FAR-1 — FINANCIAL ACCOUNTING & REPORTING 1

Topic: CONCEPTUAL & REGULATORY FRAMEWORK FOR FINANCIAL REPORTING

1 TOPIC OVERVIEW

WHAT IS IT?
The Conceptual Framework is a theoretical set of concepts describing the objective and concepts of general purpose financial reporting — issued by the IASB, revised March 2018.

WHY IMPORTANT?
It assists the IASB in developing IFRSs, guides preparers when no Standard directly applies (or a choice of policy is allowed), and helps everyone interpret Standards consistently — avoiding inconsistent accounting treatments.

CORE PRINCIPLE
Contributes to transparency, accountability, and economic efficiency by giving Standards a single, trusted conceptual foundation — lowering the cost of capital globally.

2 PURPOSE & STATUS [SP1.1–SP1.5]

Assists: (a) the IASB in developing IFRSs on consistent concepts; (b) preparers in developing policies when no Standard applies or a choice is allowed; (c) all parties in understanding/interpreting Standards.

The Conceptual Framework is **NOT a Standard** — nothing in it overrides any IAS/IFRS or Standard requirement. The IASB may sometimes issue Standards that depart from it. Framework revisions do **not automatically** change existing Standards.

3 THE 8 CHAPTERS OF THE CONCEPTUAL FRAMEWORK

1. Objective of General Purpose Financial Reporting	2. Qualitative Characteristics of Useful Financial Information	3. Financial Statements & the Reporting Entity	4. The Elements of Financial Statements
5. Recognition and Derecognition	6. Measurement	7. Presentation and Disclosure	8. Concepts of Capital and Capital Maintenance

This chapter covers key concepts from Framework chapters 2, 5, 6 and 8 (chapters 1 and 4 covered earlier in your studies).

4 ELEMENTS OF FINANCIAL STATEMENTS [4.1 & 4.2]

Item	Element	Definition
Economic resource	**Asset**	A present economic resource controlled by the entity as a result of past events — a right with the potential to produce economic benefits.
Claim	**Liability**	A present obligation of the entity to transfer an economic resource as a result of past events.
	Equity	The residual interest in the assets of the entity after deducting all its liabilities.
Change (performance)	**Income**	Increases in assets, or decreases in liabilities, that increase equity — other than contributions from equity holders.
	Expenses	Decreases in assets, or increases in liabilities, that decrease equity — other than distributions to equity holders.
Other changes	—	Contributions from/distributions to equity holders; exchanges of assets/liabilities not affecting equity.

5 WORKED RECOGNITION CHECKS [Examples 01–04]

Owned/controlled manufacturing unit	**Asset** — present resource controlled by the entity.
Fleet of trucks controlled by ANOTHER company	NOT recognised — no control by this entity.
Skilled workforce (can quit anytime)	NOT recognised — no control (unless advance salaries paid, giving a right to future service).
Rs.160,000 received for advice already given	Asset + **Income** — service performed, no obligation remains.
Same cash, but advice not yet given (future period)	Asset + **Liability** — obligation to perform exists; no income yet.
Rent Rs.120,000 paid in advance covering future period	Split into **asset** (prepaid/future benefit portion) and **expense** (portion relating to the current period).
Advance received from customer for future delivery	Asset (cash) + **Liability** (obligation to deliver) — no income yet, since equity hasn't increased.

QUALITATIVE CHARACTERISTICS OF USEFUL INFORMATION

6 FUNDAMENTAL QUALITATIVE CHARACTERISTICS [2.4–2.13]

RELEVANCE

Capable of making a difference to users' decisions — even if some users don't use it or already know it. Affected by **materiality**: information is material if omitting/misstating/obscuring it could influence users' decisions.

FAITHFUL REPRESENTATION

Faithfully depicts the substance (not just legal form) of what it purports to represent. A perfectly faithful depiction is: **complete** (all necessary info), **neutral** (unbiased), and **free from error** (a reliable estimate is acceptable — doesn't mean perfectly accurate). Perfection is rarely achievable; the goal is to maximise these qualities.

7 ENHANCING QUALITATIVE CHARACTERISTICS [2.23–2.36]

Characteristic	Meaning
Comparability	Enables identifying similarities/differences between entities, or the same entity over time. **Consistency** (same methods for same items) is related but not identical — it helps achieve comparability. Allowing too many alternative treatments for the same phenomenon reduces comparability, so Standards minimise alternatives.
Verifiability	Different knowledgeable, independent observers could reach consensus that a depiction is faithful. Can be **direct** (e.g. counting cash/inventory) or **indirect** (checking inputs to a model/formula and recalculating outputs, e.g. verifying FIFO inventory costing). A range of amounts with probabilities can also be verifiable.
Timeliness	Information available to decision-makers in time to influence their decisions — generally, older information is less useful.
Understandability	Achieved by classifying, characterising, and presenting info clearly and concisely. Complex phenomena shouldn't be excluded just because they're hard to simplify. Prepared for users with reasonable business/economic knowledge who review diligently.

