.1 Part B of this NZ *Framework* uses the term “future economic benefits”. This term is to be read as having the same meaning as the term “service potential”. Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity’s objectives but which do not directly generate net cash inflows are often described as embodying “service potential.” Assets that are used to generate net cash inflows are often described as embodying “future economic benefits.”

B50 The definitions of an asset and a liability identify their essential features but do not attempt to specify the criteria that need to be met before they are recognised in the balance sheet. Thus, the definitions embrace items that are not recognised as assets or liabilities in the balance sheet because they do not satisfy the criteria for recognition discussed in paragraphs B82 to B98. In particular, the expectation that future economic benefits will flow to or from an entity must be sufficiently certain to meet the probability criterion in paragraph B83 before an asset or liability is recognised.

B51 In assessing whether an item meets the definition of an asset, liability or equity, attention needs to be given to its underlying substance and economic reality and not merely its legal form. Thus, for example, in the case of finance leases, the substance and economic reality are that the lessee acquires the economic benefits of the use of the leased asset for the major part of its useful life in return for entering into an obligation to pay for that right an amount approximating to the fair value of the asset and the related finance charge. Hence, the finance lease gives rise to items that satisfy the definition of an asset and a liability and are recognised as such in the lessee’s balance sheet.

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B52 Balance sheets drawn up in accordance with current Standards may include items that do not satisfy the definitions of an asset or liability and are not shown as part of equity. The definitions set out in paragraph B49 will, however, underlie future reviews of existing Standards and the formulation of further Standards.

Assets

B53 The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.

B54 An entity usually employs its assets to produce goods or services capable of satisfying the wants or needs of customers; because these goods or services can satisfy these wants or needs, customers are prepared to pay for them and hence contribute to the cash flow of the entity. Cash itself renders a service to the entity because of its command over other resources.

B55 The future economic benefits embodied in an asset may flow to the entity in a number of ways. For example, an asset may be:

(a) used singly or in combination with other assets in the production of goods or services to be sold by the entity;

(b) exchanged for other assets;

(c) used to settle a liability; or

(d) distributed to the owners of the entity.

B56 Many assets, for example, property, plant and equipment, have a physical form. However, physical form is not essential to the existence of an asset; hence patents and copyrights, for example, are assets if future economic benefits are expected to flow from them to the entity and if they are controlled by the entity.

B57 Many assets, for example, receivables and property, are associated with legal rights, including the right of ownership. In determining the existence of an asset, the right of ownership is not essential; thus, for example, property held on a lease is an asset if the entity controls the benefits which are expected to flow from the property. Although the capacity of an entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control. For example, know-how obtained from a development activity may meet the definition of an asset when, by keeping that know-how secret, an entity controls the benefits that are expected to flow from it.

B58 The assets of an entity result from past transactions or other past events. Entities normally obtain assets by purchasing or producing them, but other transactions or events may generate assets; examples include property received by an entity from government as part of a programme to encourage economic growth in an area and

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the discovery of mineral deposits. Transactions or events expected to occur in the future do not in themselves give rise to assets; hence, for example, an intention to purchase inventory does not, of itself, meet the definition of an asset.

B59 There is a close association between incurring expenditure and generating assets but the two do not necessarily coincide. Hence, when an entity incurs expenditure, this may provide evidence that future economic benefits were sought but is not conclusive proof that an item satisfying the definition of an asset has been obtained. Similarly the absence of a related expenditure does not preclude an item from satisfying the definition of an asset and thus becoming a candidate for recognition in the balance sheet; for example, items that have been donated to the entity may satisfy the definition of an asset.

Liabilities

B60 An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. If, for example, an entity decides as a matter of policy to rectify faults in its products even when these become apparent after the warranty period has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities.

B61 A distinction needs to be drawn between a present obligation and a future commitment. A decision by the management of an entity to acquire assets in the future does not, of itself, give rise to a present obligation. An obligation normally arises only when the asset is delivered or the entity enters into an irrevocable agreement to acquire the asset. In the latter case, the irrevocable nature of the agreement means that the economic consequences of failing to honour the obligation, for example, because of the existence of a substantial penalty, leave the entity with little, if any, discretion to avoid the outflow of resources to another party.

