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In This Issue:

FASB and IASB Complete First Phase of Joint Project on Conceptual Framework for Financial Reporting

by Mark Crowley and Sean St. Germain, Deloitte & Touche LLP

Over four years after publishing their original discussion paper and exposure draft for public comment, the FASB and IASB have issued two chapters as part of their joint eight-phase project to develop an improved, converged conceptual framework for financial accounting and reporting. This single conceptual framework will serve as the foundation for the development of financial accounting and reporting guidance based on consistent principles. The two new chapters, issued by the FASB in Concepts Statement 8,[1] supersede Concepts Statements 1[2] and 2[3] and mark the completion of the first phase of this new conceptual framework.

The new chapters are not a part of the *FASB Accounting Standards Codification*, which means they are not generally accepted accounting principles. Rather, they outline the principles that will form the basis for future standard setting and provide a means for evaluating existing standards.

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The Objectives of General Purpose Financial Reporting

Chapter 1 notes that the overriding objective of "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." Such users are interested in relevant financial information that allows them to assess the return they can expect for their investments (e.g., cash available for dividends, ability to make principle and interest payments, projected increase in market value). To make these assessments, users need information about the "amount, timing, and uncertainty of future net cash inflows to the entity." This information, in the context of accrual accounting, includes details about the economic resources and claims against the entity (i.e., financial position); changes in these resources and claims from operations and changes from other events or transactions (e.g., issuing additional shares); and the impact of operating, investing, and financing activities on an entity's cash flows.

The concepts in Chapter 1 state that general purpose financial reports are based on management's best estimates, judgments, and models (as established in the joint conceptual framework project) and are "not designed to show the value of a reporting entity; but they provide information . . . to estimate the value of the reporting entity."

[1] FASB Statement of Financial Accounting Concepts No. 8, *Conceptual Framework for Financial Reporting*, Chapter 1, "The Objective of General Purpose Financial Reporting," and Chapter 3, "Qualitative Characteristics of Useful Financial Information."

[2] FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*.

[3] FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*.

Qualitative Characteristics of Useful Financial Information

While Chapter 1 discusses the importance of financial information that is useful to primary users (i.e., existing and potential investors, lenders, and other creditors), Chapter 3 states that if the financial information "is to be useful, it must be relevant and faithfully [represent] what it purports to represent." These two fundamental qualitative characteristics — "relevance" and "faithful representation" — constitute the essence of useful financial information.

For financial information to be relevant, it must be "capable of making a difference in the decisions made by users." Information is capable of making a difference in the decision making process when it (1) is a usable input to predict future outcomes, (2) offers feedback to confirm or change previous inputs used to predict future outcomes, or (3) both. Relevant financial information must also be faithfully represented to be useful. A faithful representation is one that is "complete, neutral, and free from error," to the extent possible.

These two fundamental qualitative characteristics — "relevance" and "faithful representation" — constitute the essence of useful financial information.

In addition, Chapter 3 notes that the usefulness of these fundamental characteristics is "enhanced if it is comparable, verifiable, timely, and understandable" and that such enhancements also should be "maximized to the extent possible." A decision about whether to include information in financial reports should take into account materiality (i.e., an omission or misstatement of financial information could influence a user's decision making) and cost-benefit constraints. The cost to report certain financial information needs to be justified by the benefits of providing that information.

What's Next?

Three additional phases of this eight-phase project are currently active: the reporting entity, measurement, and elements and recognition phases. The reporting entity phase aims to define what constitutes a reporting entity. The exposure draft for this phase was published in March, and a final chapter is expected in the fourth quarter of this year. The FASB has not indicated when it expects to issue an exposure draft for either the measurement phase or the elements and recognition phase or when it will begin discussions on the inactive phases.

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