8 COST CONSTRAINT [2.39–2.41]

Cost is a **pervasive constraint** — reporting information has a cost, and it must be justified by the benefits. Benefits obtained should exceed the cost of providing the information; users ultimately bear costs (reduced returns) or incur their own costs if needed info is withheld. **However:** a preparer must NOT omit a Standard's mandatory disclosure merely on the grounds that its cost may not be justified.

9 CALCULATION/ANALYSIS ROADMAP

1. Identify the element/scenario given
2. Test against element definitions (control, obligation, past event)
3. Check recognition criteria (relevance + faithful representation)
4. Select measurement basis
5. Calculate the measured amount
6. Present in the FS / disclose

RECOGNITION, DERECOGNITION & MEASUREMENT BASES

10 RECOGNITION CRITERIA [5.6, 5.7, 5.11]

Only items meeting the definition of an asset/liability/equity (or income/expense) are recognised. But NOT every qualifying item is recognised — an asset/liability is recognised only if doing so (and any resulting income/expense/equity change) gives users **relevant** information AND a **faithful representation**. Items failing recognition criteria are excluded from the FS but may need note disclosure.

11 DERECOGNITION [5.26]

Derecognition = removal of all/part of a recognised asset or liability from the SFP — normally when it no longer meets the element definition: for an **asset**, when the entity loses control of it; for a **liability**, when the entity no longer has the present obligation. E.g. PPE sold/destroyed → derecognised; a liability paid/settled → derecognised.

12 MEASUREMENT BASES [6.1–6.22]

Basis	Definition (asset)	Key traits
Historical cost	Consideration paid to acquire/create the asset + transaction costs.	Entry value; from a past transaction; disposal transaction costs not relevant.
Fair value	Price received to sell the asset in an orderly transaction between market participants at measurement date.	Exit value; market-participant view; no transaction costs on acquisition or disposal.
Value in use (asset) / **Fulfilment value** (liability)	PV of cash flows/benefits the entity expects from using and ultimately disposing of the asset.	Exit value; entity-specific view; acquisition costs excluded, but PV of disposal/fulfilment costs IS included.
Current cost	Cost of an equivalent asset at measurement date + transaction costs.	Entry value; reflects current market entry price; disposal transaction costs not relevant.

13 WORKED EXAMPLE — ALL 4 MEASUREMENT BASES [Example 05]

Machine: cost Rs.200,000 (2 yrs ago), acc. dep. Rs.80,000 (5-yr SL). Market sale value Rs.100,000, dismantling cost Rs.10,000. Future cash flows Rs.50,000/50,000/40,000 over next 3 yrs, discount rate 10%. New replacement cost Rs.220,000.

Basis	Calculation	Result
Historical cost	200,000 – 80,000	120,000
Fair value	Market exit price (dismantling cost NOT deducted)	100,000
Value in use	$50{,}000/1.1 + 50{,}000/1.1^2 + 40{,}000/1.1^3$	116,830
Current cost	**220,000 – (220,000/5×2 yrs)**	**132,000**

Fair value excludes both acquisition AND disposal transaction costs entirely. Value in use is entity-specific (own cash flow estimates), unlike fair value's market view. Current cost adjusts a brand-new equivalent asset's price for the asset's actual age/usage.

CAPITAL MAINTENANCE, REGULATORY FRAMEWORK & RECAP

14 CONCEPTS OF CAPITAL & CAPITAL MAINTENANCE [8.1–8.8]

PROFIT (FROM THE ACCOUNTING EQUATION)

Increase in equity – Capital introduced + Distributions

Concept	Definition	Journal entry for adjustment
Financial (money terms)	Profit = increase in nominal money net assets over the period. Mostly historical cost — no adjustment needed.	None required
Financial (real terms)	Profit = increase in **purchasing power**; only the excess of asset price increase over general inflation is profit — the rest is a capital maintenance adjustment.	Dr P&L / Cr Inflation reserve
Physical capital maintenance	Profit earned only if physical productive capacity at year-end exceeds that at the start (excl. owner transactions) — uses current cost basis.	Dr P&L / Cr Current cost reserve

15 WORKED EXAMPLE — 3 CAPITAL MAINTENANCE CONCEPTS [Example 07]

Inventory bought Rs.10,000, sold for Rs.14,000 cash. General inflation 5%; inflation specific to the item 10%.