B62 The settlement of a present obligation usually involves the entity giving up resources embodying economic benefits in order to satisfy the claim of the other party. Settlement of a present obligation may occur in a number of ways, for example, by:

(a) payment of cash;

(b) transfer of other assets;

(c) provision of services;

(d) replacement of that obligation with another obligation; or

(e) conversion of the obligation to equity.

An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

B63 Liabilities result from past transactions or other past events. Thus, for example, the acquisition of goods and the use of services give rise to trade payables (unless paid for in advance or on delivery) and the receipt of a bank loan results in an obligation to repay the loan. An entity may also recognise future rebates based on annual purchases by customers as liabilities; in this case, the sale of the goods in the past is the transaction that gives rise to the liability.

B64 Some liabilities can be measured only by using a substantial degree of estimation. Some entities describe these liabilities as provisions. In some countries, such provisions are not regarded as liabilities because the concept of a liability is defined narrowly so as to include only amounts that can be established without the need to make estimates. The definition of a liability in paragraph B49 follows a broader approach. Thus, when a provision involves a present obligation and satisfies the rest of the definition, it is a liability even if the amount has to be estimated. Examples include provisions for payments to be made under existing warranties and provisions to cover pension obligations.

Equity

B65 Although equity is defined in paragraph B49 as a residual, it may be sub-classified in the balance sheet. For example, in a corporate entity, funds contributed by shareholders, retained earnings, reserves representing appropriations of retained earnings and reserves representing capital maintenance adjustments may be shown separately. Such classifications can be relevant to the decision-making needs of the users of financial statements when they indicate legal or other restrictions on the ability of the entity to distribute or otherwise apply its equity. They may also reflect the fact that parties with ownership interests in an entity have differing rights in relation to the receipt of dividends or the repayment of capital.

B66 The creation of reserves is sometimes required by statute or other law in order to give the entity and its creditors an added measure of protection from the effects of losses. Other reserves may be established if national tax law grants exemptions from, or reductions in, taxation liabilities when transfers to such reserves are made. The existence and size of these legal, statutory and tax reserves is information that can be relevant to the decision-making needs of users. Transfers to such reserves are appropriations of retained earnings rather than expenses.

B67 The amount at which equity is shown in the balance sheet is dependent on the measurement of assets and liabilities. Normally, the aggregate amount of equity only by coincidence corresponds with the aggregate market value of the shares of the entity or the sum that could be raised by disposing of either the net assets on a piecemeal basis or the entity as a whole on a going concern basis.

B68 Reporting entities may include sole proprietorships, partnerships and trusts and various types of government business undertakings. The legal and regulatory *Framework* for such entities is often different from that applying to corporate entities. For example, there may be few, if any, restrictions on the distribution to owners or other beneficiaries of amounts included in equity. Nevertheless, the definition of equity and the other aspects of Part B of this NZ *Framework* that

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deal with equity are appropriate for such entities. [Amended in Part B of NZ *Framework*—first sentence amended by deleting reference to "commercial, industrial and business activities"—New Zealand reporting entities engage in a wider range of activities than this.]

Performance

B69 Profit is frequently used as a measure of performance or as the basis for other measures, such as return on investment or earnings per share. The elements directly related to the measurement of profit are income and expenses. The recognition and measurement of income and expenses, and hence profit, depends in part on the concepts of capital and capital maintenance used by the entity in preparing its financial statements. These concepts are discussed in paragraphs B102 to B110.

B70 The elements of income and expenses are defined as follows:

(a) Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

(b) Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

NZ B70.1 In the context of public benefit entities, references to contributions from, or distributions to, equity participants should be read as contributions from, or distributions to, equity holders acting in their capacity as equity holders.

B71 The definitions of income and expenses identify their essential features but do not attempt to specify the criteria that would need to be met before they are recognised in the income statement. Criteria for the recognition of income and expenses are discussed in paragraphs B82 to B98.

B72 Income and expenses may be presented in the income statement in different ways so as to provide information that is relevant for economic decision-making. For example, it is common practice to distinguish between those items of income and expenses that arise in the course of the ordinary activities of the entity and those that do not. This distinction is made on the basis that the source of an item is relevant in evaluating the ability of the entity to generate cash and cash equivalents in the future; for example, incidental activities such as the disposal of a long-term investment are unlikely to recur on a regular basis. When distinguishing between items in this way consideration needs to be given to the nature of the entity and its operations. Items that arise from the ordinary activities of one entity may be unusual in respect of another.

