Conceptual Framework for Financial Accounting

lecture 1

Al-Mustaqbal University
College of Administrative Sciences

Department of Accounting

Assistant.lect Hussein Ali Hussein

Conceptual Framework for Financial Accounting

Conceptual Framework

A **conceptual framework** is a coherent system of concepts that flow from the objectives of financial accounting.

The Usefulness of a Conceptual Framework

The usefulness of the conceptual framework for financial accounting is:

(1) Identifying the boundaries of financial reporting;

(2) Selecting the transactions, other events, and circumstances to be represented

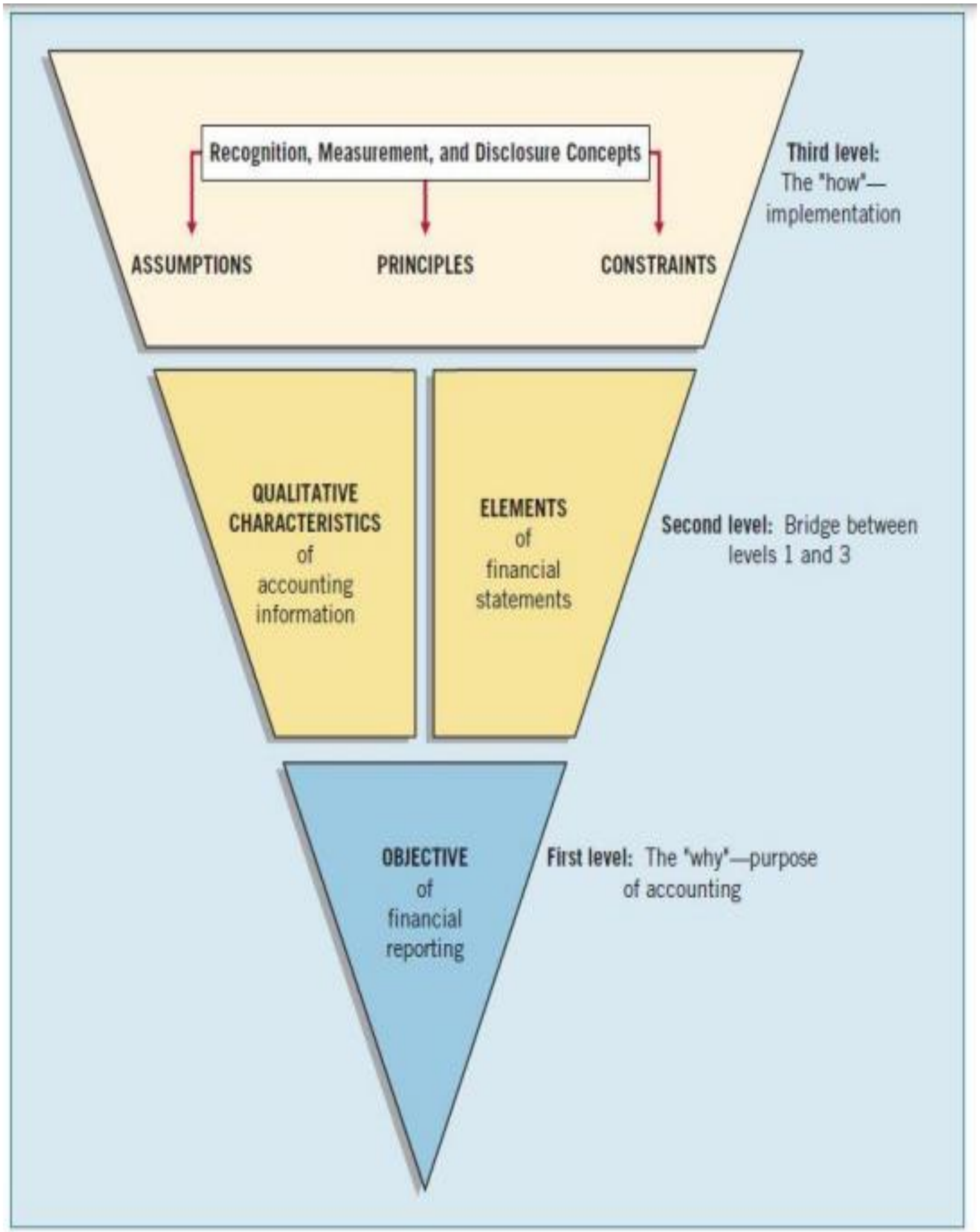
(3) How they should be recognized and measured.

