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# Research paper

## Elements for a European conceptual framework – version 1

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# Elements for a European conceptual framework – version 1

In the following chapters proposing articles for a European Financial Reporting Principles Framework, the following colour coding has been used:

- Highlighted in green: text derived from or inspired by the European Directive 2013/34 of June 2013, with related reference in footnotes,
- Highlighted in yellow: new text as proposed by the authors.
- No highlighting: text derived or inspired from the IASB conceptual framework (ED 2015), with the related reference in footnotes, or from the relevant IASB Board decisions during its 2016-2017 re-deliberations (as indicated) and deemed compatible with the EU Directive.

Other sources for the proposals have been explained in the corresponding footnotes. The use of this colour coding is based upon the authors' understanding of the corresponding texts and therefore is their sole responsibility.

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## Preliminary remarks and purposes of this Framework

1. Harmonising the financial reporting of corporate entities by providing a common European accounting language is a key goal for the Union, in particular in the context of the capital markets union initiative, with the following main objectives:

   a) facilitating the development of undertakings within the EU as well as in their respective domestic markets and internationally, in particular by improving their access to financial resources,

   b) providing all stakeholders with transparent information on the financial position and performance of undertakings, prepared on the basis of generally agreed reporting principles,

   c) organising the protection of shareholders and other stakeholders of undertakings, by improving the quality of information provided to them and the accountability of management,

   d) facilitating cross-border investment, by improving the EU-wide comparability of financial reports,

   e) improving EU-wide financial governance and accountability of undertakings,

   f) aligning undertakings' financial reporting with EU public good requirements such as financial stability, environmental and social responsibility, corporate governance, competitiveness, and fair competition,

   g) and, from a general standpoint, increasing public confidence in and support of undertakings. [1]

   In addition, a harmonised financial reporting system in the EU constitutes a key element for the development and harmonisation of general corporate reporting and a clear reference for the development of other EU regulations using financial reporting data as a basis.

2. Beyond shareholders and members of undertakings, stakeholders include inter alia lenders, employees, customers and suppliers, regulators and other public authorities as well as the general public. Management and the governance bodies of undertakings are also to be considered as stakeholders in a dual capacity, both as preparers and users of financial reporting, even if they have access to internal and more detailed sources of information on the undertaking under their responsibility.

[1] Inspired by Recital 55

3. This draft European Financial Reporting Principles Framework aims to contribute to the achievement of the objectives expressed in paragraph 1, by improving Union-wide consistency in the principles governing recognition, classification and measurement of transactions and events, and in the way they are presented in the financial statements as well as disclosures that are needed. In particular, it contributes to comparability between undertakings, transparency, public confidence in the financial reports and to therefore the European public good.

4. In order to promote Union-wide homogeneity in financial reporting, both public interest and non-public interest entities should report in accordance with the same framework to the extent possible, even if the elaboration and adoption of relevant standards follow different institutional processes. Hence, it is of critical importance[2] for the Union to maintain the accounting methods that are used for the financial reporting of those two classes of entities as comparable as possible. The differences between the applicable accounting principles should be limited, as far as possible, to the extent and nature of the disclosures required, rather than be found in the recognition and measurement principles that apply to the preparation of the financial statements. Therefore, the basic accounting principles that are described in this document should apply to all undertakings. Possible exemptions for small entities are not considered herein, as they are the responsibility of national public authorities.

5. The draft European Financial Reporting Principles Framework presented in this document does not intend to become a standard or a regulation. However, it should be considered by the EU authorities, national legislators and national standard setters when they design standards or other forms of accounting literature to guide undertakings in the implementation of the EU harmonised financial reporting. This should encompass the preparation and adoption of EU Directives in the field of accounting and related topics as well as their transposition into national legislations and the endorsement of international accounting standards.

6. It should also be considered as a useful source of guidance by the EU undertakings when they adopt an accounting method to record transactions or economic events that are not otherwise specifically described in the EU or national legislations.

7. This European Financial Reporting Principles Framework can also assist all parties concerned by the financial statements to understand and interpret the European accounting requirements.

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[2] This consistency between different classes of entities, and the comparability at the EU level, is also necessary for the progress of the project to harmonize the income tax basis (ACCIS project).

## Chapter 1 - Objectives and characteristics of general purpose financial reporting

### Section 1- Objectives and stakeholders of general purpose financial reporting

1. The central objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to all stakeholders in making assessments and decisions about the reporting entity's activities, including providing resources to the entity and other business decisions or relationships[3].

2. Due to the economic, social and societal role of undertakings, their stakeholders include:

   a) Corporate and financial stakeholders such as investors in capital, lenders and creditors,

   b) Management and governance bodies,

   c) Employees,

   d) Customers and suppliers,

   e) Public authorities and regulators,

   f) And, to a certain extent, the general public (all those in the public who may benefit from, or suffer from, the undertaking's activities).

3. Those stakeholders' decisions involve decisions about, among others[3]:

   a) buying, selling or holding equity and debt instruments,

   b) providing or settling loans and other forms of credit,

   c) entering into, or discontinuing, business transactions with the entity,

   d) becoming or ceasing to be an employee of the undertaking, or

   e) assessing compliance with laws and regulations,

   f) exercising any rights to vote on, or otherwise influence, decisions and management's actions.

4. For corporate and financial stakeholders, the decisions described above depend, among other factors, on short term as well as long term returns that investors, lenders and other creditors expect, for example, dividends, principal and interest payments or increases in the market price of the entity's equity instruments. Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of the prospects for future net cash inflows to the entity and on their assessment of management's stewardship of the entity's economic resources[4].

[3] CF 1.2
[4] CF 1.3

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5. To make the assessments described in the preceding paragraph, investors, lenders and other creditors need information about the resources of the entity, claims against the entity, changes in those resources and claims, and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources[5].

6. Employees are also interested in the financial position, performance and sustainability of the undertaking's business as a condition of their continued employment relationship.

7. General purpose financial reporting provides useful information about how efficiently and effectively the entity's management and governing bodies have discharged their responsibilities to use the entity's resources[5] in accordance with the entity's business model and in the best interests of capital providers and other stakeholders. Examples[6] of such responsibilities include:

   a) managing the entity's capital and solvency,

   b) protecting the entity's resources from unfavourable effects of economic factors such as price and technological changes, and the effect of climate change and other environmental issues,

   c) investing for the entity's future development and sustainability, and

   d) ensuring that the entity complies with applicable laws, regulations and contractual provisions.

   Information about management's discharge of its responsibilities is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions, and to employees of the entity.

8. A consideration of the business model is necessary when assessing the performance and stewardship of the undertaking's management and its corporate governance. Stewardship and corporate governance cannot be assessed in absolute terms. An undertaking usually has a stated mission (its business purpose), professional, social, societal and environmental values, a business strategy to achieve that mission, which translate into long term and short-term plans and policies. Such plans and policies are designed by, or approved, by the entity's governance bodies and shareholders in a formal or informal way. Hence, the assessment of the management's actions and performance should be conducted in the context of this "social contract" between the entity and its stakeholders.

9. Financial reporting is primarily, but not exclusively, backward looking and it offers the most concrete evidence of the past performance of an undertaking and of its present economic condition. Financial statements have direct confirmatory value. Except in the case of newly formed and start-up entities, the historical profit and loss statement together with the statement of cash flows is a vital starting point for any projections of future revenue and cash-flows. As a consequence, financial statements have also indirect predictive value.

[5] CF 1.4
[6] Examples that are not highlighted in yellow come from the 2010 version of the CF.

10. When projections of future profit and loss or cash flows are prepared by the entity, they are usually not included in the general purpose financial statements. When presented, they should be explained in relation to the historical financial statements, which are presented separately. In specific situations, the presentation of forecasts may be required by market or prudential authorities. Such documents are not considered general purpose financial reports, even if their linkage to such reports should be explained.

11. Internal projections or business plans frequently need to be developed for testing the realisable value of certain assets, and the underlying economic assumptions and methodology need to be disclosed in the notes to the financial statements to explain how the financial outcome of the tests should be interpreted. Such forward-looking information is part of general purpose financial reporting as it directly relates to the carrying amount of assets and liabilities in the financial statements.