Rs.	Financial (money)	Financial (real)	Physical
Revenue	14,000	14,000	14,000
Cost of sale	(10,000)	(10,000)	(10,000)
Inflation adjustment [5%/10% × opening]	—	(500)	(1,000)
Profit	**4,000**	**3,500**	**3,000**

Under money terms, distributing the full Rs.4,000 leaves Rs.10,000 — same currency units, but reduced real purchasing power. Real-terms capital maintenance holds back Rs.500 (into an inflation reserve) so Rs.10,500 remains — matching general inflation. Physical maintenance holds back Rs.1,000 (specific inflation) so Rs.11,000 remains — enough to replace the *same* asset. **Financial capital maintenance** suits investors (concerned with purchasing power); **physical capital maintenance** suits management/employees (concerned with operating capacity) — especially in manufacturing.

16 REGULATORY FRAMEWORK — KEY BODIES

Body	Role
IFRS Foundation	Supervisory body — governance and funding oversight for the IASB and ISSB.
IASB	Develops IFRS and IFRS for SMEs, promotes their use — a single set of high-quality, enforceable global standards (though it relies on national standard-setters for enforcement).
ISSB (est. 2021)	Develops globally consistent sustainability-related disclosure standards (climate/ESG) — issued IFRS S1 & S2 in 2023.
IFRS Advisory Council	Platform for stakeholder engagement — advises on agenda-setting and communicates stakeholder views to IASB/ISSB.
IFRS Interpretations Committee	Gives timely guidance where interpretations of IFRS vary — addresses newly identified issues or conflicting interpretations of significant, widespread relevance (approval by IASB required).

STANDARD-SETTING PROCEDURE

IASB identifies a subject → appoints an advisory committee → may issue a discussion paper → publishes an exposure draft → after considering comments, publishes the final IFRS. Publishing an IFRS, exposure draft, or IFRIC Interpretation needs votes from **at least 8 of the 15** IASB Board members.

! ⚠ EXAM TRAPS — COMMON MISTAKES

- Treating the Conceptual Framework as if it **overrides** a Standard — it never does; specific Standards prevail.
- Recognising an asset merely because it's **used** by the entity, without checking actual **control** (e.g. leased/borrowed assets controlled by someone else).
- Confusing **fair value** (market participant view, no transaction costs at all) with **value in use** (entity-specific view, includes PV of disposal costs).
- Deducting disposal/dismantling costs from **fair value** — fair value is not adjusted for any transaction costs, acquisition or disposal.
- Confusing **consistency** with **comparability** — consistency (same method, same items) is a means to the end of comparability, not the same concept.
- Treating "faithful representation" as requiring perfect accuracy — a reliable **estimate** is acceptable and still faithful.
- Applying the cost constraint to justify skipping a Standard's **mandatory disclosure** — this is never allowed.
- Mixing up **financial capital maintenance (real terms)** and **physical capital maintenance** — one adjusts for general inflation, the other for asset-specific (current cost) changes.
- Forgetting that most entities in practice use **financial capital maintenance (money terms)** — physical/real-terms concepts are conceptually valid but rarely applied without a specific reason.
- Confusing the roles of the **IASB** (standard-setting) and **IFRS Interpretations Committee** (interpreting existing standards) — or thinking IFRIC interpretations don't need IASB approval.

17 QUICK DECISION TREE — ANSWERING ANY FRAMEWORK QUESTION

1. **Question given** →
2. **Element, characteristic, recognition, measurement, or regulatory-body issue?** →
3. **Apply the definition/test** →
4. **Calculate (if measurement/capital maintenance)** →
✔ **Final answer**

CONCEPTUAL & REGULATORY FRAMEWORK IN 60 SECONDS

NOT a Standard — never overrides an IFRS; guides preparers when no Standard applies.

Elements: Asset (control), Liability (obligation), Equity (residual), Income/Expenses (changes in the above).

Fundamental QCs: relevance + faithful representation (complete, neutral, error-free).

Enhancing QCs: comparability, verifiability, timeliness, understandability — plus the cost constraint.

Recognise if: meets element definition AND gives relevant + faithfully-represented information.

4 measurement bases: Historical cost & Current cost (entry values) vs Fair value & Value in use/Fulfilment value (exit values).

Capital maintenance: Financial (money — no adjustment) / Financial (real — inflation reserve) / Physical (current cost reserve).

Profit = increase in equity – capital introduced + distributions.

Regulators: IFRS Foundation (oversight) → IASB (standards) / ISSB (sustainability); IFRS AC (advisory); IFRS IC (interpretations).