CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING: CURRENT STATE, DEVELOPMENT AND APPLICATION OUTLOOK IN UKRAINE

Ruslana Kuzina*

1. Introduction

Understanding the IFRS Conceptual Framework as an evolution of the accounting theory is imperative for the development of accounting and understanding the meaning of the International Financial Reporting Standards implementation. A number of definitions in the IFRS Conceptual Framework have recently undergone significant changes. Object of this article is analysis of those changes and review of the national regulatory and scientific literature.

In recent years, many Ukrainian, Russian and foreign authors have been addressing the issue of IFRS accounting. Fundamentals of the theory and methodology of international accounting are set out in the works of S. F. Golov, S. Y. Zubilevych, V. N. Kostiuchenko, G. G. Kireytsev, L. G. Lovinskaya, N. A. Ostap'yuk, O. Petruk, N. S. Pushkar, Y. V. Sokolov, V. V. Sopko, V. P. Suyts, L. V. Chizhevskaya, M. G. Chumachenko, V. G. Shvets, V. O. Shevchuk, M. M. Shigun and many others. Among the foreign authors are: A. Amat, D. Blake, M. van Breda, A. Britton, H. Gernon, S. Gray, D. Caldwell, M. Cohen, M. R. Matthews, G. Miyike, G. Mueller, B. Needles, K. Noubs, R. Parker, E. Hendrix, F. D. S. Choi and others.

2. Conceptual Framework for financial reporting: current state and development

The basic maxims of Conceptual Framework, derived from the objective of general purpose financial statements include the qualitative characteristics of useful financial information, definitions of the elements of financial statements and accrual methods of accounting. The new version of the IFRS Conceptual Framework (Conceptual Framework for Financial Reporting) radically changed the definition of objectives, composition of quality characteristics and many more. Studying the essence of these changes for potential use in Ukrainian accounting practice remains a challenge.

For the development of accounting and clarification of the meaning of the International Financial Reporting Standards implementation in Ukraine the understanding of the IFRS Conceptual Framework as an evolution of the accounting theory is needed. This enables:

- justification of the necessity of its existence;
- critical evaluation of its content from the theoretical point of view;
- identification of the ways to improve IFRS as a system, through revelation of additional structural elements which should be included in the Conceptual Framework from the point of view of the theory.

Unfortunately, these issues receive insufficient focus in Ukrainian literature. In the national regulations on accounting there are no separate document covering the Conceptual Framework for Financial Reporting. Some of the issues are partly considered in Ukrainian National Accounting Standards (NR(S)AR 1) [1] – "General requirements for the financial statements".

As can be seen even from a superficial analysis of the basic definitions described in the Ukrainian GAAP 1 [1] and the IFRS Conceptual Framework [2] there are fundamental terminological differences between the Ukrainian GAAP and IFRS. The most important and significant difference

* © Kuzina Ruslana; Associate professor of accounting and auditing; Odessa National University of Economics; Ukraine; E-mail: rws_1@ukr.net.

is that in the Ukrainian national standards, there is no conceptual framework for reporting, although the standards are close in meaning and correlate with IFRS.

Regarding the objectives of financial reporting, the IFRS definition emphasize that – first, the information must be financial only, and, – second, information must be useful for principal users to make decisions about investing in a company. IFRS stresses the impossibility for users to obtain information by any other means than through the financial statements. Many users (actual and potential investors, lenders and other creditors) can not require reporting entities to provide information to them directly, and to get the financial information they need, they must rely on general purpose financial statements (paragraph OB5, Conceptual Framework). As a result, they are the main users of financial reporting.

Main purpose of financial reporting in National standards is to provide impartial information to users (individuals and legal entities) to make decisions. Obviously, this definition is somewhat out of date, because the main problem of the user (investor) is to be sure that his investment will be profitable and therefore the information contained in the reports should have a predictive value.

The basic maxims of Conceptual Framework, derived from the goal of general purpose financial statements include the qualitative characteristics of useful financial information, definitions of the elements of financial statements and accrual methods of accounting. Since those and many other aspects of the Conceptual Framework follow logically from the objective of general purpose financial reporting, a clear understanding of this is fundamental. Analyzing differences in the composition of financial reporting, we can see that the changes in the Ukrainian GAAP 1 correspond to the names of IFRS reports, but it is obvious that the composition of IAS 1 accounting is more complete and includes a statement of financial position (balance sheet) for the previous period, to provide comparable information (in retrospective revaluation), but Ukrainian standard does not require it.

Considering the qualitative characteristics, it can be noted that they also vary a lot in their content. In the revised Conceptual Framework qualitative characteristics are divided into two large groups:

– fundamental (relevance and faithful representation) and
– enhancing (comparability, verifiability, timeliness and understandability).