B73 Distinguishing between items of income and expense and combining them in different ways also permits several measures of entity performance to be displayed. These have differing degrees of inclusiveness. For example, the income statement could display gross margin, profit from ordinary activities before taxation, profit from ordinary activities after taxation, and net profit.

Income

B74 The definition of income encompasses both revenue and gains. Revenue arises in the course of the ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent.

B75 Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an entity. Gains represent increases in economic benefits and as such are no different in nature from revenue. Hence, they are not regarded as constituting a separate element in Part B of this NZ *Framework*.

B76 Gains include, for example, those arising on the disposal of non-current assets. The definition of income also includes unrealised gains; for example, those arising on the revaluation of marketable securities and those resulting from increases in the carrying amount of long term assets. When gains are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. Gains are often reported net of related expenses.

B77 Various kinds of assets may be received or enhanced by income; examples include cash, receivables and goods and services received in exchange for goods and services supplied. Income may also result from the settlement of liabilities. For example, an entity may provide goods and services to a lender in settlement of an obligation to repay an outstanding loan.

Expenses

B78 The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity. Expenses that arise in the course of the ordinary activities of the entity include, for example, cost of sales, cost of services provided, wages and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, property, plant and equipment. [Second sentence amended in Part B of NZ *Framework* – the words "cost of services provided" were inserted.]

B79 Losses represent other items that meet the definition of expenses and may, or may not, arise in the course of the ordinary activities of the entity. Losses represent decreases in economic benefits and as such they are no different in nature from other expenses. Hence, they are not regarded as a separate element in Part B of this NZ *Framework*.

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B80 Losses include, for example, those resulting from disasters such as fire and flood, as well as those arising on the disposal of non-current assets. The definition of expenses also includes unrealised losses, for example, those arising from the effects of increases in the rate of exchange for a foreign currency in respect of the borrowings of an entity in that currency. When losses are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. Losses are often reported net of related income.

Capital maintenance adjustments

B81 The revaluation or restatement of assets and liabilities gives rise to increases or decreases in equity. While these increases or decreases meet the definition of income and expenses, they are not included in the income statement under certain concepts of capital maintenance. Instead these items are included in equity as capital maintenance adjustments or revaluation reserves. These concepts of capital maintenance are discussed in paragraphs B102 to B110 of Part B of this NZ *Framework*.

Recognition of the elements of financial statements

B82 Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition set out in paragraph B83. It involves the depiction of the item in words and by a monetary amount and the inclusion of that amount in the balance sheet or income statement totals. Items that satisfy the recognition criteria should be recognised in the balance sheet or income statement. The failure to recognise such items is not rectified by disclosure of the accounting policies used nor by notes or explanatory material.

B83 An item that meets the definition of an element should be recognised if:

(a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and

(b) the item has a cost or value that can be measured with reliability.

B84 In assessing whether an item meets these criteria and therefore qualifies for recognition in the financial statements, regard needs to be given to the materiality considerations discussed in paragraphs B29 and B30. The interrelationship between the elements means that an item that meets the definition and recognition criteria for a particular element, for example, an asset, automatically requires the recognition of another element, for example, income or a liability.

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The probability of future economic benefit

B85 The concept of probability is used in the recognition criteria to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the entity. The concept is in keeping with the uncertainty that characterises the environment in which an entity operates. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence available when the financial statements are prepared. For example, when it is probable that a receivable owed by an entity will be paid, it is then justifiable, in the absence of any evidence to the contrary, to recognise the receivable as an asset. For a large population of receivables, however, some degree of non-payment is normally considered probable; hence an expense representing the expected reduction in economic benefits is recognised.

Reliability of measurement

B86 The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability as discussed in paragraphs B31 to B38 of Part B of this NZ *Framework*. In many cases, cost or value must be estimated; the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When, however, a reasonable estimate cannot be made the item is not recognised in the balance sheet or income statement. For example, the expected proceeds from a lawsuit may meet the definitions of both an asset and income as well as the probability criterion for recognition; however, if it is not possible for the claim to be measured reliably, it should not be recognised as an asset or as income; the existence of the claim, however, would be disclosed in the notes, explanatory material or supplementary schedules.

