Conceptual Framework – part 1

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Conceptual Framework

- Complete and internal connected theoretical base of financial accouting and reporting;

- US GAAP – Conceptual Framework

- IAS/IFRS and US GAAP Conceptual Framework present the basis of accounting harmonization and standardization

Conceptual Framework

- Introduction: purpose of financial statements, its role, users of financial statements and their information needs,

- Aim of financial statements,

- Basic principles and assumptions,

- Qualitative characerics,

- Definition of elements of financial statements and their recognition,

- Valuation bases,

- Capital maintenance

Users of financial statements

- **Internal users:** managers, owners,

- **External users:** investors and potential investors,

    creditors,

    suppliers,

    employees,

    customers,

    governments,

    public,

    ....

Aim and purpose of financial statements

- To provide information to a wide range of financial statements users:

   - financial position (balance sheet)

   - financial performance (income statement)

   - changes in financial position (cash-flow, statement of changes in equity)

Basic principles and assumptions

- **The most important principle: true and fair view –** connected with substance over form,

- In case of inconsistency between the standard and this principle it is not necessary to follow the standard,

- Statement in note

- Contradiction from the Accounting law

Basic principles and assumptions

- Accrual principles, going concern, caution principle, substance over form, ...

- Other principles and assumptions – part of the qualitative characteristics system

- Cost versus benefits analysis is applied all over the time

Qualitative characerics

- Understandability

- Relevancy

- Comparability

- Reliability

- Objectivity

Recognition criteria

- IAS/IFRS and US GAAP give a significant area for decision-making with the aim to decide whether or not recognise the elements of financial statements,

- This is not solved in 4th Directives or CAL

Recognition criteria

- Recognition criteria:

  a) elements definition

  b) other criteria for recognition

  - conceptual framework contains 5 basic

  definitions – consistency of standards with the

  framework;

Definition of financial elements

- **Assets =** its existence is confirmed by past experience and it will bring economic benefits in future:

  - directly,

  - indirectly;

Definition of financial elements

- **Liability =** an *obligation* of an entity arising from *past* transactions or events, the settlement of which may result in the transfer or use of assets, provision of services or other yielding of economic benefits in the future

- **Equity =** residual value of assets after reduction of liabilities

- **Revenues =** the gross inflow of economic benefits (cash, receivables, other assets) arising from the ordinary operating activities of an entity (such as sales of goods, sales of services, interest, royalties, and dividends)

Definition of revenues

- **Revenues:**
  - connected with primarily business activity
  - they have continuous and repeating form,
  - mainly under control of businessváží se k primární činnosti podniku,
- **Gains:**
  - subsidiary and occasional activities,
  - non-regular activity,
  - not fully under control of business

Definition of costs

- **Costs**= decrease in economic benefits caused by activity of business during a period, that will reflect in decrease of assets or increase of liabilities

  - **Expenses -** primarily and repeating activity,

  - **Losses –** occasional and non-regular activity,

Other criteria for recognition

- **Realible valuation** – the element is possible to valuate realibly (purchase costs or other costs which is realible given)

- **Probability –** future economic benefit will flow to or from the entity (the level of uncertainty is solved at preparation of financial statements)

- **Material –** cost versus benefits

Capital maintenance

- Financial accounting influence the capital maintenance

- An example with explanation – Kovanicová D. a kol.: Finanční účetnictví – světový koncept, Polygon, str. 114 -121

THANK YOU FOR YOUR ATTENTION