(4) How they should be summarized and reported.

Development of a Conceptual Framework

In 1976, the FASB began to develop a conceptual framework that would be a basis for setting accounting rules and for resolving financial reporting Controversies . In 2018, the IASB published the Conceptual Framework for Financial Reporting (the Conceptual Framework). This fully revised document replaced the section of the 2010 version of the Conceptual Framework that had been carried forward from the 1989 version.

Figure (1) Overview of the Conceptual Framework for Financial Reporting



First Level: Basic Objective

The objective of financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions about providing resources to the entity.

Users of Accounting Information

In fact , users of accounting information may be inside or outside a business.

There are primarily two types of users of accounting information:

Internal Users (primary users)	External Users (secondary users)
- Management (Managers) - Employees - Owners	- Investors - Tax Authorities - Creditors (Lenders) - Customers - Regulatory Authorities - Suppliers - Government - Researchers

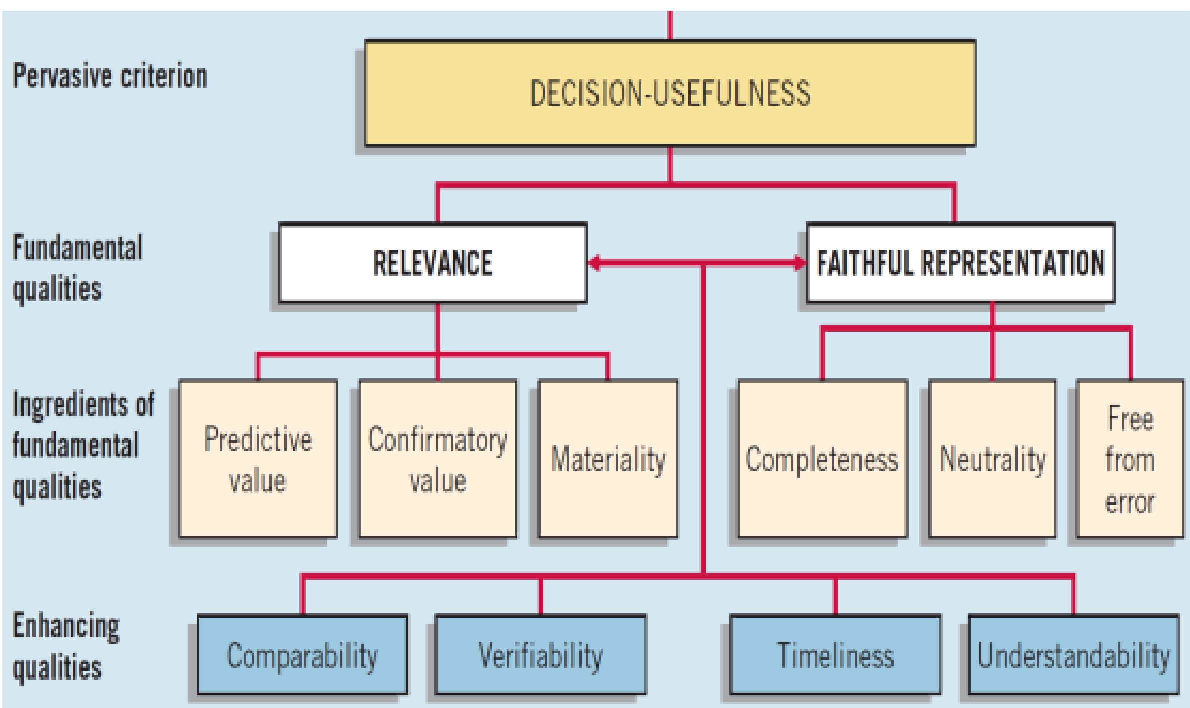
Second Level: Fundamental Concepts

The second level provides conceptual building blocks that explain the qualitative characteristics of accounting information and define the elements of financial statements.