B87 An item that, at a particular point in time, fails to meet the recognition criteria in paragraph B83 may qualify for recognition at a later date as a result of subsequent circumstances or events.

B88 An item that possesses the essential characteristics of an element but fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes, explanatory material or in supplementary schedules. This is appropriate when knowledge of the item is considered to be relevant to the evaluation of the financial position, performance and changes in financial position of an entity by the users of financial statements.

Recognition of assets

B89 An asset is recognised in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably.

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B90 An asset is not recognised in the balance sheet when expenditure has been incurred for which it is considered improbable that economic benefits will flow to the entity beyond the current accounting period. Instead such a transaction results in the recognition of an expense in the income statement. This treatment does not imply either that the intention of management in incurring expenditure was other than to generate future economic benefits for the entity or that management was misguided. The only implication is that the degree of certainty that economic benefits will flow to the entity beyond the current accounting period is insufficient to warrant the recognition of an asset.

Recognition of liabilities

B91 A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. In practice, obligations under contracts that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements. However, such obligations may meet the definition of liabilities and, provided the recognition criteria are met in the particular circumstances, may qualify for recognition. In such circumstances, recognition of liabilities entails recognition of related assets or expenses.

Recognition of income

B92 Income is recognised in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means, in effect, that recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable).

B93 The procedures normally adopted in practice for recognising income, for example, the requirement that revenue should be earned, are applications of the recognition criteria in Part B of this NZ *Framework*. Such procedures are generally directed at restricting the recognition as income to those items that can be measured reliably and have a sufficient degree of certainty.

Recognition of expenses

B94 Expenses are recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase in liabilities

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or a decrease in assets (for example, the accrual of employee entitlements or the depreciation of equipment).

B95 Expenses are recognised in the income statement on the basis of a direct association between the costs incurred and the earning of specific items of income. This process, commonly referred to as the matching of costs with revenues, involves the simultaneous or combined recognition of revenues and expenses that result directly and jointly from the same transactions or other events; for example, the various components of expense making up the cost of goods sold are recognised at the same time as the income derived from the sale of the goods. However, the application of the matching concept under Part B of this NZ *Framework* does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.

B96 When economic benefits are expected to arise over several accounting periods and the association with income can only be broadly or indirectly determined, expenses are recognised in the income statement on the basis of systematic and rational allocation procedures. This is often necessary in recognising the expenses associated with the using up of assets such as property, plant, equipment, goodwill, patents and trademarks; in such cases the expense is referred to as depreciation or amortisation. These allocation procedures are intended to recognise expenses in the accounting periods in which the economic benefits associated with these items are consumed or expire.

B97 An expense is recognised immediately in the income statement when an expenditure produces no future economic benefits or when, and to the extent that, future economic benefits do not qualify, or cease to qualify, for recognition in the balance sheet as an asset.

B98 An expense is also recognised in the income statement in those cases when a liability is incurred without the recognition of an asset, as when a liability under a product warranty arises.

Measurement of the elements of financial statements

B99 Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the balance sheet and income statement. This involves the selection of the particular basis of measurement.

B100 A number of different measurement bases are employed to different degrees and in varying combinations in financial statements. They include the following:

(a) *Historical cost.* Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash

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equivalents expected to be paid to satisfy the liability in the normal course of business.

(b) *Current cost.* Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

(c) *Realisable (settlement) value.* Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.

(d) *Present value.* Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

B101 The measurement basis most commonly adopted by entities in preparing their financial statements is historical cost. This is usually combined with other measurement bases. For example, inventories are usually carried at the lower of cost and net realisable value, marketable securities may be carried at market value and pension liabilities are carried at their present value. Furthermore, some entities use the current cost basis as a response to the inability of the historical cost accounting model to deal with the effects of changing prices of non-monetary assets.

THE ELEMENTS OF NON-FINANCIAL AND SUPPLEMENTARY INFORMATION

NZ B101.1 The elements reported in non-financial and supplementary information and how these elements are defined will depend on a range of factors, including:

(a) legislative requirements; and

(b) the entity's specific objectives, activities and accountability obligations.

NZ B101.2 For example, the elements of service performance are defined as inputs, outputs and outcomes.*

NZ B101.3 The quality of the information presented in non-financial and supplementary information should be considered with regard to the qualitative characteristics and constraints on those qualitative characteristics discussed in paragraphs B24 to B45 of Part B of this NZ *Framework*.