12. General purpose financial reporting is not designed to show the value of a reporting entity but provides information to help existing and potential investors, lenders, other creditors and stakeholders in general to estimate the value of the reporting entity[7].

## Section 2 – Other considerations on the preparation and use of general financial reporting

13. General purpose financial reporting is not designed for providing and cannot provide all of the information that the management and the other users, as defined above, need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks[8], as well as additional information provided in the management report or elsewhere by the undertaking.

14. Different classes of users pay more or less interest to different aspects of corporate life and, even though the management reports should provide an adequate description of the undertaking's business, they cannot provide all the detailed information necessary to meet the specific needs of certain users. As a consequence, Union accounting legislation needs to strike an appropriate balance between the interests of the various addressees of financial statements. In addition a proper balance between providing useful information and the interest of undertakings in not being unduly burdened with reporting requirements needs to be maintained[9].

15. Many investors, lenders, other creditors and employees cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial reports are directed[10].

[7] CF 1.7
[8] CF 1.6
[9] Recital 4
[10] CF 1.5

16. Although the management of a reporting entity has access to extensive internal information of a financial and non-financial nature, and therefore need not rely only on general purpose financial reporting, it is directly interested in general purpose financial information about the entity in order to report externally on the way it manages the entity in accordance with the agreed strategy and to meet its objectives in terms of performance, stewardship and corporate governance. Continuity and general consistency between the information systems used for internal purposes and for the preparation, approval and publication of general purpose financial reporting are a cornerstone of proper corporate reporting[11]. It is a matter of good corporate governance that the interests of management and governance bodies are aligned with the interests of those who provide resources to the entity and of other stakeholders. In this context, the financial information used for internal management purposes and remuneration incentives should as far as possible describe the financial condition and performance of the entity using the same recognition and measurement methods as those used for general purpose financial reporting to stakeholders.

17. When they differ, appropriate bridging between the information used internally (to manage the undertaking) and that which is reported externally should be established and explained. When adjustments are applied to the general purpose accounting information for the purpose of internal management (such as evaluating the performance of managers) or for analytical purposes (for instance, presenting segmental information), such adjustments should be applied consistently over time, should be disclosed and justified, and should not distort the faithful representation of transactions and events.

18. Other parties, such as public authorities, regulators and members of the public other than investors, lenders, other creditors and employees, may also find general purpose financial reporting useful[12]. They may also have specific information requirements and find the specific information they need in the management report or in other prescribed reports (for instance, in the report on payments to governments) or they may request special reports from the undertaking (such as prudential reports).

19. General purpose financial information of a true and fair nature should be provided to both existing and potential (future) stakeholders of the entity, as there is no difference in the informational responsibility of the preparers of the financial statements towards those different stakeholders, and as it is often difficult to identify which ones are existing and which ones are potential stakeholders. In particular, since the protection of all stakeholders (such as lenders, suppliers, government authorities and employees) is a matter of public good, it is important that the financial information released to the public by reporting entities is prepared regardless of the condition of the users of that information.

## Section 3 – Scope and components of general purpose financial reporting

20. General purpose financial reporting includes the general purpose financial statements and part of the management report. Taken together, they are sometimes described as the [general purpose] financial report.

[11] CF 1.9
[12] CF 1.10

21. The financial statements of an undertaking (whether for the parent entity only, its annual financial statements, or consolidated for the group formed by the parent entity and its subsidiaries) which are published in accordance with the requirements of applicable Company Laws in the Union and are prepared in accordance with the requirements of the applicable Accounting legislations in the Union are designated hereafter as “general purpose financial statements”.

22. The management report which is published together with the financial statements in compliance with applicable legislation in the Union includes, among other things, additional and explanatory information about the financial situation and performance of the undertaking, which can be regarded as an integral part of general purpose financial reporting. However, management reports also serve other goals as determined by applicable legislation in the Union and contain a wealth of non-financial information. Therefore, it is only that section of the management reports which relates to financial information which is to be considered as a component of the general purpose financial reporting. Such section should be read together with the financial statements, and not used in lieu of them, and it should be consistent with the information included in the general purpose financial statements.

23. Other elements of financial information may be published by undertakings to comply with other reporting requirements (e.g., risk and solvency reports requested by regulators, special or pro-forma financial presentations for the purpose of a prospectus, reports on payments to governments, etc.). They may follow certain prescribed presentation or measurement methods which, when different from those used for the general purpose financial statements, should be clearly identified as such and explained. Even when such other publication is mandatory, it does not make it a general purpose financial information.

24. The general purpose primary financial statements shall constitute a composite whole and shall for all undertakings comprise, as a minimum, the balance sheet, the profit and loss account and the notes to the financial statements[13].

25. The balance sheet, sometimes described as a statement of financial position, presents in a summarised form the recognised assets (resources) of the entity, its recognised liabilities (claims against the entity) and its equity (net assets).

26. The profit and loss account, sometimes described as a statement of income, presents the entity’s revenues and other income, its expenses and the net result for the period.

27. The notes to the financial statements provide explanations and additional information that are necessary for an understanding of the information presented in the financial statements.

[13] Article 4

28. In addition to these mandatory financial statements, a statement of changes in cash flows and a statement of changes in equity are often presented as primary financial statements by medium sized and large companies, as they are useful to summarise important information about changes in the financial situation of the entity. For those entities, there may exist several transactions that affect the capital and reserves in an accounting period. Also, there may be a number of financing and investing transactions, which are not easy to understand, absent a statement of cash flows. Such documents are even more useful when consolidated financial statements are presented.

29. The preparation of such additional financial statements should follow the same general principles as those that apply to the statements listed above.

30. Users of financial statements prepared by medium-sized and large undertakings typically have more sophisticated needs. Therefore, further disclosures should be provided in certain areas. Exemption from certain disclosure obligations is justified where such disclosure would be prejudicial to certain persons or to the undertaking[14].

31. From a general standpoint, the digitalisation in the communication of financial information challenges the traditional scope of general purpose financial reporting as defined by the current accounting legislation in the Union. In particular, the on-going and digital[ised] flow of information of a financial nature or which relates to present or forward-looking financial information, as well as the development of links and cross-references between the various categories of corporate information, tends to create a wider perimeter and a more continuous flow of financial information. This should lead management and governance to clearly qualify the information made available to stakeholders by distinguishing between what is general purpose financial information, subject to specific provisions in terms of preparation, governance and audit, and what is not.

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[14] Recital 25

# Chapter 2 - General principles of financial reporting

## Section 1 - Providing information about a reporting entity's financial performance and financial position

1. General purpose financial reporting is based upon financial information prepared in accordance with applicable accounting principles and standards. On the basis of those principles and standards, and together with appropriate explanatory disclosures, it aims to faithfully reflect the financial performance and the financial position of the entity. Such information provides useful input for decisions relating to providing resources to an entity and for other decisions[15].

2. Information about a reporting entity's financial performance helps users to understand the return that the entity has produced on its economic resources in accordance with its stated mission, values and business model. Information about the return the entity has produced provides an indication of how well management has discharged its responsibilities to make efficient and effective use of the reporting entity's resources and can help users to assess management's efficiency and its stewardship of the entity's economic resources. Information about the variability and components of that return is also important, especially in assessing the level of uncertainty of future cash flows. Information about a reporting entity's past financial performance and how its management discharged its stewardship responsibilities is usually helpful in predicting the entity's future returns on its economic resources[16].

3. Information about a reporting entity's financial performance during a period, reflected by changes in its economic resources and claims other than by obtaining additional resources directly from investors and creditors is useful in assessing the entity's past and future ability to generate net cash inflows[17].

4. For the assessment of the return that the entity has produced on its economic resources during the period, consideration needs to be given to the manner in which the entity has spent its resources during the period, and to whether its short-term returns have been affected by expenditures that are expected to produce economic benefits in the longer term but for which no corresponding asset has been recognised in the period. For example, investing in research projects or in staff development usually decreases the reported short term result but is expected to produce future economic benefits, hence financial returns. The general purpose financial reporting should disclose the information necessary for such assessment.