Qualitative Characteristics of Accounting Information

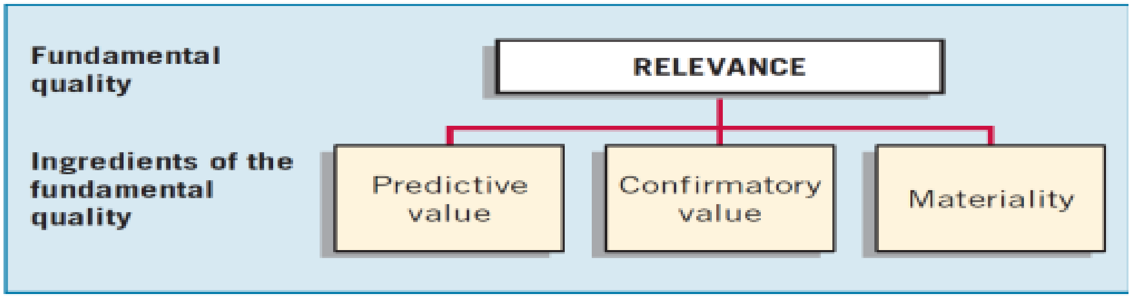
IASB identified the Qualitative Characteristics of accounting information that distinguish more useful information from less useful information for decision-making purposes. The figure (2) shows the Qualitative Characteristics of accounting information.

The figure (2) Qualitative Characteristics of accounting information



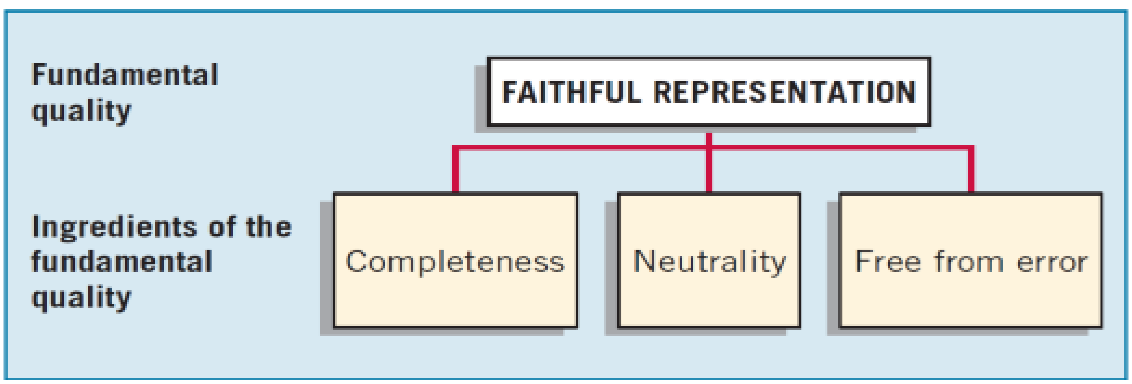
A- Fundamental Quality:

1. Relevance



To have relevance, accounting information must be capable of making a difference in a decision.

2. Faithful Representation



Faithful representation means that the numbers and descriptions match what really existed or happened.

B- Enhancing Qualities:

Enhancing qualitative characteristics are complementary to the fundamental qualitative characteristics.

Enhancing characteristics are:

1. Comparability
2. Verifiability
3. Timeliness
4. Understandability

Basic Elements of Financial Statements

1. Asset: A present economic resource controlled by the entity as a result of past events. (An economic resource is a right that has the potential to produce economic benefits).