* Technical Practice Aid No. 9 *Service Performance Reporting* (TPA-9) provides guidance on service performance reporting.

Concepts of capital and capital maintenance

Concepts of capital

B102 A financial concept of capital is adopted by most entities in preparing their financial statements. Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the entity. Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of the entity based on, for example, units of output per day.

B103 The selection of the appropriate concept of capital by an entity should be based on the needs of the users of its financial statements. Thus, a financial concept of capital should be adopted if the users of financial statements are primarily concerned with the maintenance of nominal invested capital or the purchasing power of invested capital. If, however, the main concern of users is with the operating capability of the entity, a physical concept of capital should be used. The concept chosen indicates the goal to be attained in determining profit, even though there may be some measurement difficulties in making the concept operational.

Concepts of capital maintenance and the determination of profit

B104 The concepts of capital in paragraph B102 give rise to the following concepts of capital maintenance:

(a) *Financial capital maintenance.* Under this concept a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.

(b) *Physical capital maintenance.* Under this concept a profit is earned only if the physical productive capacity (or operating capability) of the entity (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

B105 The concept of capital maintenance is concerned with how an entity defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured; it is a prerequisite for distinguishing between an entity's return on capital and its return of capital; only inflows of assets in excess

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of amounts needed to maintain capital may be regarded as profit and therefore as a return on capital. Hence, profit is the residual amount that remains after expenses (including capital maintenance adjustments, where appropriate) have been deducted from income. If expenses exceed income the residual amount is a net loss.

B106 The physical capital maintenance concept requires the adoption of the current cost basis of measurement. The financial capital maintenance concept, however, does not require the use of a particular basis of measurement. Selection of the basis under this concept is dependent on the type of financial capital that the entity is seeking to maintain.

B107 The principal difference between the two concepts of capital maintenance is the treatment of the effects of changes in the prices of assets and liabilities of the entity. In general terms, an entity has maintained its capital if it has as much capital at the end of the period as it had at the beginning of the period. Any amount over and above that required to maintain the capital at the beginning of the period is profit.

B108 Under the concept of financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period. Thus, increases in the prices of assets held over the period, conventionally referred to as holding gains, are, conceptually, profits. They may not be recognised as such, however, until the assets are disposed of in an exchange transaction. When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit. The rest of the increase is treated as a capital maintenance adjustment and, hence, as part of equity.

B109 Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the entity are viewed as changes in the measurement of the physical productive capacity of the entity; hence, they are treated as capital maintenance adjustments that are part of equity and not as profit.

B110 The selection of the measurement bases and concept of capital maintenance will determine the accounting model used in the preparation of the financial statements. Different accounting models exhibit different degrees of relevance and reliability and, as in other areas, management must seek a balance between relevance and reliability. Part B of this NZ *Framework* is applicable to a range of accounting models and provides guidance on preparing and presenting the financial statements constructed under the chosen model. At the present time, it is not the intention of the FRSB or the IASB to prescribe a particular model other than in exceptional circumstances, such as for those entities reporting in the currency of a hyperinflationary economy. This intention will, however, be reviewed in the light of world developments. [Amended in Part B of NZ *Framework*—reference to FRSB inserted.]

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Appendix to Part B
Rationale for NZ Changes to the IASB Framework (1989) and IFRSs

This Appendix provides background to the changes made to the IASB Framework (1989) in adopting the IASB Framework (1989) for application as Part B of the NZ Framework. It does not form part of Part B of the NZ Framework.

1 The ASRB announced in December 2002 that New Zealand entities would be required to apply IFRSs, issued by the IASB, for annual accounting periods commencing on or after 1 January 2007, but would have the option to adopt for accounting periods commencing on or after 1 January 2005.

2 The IASB *Framework* (1989), along with other IFRSs, is designed to be applied to profit-oriented entities. IFRSs are not designed to be applied to public sector entities or other non-profit entities (collectively referred to as public benefit entities) or to profit-oriented entities reporting on broader economic, social and environmental performance and resources.

3 In adopting the IASB *Framework* (1989) for application as Part B of the NZ *Framework*, applicable to the general purpose financial statements public benefit entities, the FRSB has acted in accordance with the guidelines developed by the ASRB regarding matters to be considered in developing a New Zealand equivalent to an international pronouncement.