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[15] CF 1.12
[16] CF 1.16
[17] CF 1.18

5. Information about a reporting entity's financial performance during a period may also indicate the extent to which events such as changes in market prices or interest rates have increased or decreased the entity's economic resources and claims, thereby affecting the entity's ability to generate net cash inflows[18].

6. Information about a reporting entity's financial position helps users to understand the entity's resources and claims by third parties against the reporting entity[15].

7. Information about the nature and amounts of a reporting entity's economic resources and claims can help users to identify the reporting entity's financial strengths and weaknesses. That information can help users to assess the reporting entity's liquidity and solvency, its needs for additional financing and how successful it is likely to be in obtaining that financing[19].

8. Different types of economic resources affect a user's assessment of the reporting entity's prospects for future cash flows differently. Some future cash flows result directly from existing economic resources, such as accounts receivable. Other cash flows result from using several resources in combination to produce and market goods or services to customers. Although those cash flows cannot be identified with individual economic resources (or claims), users of financial reports need to know the nature and amount of the resources available for use in a reporting entity's operations[20].

9. Some changes in a reporting entity's economic resources and claims result from that entity's financial performance and other changes in them result from other events or transactions such as issuing debt or equity instruments. To properly assess both the prospects for future cash flows from and to the reporting entity and management's stewardship of the entity's economic resources, users need to be able to distinguish between both of these to identify those two types of changes[21].

10. External users and the entity's management are interested in obtaining objective and reliable information about:

    a) the financial performance achieved in the current and preceding periods, which results from the recognition and comparison of income and expenses and which is presented with a sufficient level of details to highlight the undertaking's key performance indicators in a way that facilitates the analysis of its performance and a comparison with other entities;

    b) the present financial condition of the entity, which results from a true, fair and complete description of its economic resources and claims against the entity in the statement of financial position (also called the balance sheet);

[18] CF 1.19
[19] CF 1.13
[20] CF 1.14
[21] CF 1.15

c) explanations of changes in the cash position of the entity, which can take the form of a statement of cash flows[22] that reconciles the opening and closing balances of the cash position and highlights the sources of cash from operating and financing activities, the cash spent on investments, the contributions from and distributions to equity holders, and other sources of variations in cash balances;

d) additional information in other statements, such as a statement of changes in equity, in the notes to the financial statements, and in the management report, in order to enhance their understanding of:

i. the nature and source of recognised assets and liabilities, income and expenses, and the risks arising from them,

ii. assets and liabilities that have not been recognised, the reason therefore, and the risks and opportunities arising from them,

iii. contributions from and distributions to holders of equity claims, including the dividends policy,

iv. accounting methods used, significant assumptions, estimates and judgments and changes in those that affect the amounts presented or disclosed,

v. the business model and activities of the entity, its sources of financing and the management of its capital, the main sources of its revenues and expenses, the degree of their variability, in order to assess the prospects for future cash flows and the stewardship of management.

## Section 2 - Presenting a true and fair view of the undertaking's financial performance and position

11. Annual financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss[23].

12. To achieve this true and fair view[24], items presented in the annual and consolidated financial statements shall be recognised and measured in accordance with applicable general accounting principles and accounting standards as stated in accounting regulations[25]. The following general accounting principles apply:

a) the undertaking shall be presumed to be carrying on its business as a going concern;

b) accounting policies and measurement bases shall be applied consistently from one financial year to the next;

c) recognition and measurement shall be on a prudent basis,

[22] See Chapter 6, Section 5
[23] Article 4.3
[24] Article 6.1
[25] By regulations the authors mean the Directive itself, its national transpositions and national standards and guidance published by the competent authorities.

d) amounts recognised in the balance sheet and profit and loss account shall be computed on the accrual basis;

e) the opening balance sheet for each financial year shall correspond to the closing balance sheet for the preceding financial year;

f) the components of asset and liability items shall be valued separately;

g) any set-off between asset and liability items, or between income and expenditure items, shall be prohibited;

h) items in the profit and loss account and balance sheet shall be accounted for and presented having regard to the substance of the transaction or arrangement concerned;

i) items recognised in the financial statements shall be measured in accordance with the principle of purchase price or production cost, except for those items for which an alternative measurement basis is more relevant; and

j) the requirements regarding recognition, measurement, presentation, disclosure and consolidation need not be complied with when the effect of complying with them is immaterial.

13. Financial statements should give a true and fair view, but "true and fair" is a general qualitative concept, not a mathematical notion; it should rather be considered as a consequence of the proper application of generally agreed accounting concepts, which reflect:

a) the expectations of the users of the information (different users may have different expectations regarding the type of information that is useful to them to assess the financial condition and performance of the undertaking) and

b) the objectives of the report prepared (true and fair with respect to what nature of information).

Therefore, an assertion that a piece of information is true and fair should be accompanied by a reference to the principles or rules that guide the preparation of the information ("true and fair in accordance with…").

14. Giving a true and fair view is the ultimate objective and complying with the accounting rules and principles is the means to achieve that objective in most cases. However, in certain circumstances, giving a true and fair view requires the provision additional information or, in exceptional situations, the departure from accounting standards.

15. Where the application of accounting principles would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, such additional information as is necessary to comply with that requirement shall be given in the notes to the financial statements[26].

[26] The objective and the concept that a true and fair view (a faithful presentation) is usually achieved by complying with the relevant Framework and related standards are similar to the concepts of fair presentation and compliance with IFRS's expressed in IAS 1.15: "Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation

16. It is possible that, in exceptional cases, a financial statement does not give such a true and fair view where accounting principles are applied. In such cases, the undertaking should depart from such provisions in order to give a true and fair view. The Member States should be allowed to define such exceptional cases and to lay down the relevant special rules which are to apply in those cases. Those exceptional cases should be understood to be only very unusual transactions and unusual situations and should, for instance, not be related to entire specific sectors. Where in exceptional cases the application of an accounting regulation is incompatible with the obligation, that provision shall be disapplied in order to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. The disapplication of any such provision shall be disclosed in the notes to the financial statements together with an explanation of the reasons for it and of its effect on the undertaking's assets, liabilities, financial position and profit or loss[27].

17. Application of prudence is one condition of the "true and fair" quality, i.e. a means of reporting a true and fair view to the external users of financial statements, without however introducing a systematic negative measurement bias which would not give faithful information on the true financial condition. The use of the word "true" in this overarching objective excludes the application of a deliberate measurement bias. In this Section, the concepts of prudence, going concern, accruals basis and offsetting will be further discussed.

## Section 3 - Applying prudence and neutrality in the search of true and fair view

18. To be a perfectly faithful representation, a depiction would have three characteristics. It would be complete, neutral and free from error[28].

19. A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users. Neutral information does not mean information with no purpose or no influence on behaviour. On the contrary, relevant financial information is, by definition, capable of making a difference in users' decisions[29].

20. In this context, recognition and measurement shall be on a prudent basis[30], and in particular:

    a) only profits made at the balance sheet date may be recognised,

of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of IFRS's, with additional disclosures when necessary, is presumed to result in financial statements that achieve a fair presentation".

The requirement to depart from the provisions of the Directive in exceptional cases to achieve a true and fair view is also consistent with the requirement expressed at paragraphs 19-20 of IAS 1: "In the extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS would be so misleading that it would conflict with the objectives of financial statements set out in the Framework, the entity shall depart from that requirement in the manner set out in paragraph 20 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure". IAS 1.20 requires specific disclosures in such circumstances.

[27] Recital 9, Article 4.3
[28] CF 2.15
[29] CF 2.17
[30] Article 6.1.c

b) all liabilities arising in the course of the financial year concerned or in the course of a previous financial year shall be recognised, even if such liabilities become apparent only between the balance sheet date and the date on which the balance sheet is drawn up, and

c) all negative value adjustments shall be recognised, whether the result of the financial year is a profit or a loss;

21. In general, the notion that only profits "made" at balance sheet date may be recognised means that such profit results from a finalised transaction. Usually, a finalised transaction is one where the parties have completed their respective obligations to perform or deliver what was promised and to pay for it. It can also be one where an asset has been sold without recourse, or an obligation has been fulfilled and only the settlement of the amount receivable or payable is outstanding and there is no significant credit risk. However, when the delivery of goods or the provision of services to a customer spans several accounting periods, a profit can be realised as the entity performs the continuous service or as it delivers the promised goods to its customer under the contract. Specific standards explain how to recognise over time or at a point in time the revenues from contracts with customers.