Some qualitative characteristics are no longer mentioned in the Conceptual Framework. Such as:

– reliability,
– substance over form
– prudence (conservatism).

The revised framework uses faithful representation in place of reliability because of great confusion about what was meant by reliability in the old framework. Substance over form was removed because it seemed to be redundant in presence of a faithful representation, which is complete, neutral and free from error. In other words, it represents the substance of an economic phenomenon rather than merely its legal form. Prudence and conservatism are excluded because these concepts are incompatible with neutrality.

Let us remind what qualitative characteristics of accounting are – the attributes of accounting information, which tend to increase their usefulness. The qualitative characteristics of reporting should be targeted at both the users and decision-making. Qualitative characteristics of accounting are: relevance (predictability, feedback, timeliness), reliability (verifiability, representational faithfulness, independence), comparability (uniformity, consistency), and the significance [3]. In other words, the qualitative characteristics of accounting are properties that make information useful to the user. Obviously, not all of the qualitative characteristics in the wording of Ukrainian GAAP 1 perform such function. Referring to the differences in principles, it is arguable that some mistakes were made while developing Ukrainian GAAP, namely the qualitative characteristics included in the principles (frequency, faithful representation, sequence, prudence and substance over form predominance) and evaluation elements (historical cost). Regarding the integrated money measurement, its application logically follows from comparability (qualitative characteristic).

It is hard to escape a conclusion that Ukrainian GAAP 1 needs to be thoroughly revised or, ultimately, a Ukrainian GAAP Conceptual Framework for Financial Reporting has to be created. As to new revision of the IFRS Conceptual Framework, there are more changes made by IASB to the Framework text. By the way, only part of significant changes to 1989 Conceptual Framework for Financial Reporting was made in 2010. Work will be continued as the Conceptual Framework is the theoretical basis for all International Financial Reporting Standards. As for primary users - existing and potential investors, it is important to understand the financial information in the financial statements, than, respectively, investors should be aware of changes made to the Conceptual Framework. All qualitative changes are reflected in the new text of the Conceptual Framework that is now called the Conceptual Framework for Financial Reporting 2010, but also a considerable part of the old edition of 1989 is retained.

Revolutionary, in the author's opinion, is the title change which greatly extended the scope of the anticipated reports. So the old title Framework for the Preparation and Presentation of Financial Statements is replaced by the Conceptual Framework for Financial Reporting.

It can be concluded that these changes correlate with the popular idea of Integrated Reporting (IR). It will take into account not only financial, but also non-financial indicators, to improve the quality of reporting and reflecting significant influence of environmental, social and the governance factors (ESG): this refers to the use of natural resources, protection of human rights and business impact on the social phenomena and climate change. The new model is seen as a possible way to obtain a more complete picture of the reporting entity, reflecting the risks and opportunities, and more logically integrating ESG factors and financial performance. Schematically, differences in new and old version can be represented as follows:

Tab. 1. Differences between Framework for the Preparation and Presentation of Financial Statements, 1989 Conceptual Framework for Financial Reporting, 2010

Framework for the Preparation and Presentation of Financial Statements, 1989	Conceptual Framework for Financial Reporting, 2010
– Balance sheet – Profit and loss statement – Statement of Cash Flows – Statement of changes in equity – Notes	Financial Information: – Statement of Financial Position; – Statement of total gains and losses; – Statement of Cash Flows; – Statement of changes in equity; – Notes Non-financial information: – Review of the organizational structure and its external environment; – The management structure of the company; – An overview of the risks and opportunities; – Strategy and resource allocation; – Business model sustainability; etc.

As we can see, the purpose of the changes made to the IFRS Conceptual Framework is the establishment of a unified and comprehensive concept of integrated reporting, which would be structured around the strategic objectives of the organization, its business model and corporate governance. However, the basic financial statements of the company will continue to be a "backbone" of the financial reporting.

IASB not merely changed the title of the framework. It has also updated the definitions of the objective of financial reporting and the qualitative characteristics of useful information.

The objective of Conceptual Framework is "to provide a consistent and logical formulation of IFRS" (paragraph 8 of the Preface to IFRS). In other words the Conceptual Framework outlined established concepts, used by IASB in standards development. Consequently, most of the IFRS requirements conform to the concepts outlined in the Conceptual Framework. However, the use of restriction associated with the efficiency of accounting ((developing standards, the IASB estimates the benefits from providing certain information to justify the costs of providing and using of this information (paragraph QC38 of Conceptual Framework)), still leads to the fact that some of the IFRS requirements do not maximize qualitative characteristics or other basic concepts of the Conceptual Framework.