4 In considering the type of changes required, the FRSB considered the different needs of public benefit entities and profit-oriented entities. New Zealand's experience suggests that standards need to pay particular attention in the following areas.

(a) Information to meet user needs: Stakeholders providing finance to public benefit entities are predominantly funders and financial supporters rather than investors. These groups are primarily seeking information for accountability purposes rather than information about their return on investment.

(b) Reporting entity definition: the boundary of the consolidated reporting entity may have distinctive features, particularly where legal instruments of ownership such as shares do not exist.

(c) Assets: In the public benefit sector special consideration needs to be given to the reporting of assets that do not generate cash, where there is little market evidence, and where the provision of an asset or the supply of benefits arising from the asset are provided at non-market rates.

(d) Liabilities: Rules established regarding the recognition of liabilities need to consider the situation where public benefit entities have commitments, whether general or specific, that do not arise out of market-style

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transactions, and how to account for this sort of "non-exchange" transaction.

5 Many of the above issues are not unique to public benefit entities, but they may require more emphasis and consideration for the accounting standards to be relevant to public benefit entities and to ensure that the desired level of consistency in reporting by those entities is achieved.

6 The FRSB considered issuing the IASB *Framework* (1989) without public benefit material, and restricting its scope to profit-oriented entities, pending a more comprehensive review that would have provided additional consultation with constituents. Under this approach public benefit entities would have continued to apply the New Zealand *Statement of Concepts*. This approach reflected the inherent difficulty in developing a sector-neutral *Framework* from a document that has a profit focus. The FRSB determined not to take that approach because it assessed that the costs of doing so outweighed the benefits. Under that approach the *Statement of Concepts* would need to be amended to ensure that it provided an appropriate foundation for the New Zealand equivalents to IFRSs. The FRSB resolved to issue Part B of the NZ *Framework* based on the IASB *Framework* (1989) but to review the NZ *Framework* as appropriate as part of the review to consider any changes proposed by the IASB to the IASB *Framework* (1989).

7 In some cases the narrower scope of the IASB standards means that further development of the international standards would be needed for them to be relevant to public benefit entities. To the extent that New Zealand has not developed such guidance to date, the general approach taken by the FRSB in developing New Zealand equivalents to IFRSs has been to provide an exemption for public benefit entities from certain requirements and to resolve to either work with the IASB to develop more suitable comprehensive guidance, or to develop specific public benefit entity application guidance itself. At the time Part B of this NZ *Framework* was approved, instances where this approach has been taken include:

(a) non-exchange revenue—where the IASB is updating IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* and the International Public Sector Accounting Standards Board of the International Federation of Accountants (IFAC IPSASB) is also developing guidance;

(b) social policy obligations—where the IFAC IPSASB is currently developing guidance;

(c) impairment of non-cash generating assets—where an assessment of the applicability of the recently issued International Public Sector Accounting Standard IPSAS 21 *Impairment of Non-Cash-Generating Assets* is required; and

(d) segment reporting—where revenue and risk based segments are not considered appropriate, but the integration of segment reporting with service performance information requires further consideration.

Appendix to the NZ *Framework*
Rationale for approach taken to adopting framework consisting of two parts

This Appendix provides background to the decision to adopt the IASB's Conceptual Framework for Financial Reporting 2010 *for profit-oriented entities only as Part A of this NZ* Framework *and retain for public benefit entities only the New Zealand Equivalent to the IASB Framework for the Preparation and Presentation of Financial Statements (issued in June 2005) as Part B of this NZ* Framework.

1 The IASB's *Conceptual Framework for Financial Reporting* (2010) has been adopted for profit-oriented entities only as Part A of this NZ *Framework*. The New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements* issued in June 2005 (the New Zealand Equivalent to the IASB's Framework (1989)) has been retained as Part B of this NZ *Framework* for public benefit entities only.

2 The FRSB decided on its approach for the following reasons:

(a) Public benefit entities could continue applying existing requirements until the IASB has considered not-for-profit entities in Phase G of its Conceptual Framework Project and the outcome of the Ministry of Economic Development's (MEDs) review of the financial reporting framework is known.