22. Under certain circumstances and conditions, profits may also arise from re-measurements of assets and liabilities in the absence of a transaction, for instance following a fair value measurement which may be deemed more appropriate in these circumstances.

23. [31]The exercise of prudence does not imply a need for asymmetry in exercising judgement, for example a need for more persuasive evidence to support the recognition of assets or income than that of liabilities or expenses. Such asymmetry is not a qualitative characteristic of useful financial information. Equally, the exercise of prudence does not allow for the understatement of assets or income or the overstatement of liabilities or expenses. Such misstatements can lead to the overstatement or understatement of income or expenses in future periods.

24. In addition, prudence[32] does not necessarily ensure that the income reported in financial statements is sustainable. Accounting standards derived from the principle of prudence require the recognition of non-recurring losses, for example when assets are impaired. Prudence can also have the effect of distorting reported performance as prudent accounting applied in an earlier accounting period reverses.

[31] Board decision 18 October 2016
[32] (EFRAG Bulletin Getting a Better Framework, April 2013, paragraph 35)

25. As a consequence of the above, particular accounting standards contain or may contain asymmetric requirements if this is a consequence of decisions intended to select the most relevant information that faithfully represents what it purports to represent[33]. For instance, only profits made at the balance sheet date may be recognised, whereas all negative value adjustments shall be recognised, whether the result of the financial year is a profit or a loss. Considering the uncertainties that are inherent in business life, and the attitude of a large number of users towards uncertainty of the reported result, it is usually appropriate to establish higher hurdles for the recognition of uncertain revenues (assets) than for the recognition of uncertain expenses (liabilities).

26. In certain cases, the exercise of prudent judgement is required in order to avoid the understatement of liabilities and, as a consequence, the overstatement of income. In particular, for the determination of provisions, estimates should be based on a prudent judgement of the management of the undertaking and calculated on an objective basis, supplemented by experience of similar transactions and reports from independent experts[34].

27. Therefore, the requirement to apply prudence should be interpreted as the adoption of a conservative approach in developing accounting standards and policies for the recognition of uncertain assets and uncertain liabilities, as well as in making certain sensitive estimates when implementing the standards. It should however not lead to an over-conservative approach, i.e. a systematic understatement of assets or overstatement of liabilities. A systematic negative bias in recognition principles or measurement methods would conflict with the overarching requirement that true and fair information is provided. Beyond the introduction of prudence in standard setting, "prudence" should also be considered as an attitude of caution (and scepticism) to be observed by those who prepare and approve for publication the financial statements when making judgments under conditions of uncertainty. In the absence of uncertainty about the existence and measurement of an asset or liability, a negative bias is generally not helpful in providing relevant information to the users.

28. The recognition[35] of [all] foreseeable liabilities and potential losses arising in the course of the financial year concerned or in the course of a previous financial year, even if such liabilities or losses become apparent only between the balance sheet date and the date on which the balance sheet is drawn up is not appropriate. Such additional layer of prudence, beyond the recognition of liabilities and losses that are probable, may conflict with the definition of a liability and the provision of a true and fair view.

29. The application of the above requirements should normally help to achieve the necessary prudent approach, but is not sufficient; prudence should also apply in developing other accounting estimates, such as *inter alia*:

    a) selecting the useful life of an asset for the purpose of its amortisation,

[33] Board decision 18 October 2016
[34] Recital 22
[35] Article 6.5 of the Directive

b) making value adjustments when an asset is impaired,

c) estimating the risk of credit losses,

d) determining the recoverable amount of deferred tax assets,

e) selecting a discount rate for the measurement of long-term liabilities,

f) capitalising expenditures such as development costs or formation expenses, etc.

30. The application of prudence in the preparation of the financial statements and in disclosing useful information about the accounting policies used and estimates made should not be confused with a prudent approach in the financial management of the entity. It is up to those responsible for corporate governance to use all the information made available to them to decide whether the reported profit should be distributed under the form of management incentives or dividends, or retained to maintain a sufficient amount of equity.

31. As regards the faculty to depart from the principle of purchase price of production cost, the need for comparability of financial information throughout the Union makes it necessary to allow a system of fair value accounting for certain financial instruments. Furthermore, systems of fair value accounting provide information that can be of more relevance to the users of financial statements than purchase price or production cost-based information in particular when the corresponding items can be easily traded on an active market. For practical reasons, certain classes of undertakings can be excluded from such fair value system[36]. Where such fair value accounting method is applied, the resulting value adjustments, when positive, are deemed to be a profit made at the balance sheet date, provided that such value adjustments are determined with a sufficient degree of reliability and with prudence in making the necessary estimates and except for those adjustments corresponding to a dual measurement approach.

32. All the information disclosed should be presented in a faithful manner, including a reasonable degree of prudence in formulating the explanations and assertions.

33. Fom a general standpoint, the use of estimates in preparing financial statements requires both a neutral and a prudent approach. The recognition and measurement of some items in financial statements are based on estimates, judgements and models rather than exact depictions. As a result of the uncertainties inherent in business activities, certain items in financial statements cannot be measured precisely but can only be estimated. Estimation involves judgements based on the latest available reliable information. The use of estimates is an essential part of the preparation of financial statements. This is especially true in the case of provisions, which by their nature are more uncertain than most other items in the balance sheet. Estimates should be based on a prudent judgement of the management of the undertaking and calculated on an objective basis, supplemented by experience of similar transactions and, in some cases, by reports from independent experts. The evidence considered should include any additional evidence provided by events after the balance-sheet date[37].

[36] Recital 19
[37] Recital 22

34. However, the need for prudence should not conflict with the reasonableness of estimates. When monetary amounts in financial reports cannot be observed directly and must instead be estimated, measurement uncertainty arises. The use of reasonable estimates is an essential part of the preparation of financial information and does not undermine the usefulness of the information if the estimates are clearly and accurately described and explained. Even a high level of measurement uncertainty does not prevent such an estimate from providing useful information.[38]

35. The requirement[39] that the estimates are calculated on an objective basis, based on the latest available reliable information, is equivalent to developing reasonable estimates. At the level of standards, it may also be necessary to require that a risk margin is included in the calculation of estimates[40].

36. Enhanced disclosures of the economic assumptions used and of their variability are useful in mitigating the effect of measurement uncertainty. In some cases, the level of measurement uncertainty involved in making an estimate may be so high that it is necessary to consider whether other information about the economic phenomenon would be more useful than recording an amount on the basis of that highly uncertain estimate.

## Section 4 - The accruals basis of accounting

37. Amounts recognised in the balance sheet and profit and loss account shall be computed on the accrual basis[41].

38. All liabilities arising in the course of the financial year concerned or in the course of a previous financial year shall be recognised, even if such liabilities become apparent only between the balance sheet date and the date on which the balance sheet is drawn up[42].

39. Accrual accounting depicts the effects of transactions and other events and circumstances on a reporting entity's economic resources and claims in the periods in which those effects occur, even if the resulting cash receipts and payments occur in a different period. This is important because information about a reporting entity's economic resources and claims and changes in its economic resources and claims during a period provides a better basis for assessing the entity's past and future performance than information solely about cash receipts and payments during that period[43].

40. Accruals basis of accounting is necessary because the reporting of transactions and events in the financial statements follows the discrete period approach and there is a need to operate a "cut off" between two successive accounting periods. This cut off can take place at the end of the annual period, but can also be necessary at the end of any interim reporting period for which financial statements are presented. . A cash basis of accounting is not appropriate, except for micro-undertakings for practical reasons.

[38] Board decision
[39] Article 6.1, Recital 22
[40] See IAS 37 and IFRS 17 "insurance contracts"
[41] Article 6.1.d
[42] Article 6.1.c. ii
[43] CF 1.17



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41. Specific procedures need to be applied for the determination of accruals at the end of an interim reporting period for certain types of expenses, such as for instance income tax or levies, which are calculated only once a year on the basis of the underlying indicator for the whole annual reporting period.