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 decision about providing resources to the entity. These decisions are related to the purchase, sale or holding of equity and debt instruments, and the provision or repayment of loans and other forms of credit (see paragraph OB2 of Conceptual Framework). To evaluate the organization prospects for the future net cash flows, existing and potential investors, lenders and other creditors need information on the organization's resources, requirements for the organization, and how rationally and effectively the management and the board perform their duty to use the organization's resources (see paragraph OB4 of Conceptual Framework). In other words, the objective of financial reporting focuses on the information needs of capital providers. As for the regulatory and tax authorities, they also may find the information in general purpose financial reports useful, but financial reporting is not directed at them.

3. Qualitative characteristics of useful information

Conceptual Framework identifies two fundamental qualitative characteristics of useful financial information: relevance and faithful representation. In order to be useful, financial information must be both relevant and faithfully represented. Comparability, verifiability, timeliness and understandability are identified as enhancing qualitative characteristics. They increase the usefulness of information that is relevant and faithfully represented. However, the information may not possess all of the enhancing characteristics but that it may still be useful.

Conceptual Framework also acknowledges the limitations in terms of compiling the information: the cost of its preparation, the so-called "cost accounting", which suggests that the cost of accounting will not exceed the accounting entity. Financial information has predictive value if it can be used as an input to processes used to predict future outcomes. It has confirmatory value if it provides feedback about previous predictions. Information is material if omitting it or misstating it could influence decisions based on the information. Immaterial information does not affect decisions. Consequently, immaterial information is not relevant. Because materiality is entity-specific, Conceptual Framework doesn't consider materiality separately when developing standards.

A faithful representation is complete, neutral and free from error. Information is complete if a user can understand the phenomenon being depicted. This may require descriptions and explanations as well as a numerical depiction. Information is neutral if it is without bias in its selection or presentation. In other words, it is not intentionally overstated, understated, emphasized or de-emphasized. Neutral information does not mean the information does not have an impact on decisions. By definition, useful information affects decisions. Likewise, free from error does not mean perfectly accurate. It means that there are no errors in the process used to produce the information and no errors in its description. How to use the qualitative characteristics in IFRS implementation? First step is to identify an economic phenomenon that is potentially useful to investors, lenders and other creditors in making decisions. Then to identify the type of information about that phenomenon that would be most relevant if it were available. Then determine whether that information is available and if it can be faithfully represented at a reasonable cost. If so, require that information. If not, repeat the process with the next most relevant type of information.

Qualitative characteristics enhance the usefulness of information. If two ways of depicting an economic phenomenon are considered equally relevant and faithfully represented, we can make the choice between them by examining them to see which embodies more of the enhancing characteristics (comparability, verifiability, timeliness and understandability).

Comparability enables investors, lenders and other creditors to identify and understand similarities in, and differences among, items. Occasionally, a single economic phenomenon can be faithfully represented in multiple ways, but permitting alternative accounting methods for the same economic phenomena diminishes comparability. It is important to note that, comparability does not mean uniformity. For information to be comparable, like things must look alike and different things must look different. Verifiability lends credibility to financial information by providing assurance that information faithfully represents what it purports to represent. Timeliness means that information is available to investors, lenders and other creditors in time to be used in their decision making processes.

The enhancing qualitative characteristic of understandability means that information that may be difficult to understand is made more useful by presenting and explaining it as clearly as possible. Investors, lenders and other creditors are expected to actually study the reported financial information with reasonable diligence and to seek the aid of advisors to understand information that they find particularly complex.

4. Conclusion

The main changes introduced by IASB to the Conceptual Framework for Financial Reporting, concerned title, objective and qualitative characteristics of reporting.

1. The old title Framework for the Preparation and Presentation of Financial Statements is replaced by the Conceptual Framework for Financial Reporting, so it can be concluded that these changes correlate with the popular idea of Integrated Reporting (IR) which deals with financial and non-financial indicators.
2. The objective of financial reporting now focuses on the information needs of capital providers.
3. Conceptual Framework defines two fundamental qualitative characteristics of useful financial information: relevance and faithful representation. To be useful, financial information has to be relevant and faithfully represented. Comparability, verifiability, timeliness and understandability are defined as enhancing qualitative characteristics, which enhance usefulness of relevant and faithfully represented information.
4. There is no Conceptual Framework as a separate document in Ukrainian National Accounting Standards (NR(S)AR). Some items can be found in NR(S)AR 1 and Ukrainian Law on accounting and financial reporting [4]. Object of financial reporting and qualitative characteristics stated in NR(S)AR 1 require immediate revision in order to meet the needs of users (suppliers of capital). Ultimately, a separate document in the form of the Conceptual Framework for Financial Reporting by NR(S)AR should be elaborated.

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Summary

This paper presents cardinal improvements to Conceptual Framework for Financial Reporting, analysis of actual National Regulations (Standards) of Accounting Reporting, recommendations on converging it to IFRS.

Key words: the IFRS, objectives of financial reporting, Conceptual Framework, qualitative characteristics of useful financial information.

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