(b) Deferring application of the IASB's *Conceptual Framework for Financial Reporting* (IASB *Conceptual Framework*) to public benefit entities will allow time to consider the issues likely to be faced by public benefit entities in applying the IASB *Conceptual Framework*.

(c) Deferring application of the IASB's new chapters to PBEs will avoid both: (i) the need to undertake a costly project to make public-benefit-entity-specific interim amendments to the IASB's *Conceptual Framework* pending the outcome of Phase G of the IASB's Conceptual Framework project and the review of the New Zealand financial reporting framework by the New Zealand Ministry of Economic Development and the Accounting Standards Review Board; and (ii) the subsequent need to update any interim amendments following the outcome of Phase G of the IASB's project and/or the Ministry of Economic Development review.

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4 The FRSB agreed that, consistent with the approach to naming other New Zealand equivalents to International Financial Reporting Standards (NZ IFRSs), the title of the framework should be '*The New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting 2010*'. Although the framework is to include as Part B the existing New Zealand *Framework* (NZ *Framework*) for public benefit entities only, this is no different from including within NZ IFRSs additional New Zealand-specific paragraphs over and above the requirements of IFRS and, therefore, the title of the framework should still make it clear that the framework is a New Zealand equivalent to the IASB's framework.

3 The FRSB decided to maintain a single New Zealand framework consisting of two parts, one part for profit-oriented entities and one for public benefit entities. This is in order to avoid potential complexities that would arise if two completely separate frameworks were to be maintained and in order to minimise the number of consequential amendments to NZ IFRSs that would be required in order for the public-benefit-entity-specific framework to be retained pending the outcome of Phase G of the IASB's conceptual framework project and the Ministry of Economic Development's review.

5 The FRSB noted that the IASB had finalised the new chapters for its framework and that these new chapters had replaced existing paragraphs within the IASB, original framework. However, rather than amending its original framework, the IASB had published a new framework (*Conceptual Framework for Financial Reporting 2010*) comprised of: (i) the new chapters; and (ii) parts of the IASB's original framework not replaced by the new chapters. As such, Parts A and B of the new framework duplicated aspects of the IASB's new framework. For example, Chapter 4 of the IASB's new framework consists of parts of the IASB's previous framework which are repeated in Part B of this NZ *Framework*. It would be possible to avoid such duplication if Part A and B were combined by, for example, adopting the IASB's new framework but inserting into this framework as PBE-only paragraphs the parts of the IASB's previous framework that the IASB has now replaced with its new chapters. However, the FRSB considered that, although the approach taken resulted in some duplication, having Parts A and B as stand-alone parts made this NZ *Framework* as user-friendly as possible and would allow future alterations to be made with greater ease.

7 The FRSB agreed that none of the New Zealand-specific paragraphs in the New Zealand Equivalent to the IASB *Framework for the Preparation and Presentation of Financial Statements* issued in June 2005 would be retained and included in Part A of this NZ *Framework* for profit-oriented entites. In regards to the New Zealand-specific paragraphs applicable to public benefit entities only, the FRSB considered that these paragraphs were not relevant to profit-oriented entities. In regards to the other New Zealand-specific paragraphs the FRSB aims to adopt IASB material with as little modification as possible and therefore chose not to retain these paragraphs noting also that some of these paragraphs are in fact are more relevant to public benefit entities than profit-oriented entities.

8 The FRSB noted that, in the 'Purpose and status' section of Part A of this NZ *Framework,* it is stated that the IASB's *Conceptual Framework* is not an

IFRS and hence does not define standards for any particular measurement or disclosure issue. However, in the absence of an IFRS that specifically applies to a transaction, other event or condition, management develops and applies an accounting policy by referring to, and considering the applicability of, the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in this *Conceptual Framework* (among other sources) in accordance with IAS8 *Accounting Policies, Changes in Accounting Estimates and Errors* (and NZ IAS8 *Accounting Policies, Changes in Accounting Estimates and Errors*). Rather than clarify this relationship in the 'Purpose and status' section of Part A of this NZ *Framework* the FRSB agreed that, in keeping with the policy of adopting IFRSs without amendment, the wording in the 'Purpose and status' section is to remain exactly the same as that of the IASB's *Conceptual Framework for Financial Reporting 2010* and, therefore, no change would be made to the wording of this section.

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