## Section 5 - The going concern assumption

42. Financial statements and the management report are normally prepared on the assumption that the reporting entity is a going concern i.e, it will continue in operation for the foreseeable future[44]. Hence, it is presumed that the entity has neither the intention nor the need to liquidate or to cease trading in the foreseeable future.

43. If such an intention or need exists, the financial statements may have to be prepared on a different basis. If so, the basis used is disclosed in the financial statements[44]. Such a basis normally involves inter alia:

    a) The impairment of assets which become difficult to sell or otherwise recover in the context of the undertaking ceasing its activity and for which a fire sale or distressed recoverability approach becomes justified;

    b) The recognition of all liabilities that become due as a consequence of a liquidation either voluntary or forced.

44. Going concern is an economic assumption which guides the selection of the basis on which assets and liabilities are recognised and measured. When there are uncertainties surrounding this assumption, appropriate disclosures should be provided.

45. Usually, the foreseeable future considered for the purpose of making such an assumption is a period of 12 months beginning at the date on which the financial statements are authorised for publication. However, a shorter or longer period should be considered when special economic conditions prevail as it may be the case for start-up undertakings for which the development of the turnover is very critical and difficult to forecast.

## Section 6 -Prohibition of Offsetting when presenting financial statements

46. To allow a proper analysis of resources and claims and changes thereto, set-offs between asset and liability items and income and expense items should not be allowed and components of assets and liabilities should be valued separately. In specific cases, however, Member States should be allowed to permit or require undertakings to perform set-offs between asset and liability items and income and expense items[45].

[44] CF 3.10
[45] Recital 16

47. Offsetting occurs when an entity recognises and measures both an asset and a liability as separate units of account, but combines them into a single net amount in the statement of financial position. Offsetting classifies dissimilar items together and therefore is generally not appropriate. Offsetting assets and liabilities differs from treating a set of rights and obligations as a single unit of account[46], in which case the net position is measured and presented.

### Section 7 - Completeness of the information

48. The requirements regarding recognition, measurement, presentation, disclosure and consolidation need not be complied with when the effect of complying with them is immaterial[47].

49. The exemption in the preceding paragraph from recognising, measuring, presenting or disclosing items the effect of which is presumed to be immaterial does not mean that an undertaking should not account for all transactions or events to which it is a party. Keeping a complete record of all transactions is necessary for the maintenance of proper system of internal controls and for the assessment of the stewardship of management.

50. A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations. A complete depiction of a group of assets would include, at a minimum, a description of the nature of the assets in the group, a numerical depiction of all of the assets in the group, and a description of what the numerical depiction represents (for example, historical cost or fair value). For some items, a complete depiction may also entail explanations of significant facts about the quality and nature of the items, factors and circumstances that might affect their quality and nature, and the process used to determine the numerical depiction[48].

51. The future cash flows will arise from the realisation of recognised assets and liabilities, from future transactions and events, and also from the possible financial effects of unrecognised assets and liabilities. Therefore, disclosures about unrecognised assets and liabilities are important to provide a complete picture of the financial condition.

52. A reporting entity's economic resources and claims may also change for reasons other than financial performance, such as issuing additional ownership shares debt or equity instruments. Information about this type of change is necessary to give users a complete understanding of why the reporting entity's economic resources and claims changed and the implications of those changes for its future financial performance[49].

[46] CF 7.13
[47] Recital 17
[48] CF 2.16
[49] CF 1.21

53. Completeness also applies to the preparation of the management report, which should provide a balanced and comprehensive analysis of the development and performance of the undertaking's business and its position, consistent with the size and complexity of the business[50] .

## Section 8 - The principle of materiality

54. 'Material' means the status of information where its omission or misstatement could reasonably be expected to influence decisions that users make on the basis of the financial statements of the undertaking. The materiality of individual items shall be assessed in the context of other similar items[51].

55. The principle of materiality should govern recognition, measurement, presentation, disclosure and consolidation in financial statements. According to the principle of materiality, information that is considered immaterial may, for instance, be aggregated in the financial statements. However, while a single item might be considered to be immaterial, immaterial items of a similar nature might be considered material when taken as a whole[52].

56. Materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of a specific entity's financial report. Qualitative aspects are important. Consequently, one cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation[53].

## Section 9- Capital and capital maintenance

57. As a general principle, historical cost is the basic measurement method, and revaluation or fair value measurement are alternative methods that can be applied only in specific circumstances when the provision of information on that basis is more relevant.

58. Given the current economic situation in the Union, where inflation rates are low, the need for accounting on the basis of a financial capital maintenance system is remote. However, certain consolidated subsidiaries may operate in high inflation economies and may therefore necessitate appropriate accounting corrections to give a true and fair view of their economic performance.

[50] Article 19.1
[51] Article 2.16
[52] Recital 17
[53] CF 2.11

59. The maintenance [54]of the financial capital is a way to protect the interests of members of limited liability companies and others. European Union provisions are necessary for maintaining the capital, which constitutes the creditors' security, in particular by prohibiting any reduction thereof by distribution to shareholders where the latter are not entitled to it and by imposing limits on the company's right to acquire its own shares[55].

60. In addition, European legislations require minimum amounts of capital, regulate the nature of the assets that can be contributed as capital and restrict the distributions to the holders of equity claims.

    Except [56]for cases of reductions of subscribed capital, no distribution to shareholders may be made when on the closing date of the last financial year the net assets as set out in the company's annual accounts are, or following such a distribution would become, lower than the amount of the subscribed capital plus those reserves which may not be distributed under the law or the statutes.

    The amount of a distribution to shareholders may not exceed the amount of the profits at the end of the last financial year plus any profits brought forward and sums drawn from reserves available for this purpose, less any losses brought forward and sums placed to reserve in accordance with the law or the statutes.

    The expression 'distribution' used above includes in particular the payment of dividends and of interest relating to equity instruments.

61. Therefore, the concept of prudence applies not only in the determination of the profits and losses for financial reporting purposes, but also in determining the minimum amount of capital that a limited liability entity needs at the start of, and over its life for conducting its business.

62. There is no restriction regarding the distributions and the level of capital at consolidated level as long as the financial condition of the parent entity complies with the legislation.

63. In determining the proposed distribution to the shareholders of a parent entity, and the distributions by its subsidiaries to the parent and to minority shareholders, management should also consider the effect of such proposed distribution on the consolidated equity of the group, after deduction of the portion of equity attributable to minority shareholders in the consolidated subsidiaries, and the need to maintain a sufficient amount of financial capital for the group as a whole.

[54] Directive 2012/30/EU of the European parliament and of the council of 25 October 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent
[55] Recital 5
[56] Article 17

64. A financial concept of capital is adopted by most entities in preparing their financial statements. Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the entity. Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of the entity based on, for example, units of output per day[57].

65. There are other forms of important economic capital, such as reputation, human resources, know-how, and natural resources which are considered non-financial resources and need to be maintained, however they are usually presented by undertakings outside their financial statements (see chapter 7).

66. The selection of the appropriate concept of capital by an entity should be based on the needs of the users of its financial statements[58]. Given the objectives assigned to general purpose financial reporting in this Framework, a financial concept of capital is generally adopted as the users of financial statements are primarily concerned with the maintenance of nominal invested capital or the purchasing power of invested capital.

67. The concept of capital maintenance is concerned with how an entity defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured[59].

68. Under this concept a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, holders of equity claims during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power[60], after making the necessary corrections for the effect of inflation (increase in the general level of prices).

69. The financial capital maintenance concept does not require the use of a particular measurement basis of measurement. Selection of the basis under this concept is dependent on the type of financial capital that the entity is seeking to maintain[61].

## Section 10 - Applying the general principles of financial reporting to the financial contents of the management reports and to other published financial information

70. Because the providers of financial resources to an entity and other stakeholders rely not only on the periodic financial statements, but also on other financial information that emanates periodically or at any point in time from the entity to make economic decisions, the quality of that other financial information is critical, in particular for a proper functioning of capital markets[62].

[57] CF 8.1
[58] CF 8.2
[59] CF 8.4
[60] CF 8.3
[61] CF 8.5
[62] This information is regulated by the Transparency directive

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71. Such other financial information can be published under different formats and using diverse communication channels, such as primarily the management report, but also ,in interviews in the media, in press releases, presentations to financial analysts, information on the entity's website and in social media.

