

# The IASB Framework

The most likely tasks in this area fall into the following groups:

- ☞ The purpose of financial statements, users and their needs
- ☞ The elements of financial statements and the balance sheet (accounting) equation

## ***The Purpose of Financial Statements, Users and Their Needs***

The IASB's *Framework for the Preparation and Presentation of Financial Statements* describes the basic concepts underlying financial statements. It identifies a number of different users of financial statements:

- ☺ Present and potential investors
- ☺ Employees
- ☺ Lenders
- ☺ Suppliers and other trade creditors
- ☺ Customers
- ☺ Governments and their agencies
- ☺ The general public

All of these groups use financial statements to help with decision making, but their needs vary. The Framework recognises that not all needs can be met by general purpose financial statements. However, if financial statements can meet the needs of investors, they will also meet most of the needs of other users.

*The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions.*

Financial position is illustrated primarily by the statement of financial position, performance by the income statement. Changes in financial position are covered, in the main, by the cashflow statement.

The concepts of accruals and going concern are assumed, and the Framework identifies four qualitative characteristics for the information in financial statements:

- ☺ Understandability
- ☺ Relevance
- ☺ Reliability
- ☺ Comparability

## ***The Elements of Financial Statements and the Balance Sheet (Accounting) Equation***

The Framework also defines the elements of financial statements. Any item which does not fall under one of these definitions should not be included in financial statements.

<b>Assets</b>	<i>Resources controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise</i>
<b>Liabilities</b>	<i>Present obligations of the enterprise arising from past events, the settlement of which is expected to result in outflows from the enterprise of resources embodying economic benefits</i>
<b>Equity</b>	<i>The residual interest in the assets of the enterprise after deducting all its liabilities</i>
<b>Income</b>	<i>Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants</i>
<b>Expense</b>	<i>Decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants</i>

Unit 11 requires an understanding of how the above elements impact on the Balance Sheet equation (also known as the Accounting Equation).

Recall that the equation is as follows:

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

This can be amended to fit the definitions of the Framework:

$$\text{Equity} = \text{Assets} - \text{Liabilities}$$

The format of the statement of financial position, with assets at the top and equity and liabilities at the bottom, proves that this equation holds at the period end.

The other elements affect the equation as follows:

### **Income**

This will increase equity. It must therefore increase assets, or reduce liabilities, or a combination of the two. For example, if stock is sold at a profit for cash, the asset of cash increases by more than the asset of stock decreases (selling price rather than cost).

### **Expenses**

These will reduce equity, and must result in a decrease in assets, an increase in liabilities, or a combination. Consider the sale of stock at a loss.

### **Contributions from Equity Participants**

These will increase equity, and usually assets too (consider a further cash investment by an owner)

### **Distributions to Equity Participants**

These will reduce equity, and usually assets too (consider a dividend paid).