2. Liability: A present obligation of the entity to transfer an economic resource as a result of past events.

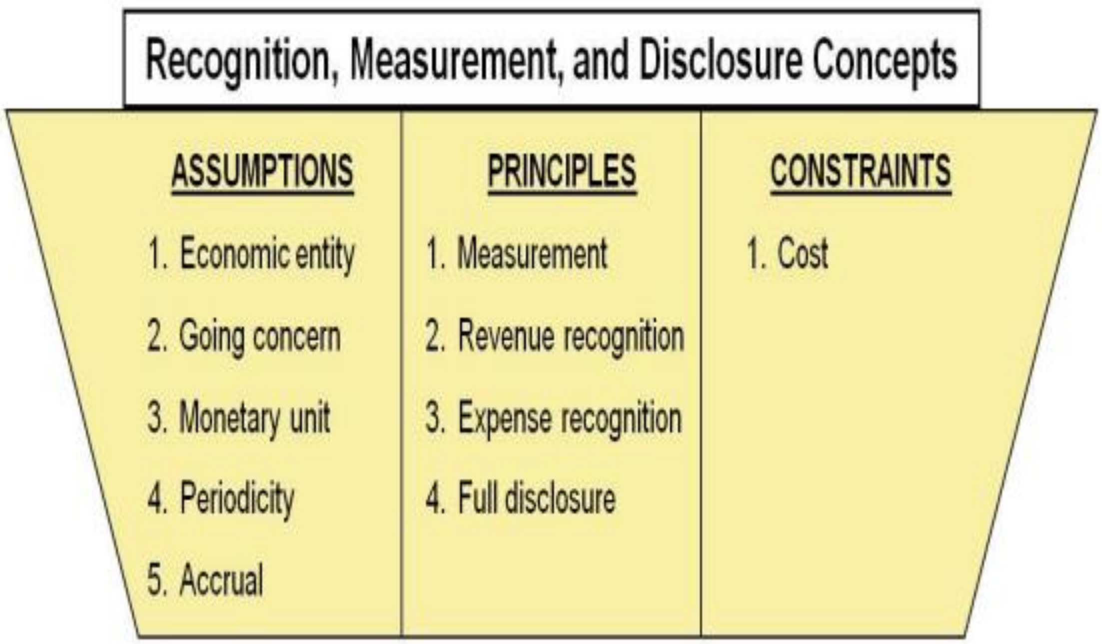
3. Equity: The residual interest in the assets of the entity after deducting all its liabilities.

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

5. Expenses: Decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.

Third Level: Recognition and Measurement Concepts

The third level explains how companies should recognize, measure, and report financial elements and events.



A- The Basic Assumptions of Accounting

1. Economic Entity: The activity of a company can be kept separate and distinct from its owners and any other business.

2. Going Concern: The company will have a long life.

3. Monetary Unit: The monetary unit provides an appropriate basis for measurement and analysis of the economic activities.

4. Periodicity: Company can divide its economic activities into time periods.

5. Accrual Basis: Transactions that change a company's financial statements are recorded in the periods in which the events occur.

B- The Basic Principles of Accounting

1. Measurement Principle: (Historical Cost and Current value)

Historical cost means that assets and liabilities measurement based on

acquisition price.

Current value using information updated to reflected conditions at the

measurement date. It includes (Fair value and current cost).

2. Revenue Recognition: companies recognize revenue in the accounting period in which the performance obligation is satisfied.

3. Expense Recognition: Companies recognize expenses when the service or the product actually makes its contribution to revenue (commonly referred to as matching)

4. Full Disclosure: Companies generally provide information that is of sufficient importance to influence the judgment and decisions of an informed user.

Provided through:

- Financial Statements
- Notes to the Financial Statements
- Supplementary information

Financial Statements

Financial statements are the principal means through which a company communicates its financial information to those outside it.

These statements provide a company's history quantified in money terms.

The four main types of financial statements are:

(1) the balance sheet,

(2) the income statement,

(3) the statement of cash flows, and

(4) the statement of changes in equity.

C- Cost Constraint

This is referred to the cost-benefit relationship. The cost of providing the information must be weighed against the benefits that can be derived from using the information.

Conceptual Framework for Financial Reporting