72. Although the financial information published outside the financial statements is to a large extent not standardised, the general principles of true and fair view, prudence, completeness, consistency, comparability and understandability that are followed in preparing the financial statements should apply *mutatis mutandi* to financial information published elsewhere.

73. In the Union, the management report (and the consolidated management report) is the most standardised type of such financial information. The management report and the consolidated management report are important elements of financial reporting. A fair review of the development of the business and of its position should be provided, in a manner consistent with the size and complexity of the business. The information should not be restricted to the financial aspects of the undertaking's business, and there should be an analysis of environmental and social aspects of the business necessary for an understanding of the undertaking's development, performance or position. In cases where the consolidated management report and the parent undertaking management report are presented in a single report, it may be appropriate to give greater emphasis to those matters which are significant to the undertakings included in the consolidation taken as a whole[63].

74. Alternative performance measures are often published by undertakings in their management reports or in other publications to highlight certain key performance indicators or to explain their financial performance on an adjusted basis. Guidelines on Alternative Performance Measures (Guidelines on APMs) aimed at promoting the usefulness and transparency of APMs included in prospectuses and/or regulated information exist[64]. Such guidelines contribute to the quality of financial reporting as a consequence of and in conjunction with applicable accounting principles and standards.

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[63] Recital 26

[64] ESMA guidelines : "Adherence to the guidelines should improve the comparability, reliability and/or comprehensibility of APMs. Issuers or persons responsible for the prospectus which comply with these guidelines will provide a faithful representation of the financial information disclosed to the market". In its related Q&A document, ESMA says: "the APM Guidelines are based on the principle stated in Articles 4 and 5 of the Transparency Directive of providing a fair review of the development and performance of the business and the position of the issuer. In addition, the overall objective of the APM Guidelines, as prescribed in paragraph 6 of the Guidelines, is to contribute to transparent and useful information to the market and improve comparability, reliability and/or comprehensibility of APMs used."

## Chapter 3 - The Reporting entity's financial statements

### Section 1 - Reporting entities in the scope of this Framework

1. A reporting entity[65] is an undertaking that chooses or is required to prepare financial statements either on a stand-alone basis or on a consolidated basis.

2. A reporting entity on a stand-alone basis is usually a legal entity, such as an incorporated entity. The scope includes certain undertakings with limited liability such as public and private limited liability companies. Although they are not in the scope of the Directive, certain unincorporated entities can also report financial information to their stakeholders.

3. General purpose financial statements cannot depict a portion[66] only of a legal entity. However, presenting certain financial information on the basis of a segment or another portion of an entity is sometimes required by contracts and, if prepared for publication, such financial presentation would be special purpose financial statements and should be clearly labelled as such. Segment-level information which gives more detailed information than the aggregate financial position and performance of an entity may be prescribed by accounting standards[67], or provided on a voluntary basis, and should be considered general purpose financial information when it is published as part of and together with general purpose financial statements.

### Section 2 - The entity perspective in the preparation of financial statements

4. Financial statements provide information about transactions and other events viewed from the perspective of the reporting entity as a whole, instead of from the perspective of any particular group of the entity's investors, lenders or other creditors[68]. This is because the incorporated undertakings have legal existence independent from that of the holders of their equity claims and the financial position of an undertaking should be assessed separately from the assets and liabilities of the holders of equity claims, even when there is not a total separation such as in case of liquidation.

5. This perspective results in presenting the assets and liabilities of the entity separately from those of its equity claims holders, and reporting transactions between the entity and its holders of equity claims (acting in their capacity of holders and not as parties to a commercial contract with the entity) as movements that increase or decrease the equity. Examples of such transactions are: distributions of dividends, contributions of capital in cash or otherwise, reduction of capital and repurchases of equity instruments.

[65] CF 3.11
[66] By portion, we mean a group of assets, liabilities and associated revenues and expenses that form an economic unit and can be identified within the entity taken as a whole. Such an economic unit is not necessarily a reportable segment. Sometimes, it is necessary to summarise the activities of such an unit, to inform certain stakeholders.
[67] Such as IFRS 8 "Segment information" and corresponding national standards.
[68] CF 3.9

6. In preparing the financial statements, it is important to distinguish the movements in equity from the changes in net assets that result from the financial performance of the entity during the period. When the undertaking presents a statement of performance instead of a statement of profit and loss, the financial performance is its net profit (or loss) and the other items deemed to be related to performance, which includes changes in the reported amount of assets and liabilities that are more appropriately reported outside of profit and loss.

7. When other items related to performance are presented separately from the profit and loss, it is important to disclose it separately in the accumulated reserves of the entity, in order to allow a subsequent reclassification (recycling) to profit and loss, when such reclassification is prescribed.

8. The distinction between profit and loss and other related items are discussed in Chapter 6, Sections 4 and 5.

### Section 3 – Annual (unconsolidated) financial statements

9. Annual (unconsolidated) financial statements are prepared on a legal entity basis. They provide information about:

   a) The economic resources it controls directly[69], and

   b) The direct claims against the entity.

10. In general, when the entity is a parent in a group, consolidated financial statements are more likely to provide useful information to users of financial statements than unconsolidated financial statements[70].

11. Nevertheless, in a group, information about the financial situation and performance of the parent alone and information about the financial situation and performance of the consolidated subsidiaries, the unconsolidated financial statements is useful to their respective investors, lenders, other creditors and employees:

   a) claims against the parent typically do not give holders of those claims a direct claim against subsidiaries;

   b) claims against the subsidiaries typically do not give holders of those claims a direct claim against the parent, unless the parent has issued guarantees,

   c) the profits and losses of the subsidiaries are not attributed in full to the parent when there are minority interests in the subsidiaries, or cannot be remitted to the parent without withholding taxes, and

   d) in the Union, the amounts that can be legally distributed to holders of equity claims against the parent usually depend on the distributable reserves of the parent only.

[69] CF 3.19
[70] CF 3.23

## Section 4 - Consolidated financial statements

12. Many undertakings own other undertakings and the aim of coordinating the legislations governing consolidated financial statements is to protect the interests of stakeholders from a group perspective. Consolidated financial statements should be drawn up so that financial information concerning such undertakings may be conveyed to shareholders, members and third parties[71].

13. Consolidated financial statements are prepared for the parent and its subsidiaries as a single reporting entity. In consolidated financial statements, the reporting entity reports on[72]:

    a) the economic resources that the parent controls directly and those that it controls indirectly by controlling its subsidiaries; and

    b) the direct claims against the parent and the indirect claims against it through claims against its subsidiaries.

14. The returns to investors, lenders and other creditors of a parent depend on the future net cash inflows to the parent. The lenders and other creditors of the parent often do not have a claim against the subsidiary. In addition, in some jurisdictions, dividends to holders of shares issued by the parent depend on the distributable profits of the parent. Hence, distinguishing economic resources held directly by the parent from those held by its subsidiaries can provide useful information to users of financial statements[73].

15. An entity that is not required to prepare, or is exempted from preparing, consolidated financial statements may nevertheless choose to publish such financial statements in order to meet certain stakeholders' information needs and thus should follow the same accounting principles as if it was required to prepare such statements.

16. Consolidation of subsidiaries should be based on the notion of control by the parent undertaking. Control can be direct or indirect. Control can be exclusive, i.e. the parent alone controls its subsidiary, but control can also be shared with one or several other parties, in which case the subsidiary is controlled jointly.

17. Control should be based on holding a majority of voting rights, but control may also exist where there are agreements with fellow shareholders or members[74].

18. In certain circumstances control may be effectively exercised where the parent holds a minority or none of the shares in the subsidiary[74].

19. Under certain circumstances, it may be justified to require that undertakings not subject to control, but which are managed on a unified basis or have a common administrative, managerial or supervisory body, be included in consolidated financial statements[74].

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[71] Recital 29
[72] CF 3.21
[73] CF 3.20
[74] Recital 31



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20. In special circumstances, the reporting entity can combine two or more legal entities. When financial statements are prepared for two or more entities that do not have a parent-subsidiary relationship with each other, these financial statements are referred to as combined financial statements.

21. Consolidated financial statements for the parent and its subsidiaries are not designed to provide information needed by investors, lenders and other creditors of a subsidiary about the subsidiary's economic resources, claims against the subsidiary and changes in those resources and claims. The subsidiary's own financial statements are designed to provide that information[75].

22. Recognition and measurement principles applicable to the preparation of annual financial statements should also apply to the preparation of consolidated financial statements[76].

23. The assets and liabilities of undertakings included in a consolidation shall be incorporated in full in the consolidated balance sheet.

24. Associated undertakings should be included in consolidated financial statements by means of the equity method[77].

25. Other methods may be more appropriate to reflect faithfully the business activities in the case where the parent undertaking is an investment entity which manages its investments for the sole purpose of capital appreciation and subsequent sale.

26. A jointly managed undertaking may be proportionately consolidated within consolidated financial statements.

27. Acquisitions of subsidiaries by the parent entity or by any of its controlled subsidiaries (business combinations) are normally accounted for following the purchase accounting method[78] for the first consolidation. However, given the lack of an arm's-length transaction price, intra-group transfers of participating interests, so-called common control transactions, may be accounted for using the pooling of interests method of accounting, in which the book value of shares held in an undertaking included in a consolidation is set off against the corresponding percentage of capital only[79]. This "pooling of interests method" shall not be applied for transactions other than transactions under common control.

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[75] CF 3.23
[76] Recital 35. However, Member States may decide to permit the general provisions and principles stated in this Directive to be applied differently in annual financial statements than in consolidated financial statements
[77] Recital 36
[78] Also sometimes referred to as the purchase price allocation method.
[79] Recital 29

## Section 5 - The reporting period and the presentation of comparative information

28. Financial statements provide information about the financial effects of transactions and other events of a specified period. Those transactions and other events give rise to changes in the entity's assets, liabilities and equity. These changes, combined with the effects of transactions and other events from previous periods, give rise to the entity's assets, liabilities and equity at the end of the period[80]. Usually, a complete reporting period comprises 12 months or 52 weeks.

29. To help users of financial statements identify and assess changes and trends, financial statements should also provide comparative information for one or several preceding periods[81].

30. Interim financial statements can be prepared for shorter periods (for example, for a quarter or a half year) that will be included in the whole reporting period. For some public interest entities, such publication can be mandatory.

31. The same general accounting principles as will be used for the whole reporting period shall be used when presenting interim financial statements, with the necessary adaptations, and comparative information for the same interim period in the preceding year should be provided.

32. The opening balance sheet for each financial year shall correspond to the closing balance sheet for the preceding financial year[82].

33. Accounting policies and measurement bases shall be applied consistently from one financial year to the next[83]. In the unusual circumstance when a change in accounting policy or measurement basis occurs, special procedures must be followed.

34. When a significant change in accounting policies takes place, a restatement of the previously published financial statements on the basis of the new accounting policies is usually necessary to make comparative information more useful and the opening balances of the current period are adjusted to record the cumulative effect of the change. It is however not always possible to do so at a reasonable cost. In those circumstances only, simplified methods of transition, or exemptions from restating previously published information, may be permitted or required.

[80] CF 3.5
[81] CF 7.7
[82] Article 6.1.e
[83] Article 6.1.b

35. Information about transactions or events that have occurred after the end of the reporting period is included in the financial statements, especially in the notes, if such information is necessary to meet the objective of financial statements[84]. Certain information about events and transactions that come to the knowledge of management only after the end of the reporting period and up to the date when the financial statements are authorised for publication need to be taken into account when preparing the financial statements. Other information should only be disclosed as it is important, but does not adjust the financial statements. Adjusting events and transactions are those providing evidence of conditions existing at the end of the reporting period, whereas non-adjusting events are indicative of conditions arising after the end of the reporting period[85].

36. Information about possible future transactions and other events (forward-looking information) is included in the financial statements[86] if it:

    a) relates to the entity's assets and liabilities (including unrecognised assets and liabilities) and equity that existed during the reporting period or at the end of the reporting period, or to income and expenses for the reporting period; and

    b) is useful to users of financial statements.

37. Outside the financial statements, for example, in management reports, entities sometimes provide forward-looking financial information, such as forecasts, and other types of information[87]. The principles of true and fair view, prudence and understandability should also apply when providing such information.

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[84] CF 7.6
[85] IAS 10 "Events after the reporting period"
[86] CF 7.4
[87] CF 7.5

## Chapter 4 - Qualitative characteristics of useful financial information

1. The annual and consolidated financial statements shall be drawn up clearly and in accordance with the provisions of this Framework and the applicable standards derived from it[88].

2. Annual and consolidated financial statements should give a true and fair view of an undertaking's assets and liabilities, financial position and profit or loss and should be prepared on a prudent basis[89].

3. The qualitative characteristics of useful financial information[90] identify the types of information that are likely to be most useful to the users as defined in chapter 1 for making an assessment and decisions about the reporting entity on the basis of its general purpose financial reporting.

4. If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable[91]. The fundamental qualitative characteristics are relevance and faithful representation[92] (i.e, the information gives a true and fair representation).

5. The qualitative characteristics of useful financial information[93] apply to financial information provided in the annual and consolidated financial statements, as well as to financial information provided in other ways such as in interim financial statements, in the management reports and in other means of financial communication.

### Section 1 - Consideration of the European public good

6. Financial reporting standards that apply to EU undertakings should be conducive to the European public good[94]. European public good is a comprehensive whole which is defined in the institutional documents founding the Union and in the policies and legislations adopted by its governing bodies. It includes inter alia:

   a) Financial stability in the Union,

   b) Capital Markets Union, including the freedom of movement of capital and the competitiveness of capital markets,

   c) Facilitation of appropriate financing of the Union economy and, in particular, of undertakings and projects, including long-term investments,

[88] Article 4.2
[89] Article 4.3
[90] CF 2.1
[91] CF 2.4
[92] CF 2.5
[93] CF 2.3
[94] (Source - Non paper prepared by DG FISMA for the ARC meeting in Brussels)

d) Environmental and social responsibility,

e) Governance and regulation of undertakings

7. Therefore, the financial information that is published by Union undertakings on the basis of these general accounting principles and derived standards and guidance is expected to:

a) Ensure a level of transparency that provides an adequate protection of users as defined in chapter 1,

b) Facilitate comparisons of financial condition and performance between Union undertakings and with third-country undertakings,

c) Enhance corporate governance through the oversight of management's stewardship and efficiency,

d) Not endanger financial stability,

e) Not hinder the Union economic development by creating competitive disadvantages for European undertakings, and it is necessary, moreover, to establish minimum equivalent legal requirements at Union level as regards the extent of the financial information that should be made available to the public by undertakings that are in competition with one another[95].

f) Present an appropriate trade-off between costs and benefits.

8. In addition, sufficient (but not absolute) stability over time in the applicable reporting principles and standards is desirable, and newly proposed accounting standards should have added value for the Union, for example because they represent a sufficient improvement to financial reporting to justify the costs and disruptions caused by changes.

## Section 2 - Relevance

9. Relevant financial information is capable of making a difference in the decisions made by users. Information may be capable of making a difference in a decision even if some users choose not to take advantage of it or are already aware of it from other sources[96].

10. Financial information is capable of making a difference in decisions if it has confirmatory and predictive value, value or both[97].

11. Financial information has confirmatory value if it provides feedback about (confirms or changes) previous evaluations[98].

[95] Recital 8
[96] CF 2.6
[97] CF 2.7
[98] CF 2.9

12. Financial information has predictive value if it can be used as an input to processes employed by users to predict future outcomes. Financial information need not be a prediction or forecast to have predictive value. Financial information with predictive value is employed by users in making their own predictions[99].

13. The predictive value and confirmatory value of financial information are interrelated. Information that has predictive value often also has confirmatory value. For example, revenue information for the current year, which can be used as the basis for predicting revenues in future years, can also be compared with revenue predictions for the current year that were made in past years. The results of those comparisons can help a user to correct and improve the processes that were used to make those previous predictions[100].

## Section 3 -True and fair representation of the substance of the transactions and economic phenomena

14. Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the substance of the phenomena that it purports to represent[101]. Items in the profit and loss account and balance sheet shall be accounted for and presented having regard to the substance of the transaction or arrangement concerned[102].

15. In most circumstances, the substance of an economic phenomenon and its legal form are the same. If, in exceptional cases, they are not the same, providing information only about that legal form would not faithfully represent the economic phenomenon[101]. Such cases should be duly justified in order to make sure that departing from a definition that legally binds the parties does not disrupt the conduct of business and effectively contributes to better financial information on the basis of an acceptable cost benefit balance. In such cases, the transaction or event is reported in the financial statements on the basis of its substance rather than its legal form. Such situations justify specific disclosures.

## Section 4 - Accuracy, reliability and verifiability

16. As a result of the uncertainties inherent in business activities, certain items in financial statements cannot be measured precisely but can only be estimated. Estimation involves judgements based on the latest available reliable information. The use of estimates is an essential part of the preparation of financial statements. This is especially true in the case of provisions, which by their nature are more uncertain than most other items in the balance sheet. Estimates should be based on a prudent judgement of the management of the undertaking and calculated on an objective basis, supplemented by experience of similar transactions and, in some cases, even reports from independent experts. The evidence considered should include any additional evidence provided by events after the balance-sheet date[103].

[99] CF 2.8
[100] CF 2.10
[101] CF 2.14
[102] Article 6.1.h
[103] Recital 22

17. Faithful representation does not mean accurate in all respects. Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate[104].

18. Verifiability helps assure users that information faithfully represents the economic phenomena it purports to represent. Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation[105]. Quantified information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified.

19. Verification can be direct or indirect. Direct verification means verifying an amount or other representation through direct observation, for example, by counting cash. Indirect verification means checking the inputs to a model, formula or other technique and recalculating the outputs using the same methodology. It may not be possible to verify some explanations and forward-looking financial information until a future period, if at all. To help users decide whether they want to use that information, it would normally be necessary to disclose the underlying assumptions, the methods of compiling the information and other factors and circumstances that support the information[106].

## Section 5 – Comparability, consistency, timeliness and understandability

20. Comparability, consistency, timeliness and understandability are qualitative characteristics that enhance the usefulness of information that both is relevant and provides a faithful representation. The enhancing qualitative characteristics may also help determine which of two ways should be used to depict a phenomenon if both ways provide information that are considered equally relevant and produce an equally faithful representation[107].

21. Users' decisions involve choosing between alternatives, for example, selling or holding an investment, or investing in one reporting entity or another. Consequently, information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date[108].

[104] CF 2.19
[105] CF 2.29
[106] CF 2.30, CF 2.31
[107] CF 2.22
[108] CF 2.23

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22. Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. Unlike the other qualitative characteristics, comparability does not relate to a single item as a comparison requires at least two items[109].

23. Consistency, although related to comparability, is not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Comparability is the goal; consistency helps to achieve that goal[110].

24. Accounting policies and measurement bases shall be applied consistently from one financial year to the next[111].

25. The layout of the balance sheet and of the profit and loss account shall not be changed from one financial year to the next[112]. Departures from that principle shall, however, be permitted in exceptional cases in order to better achieve the objective of giving a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. Any such departure and the reasons therefor shall be disclosed in the notes to the financial statements.

26. If the composition of the undertakings included in a consolidation has changed significantly in the course of a financial year, the consolidated financial statements shall include information which makes the comparison of successive sets of consolidated financial statements meaningful. This obligation may be fulfilled by the preparation of an adjusted comparative balance sheet and an adjusted comparative profit and loss account.

27. Comparability is not uniformity. For information to be comparable, like things must look alike and different things must look different.[113] Some degree of comparability is likely to be attained by satisfying the fundamental qualitative characteristics. A faithful representation of a relevant economic phenomenon should naturally possess some degree of comparability with a faithful representation of a similar relevant economic phenomenon by another reporting entity[114].

28. Although a single economic phenomenon can be faithfully represented in multiple ways, permitting alternative accounting methods for the same economic phenomenon diminishes comparability[115].

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[109] CF 2.24
[110] CF 2.25
[111] Article 6.1.b
[112] Article 9.1
[113] CF 2.26
[114] CF 2.27
[115] CF 2.28

29. Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is. However, some information may continue to be timely long after the end of a reporting period[116].

30. As indicated above, the annual financial statements shall be drawn up clearly and in accordance with applicable accounting principles and standards.

31. Classifying, characterising and presenting information clearly and concisely makes it understandable[117].

32. Some phenomena are inherently complex and cannot be made easy to understand. Excluding information about those phenomena from financial reports might make the information in those financial reports easier to understand. However, those reports would be incomplete and therefore potentially misleading[118].

33. Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently[119].

### Section 6 - The cost constraint on useful financial reporting

34. Union accounting legislations need to strike an appropriate balance between the interests of the addressees of financial statements and the interest of undertakings in not being unduly burdened with reporting requirements[120].

35. Cost, which is a pervasive constraint on the reporting entity's ability to provide useful financial information, applies similarly. However, the considerations in applying the qualitative characteristics and the cost constraint may be different for different types of information. For example, applying them to forward-looking information may be different from applying them to information about existing economic resources and claims and to changes in those resources and claims[121].

36. Preparers of financial information expend most of the effort involved in collecting, processing, verifying and disseminating financial information, but users ultimately bear those costs in the form of reduced returns. Users of financial information also incur costs of analysing and interpreting the information provided. If needed information is not provided, users incur additional costs to obtain that information elsewhere or to estimate it[122].

[116] CF 2.32
[117] CF 2.33
[118] CF 2.34
[119] CF 2.35
[120] Recital 4
[121] CF 2.3
[122] CF 5.24

37. Reporting financial information that is relevant and faithfully represents what it purports to represent helps users to make decisions with more confidence. This results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole. An individual investor, lender or other creditor also receives benefits by making more informed decisions. However, it is not possible for general purpose financial reports to provide all the information that every user finds relevant[123].

38. In applying the cost constraint, the standard setters and undertakings assess whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information[124].

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[123] CF 2.40
[124] CF 2.41

## Chapter 5 - Definition, Recognition and Measurement of assets, liabilities, income and expenses

1. For many entities, the nature of the business activities is such that the revenue transactions result in immediate cash payments and therefore do not create recognition or measurement difficulties. The same applies to expenses paid immediately in cash. The profit and loss statement will record those transactions at face value and the statement of financial position will reflect the corresponding cash increase or decrease. However, in many instances, the revenues or expenses are not immediately settled in cash and the transactions will, or may, result in an asset or liability other than cash (or cash reduction) that needs to be recognised and measured. Also, economic events other than transactions can create assets or liabilities or modify the carrying amount of previously recognised assets and liabilities. It is necessary to define criteria for recognition and measurement of assets and liabilities in order to enable undertakings to prepare statements of position and performance that give a true and fair view of their activities.

2. Recognition is the process of capturing, for inclusion in the statement of financial position or the statement of financial performance, an item that meets the definition of one of the elements of the financial statements, i.e. an asset, a liability, equity, income or expenses. Recognition involves depicting the item in one of the statements (either alone or in aggregation with other items) in words and by a monetary amount, and including that amount in one or more totals in that statement. The amount at which an asset, a liability or equity is recognised in the statement of financial position is referred to as its carrying amount[125].

### Section 1 – Basic requirements and explanatory comments

3. Recognition and measurement shall be on a prudent basis[126].

4. Items recognised in the financial statements shall be measured in accordance with the principle of purchase price or production cost. Under certain circumstances, alternative measurement of fixed assets at revalued amounts and at fair value may be used.

5. Prudence is a condition of "true and fair" i.e. a means of reporting a true and fair view to the external users of financial statements, without however introducing a systematic negative measurement bias which would not give a faithful information on the true financial condition.

6. The cost basis is sometimes considered more prudent than a measurement on the basis of fair value or revalued amounts, provided that appropriate value adjustments or impairments are made when the cost is no longer fully recoverable.

[125] CF 5.2
[126] Article 6.1

The use of fair value measurement implies that unrealised gains are recorded, either in the profit and loss statement or in equity, hence the perception of a less prudent accounting. It is also considered less prudent when fair value accounting is not based on observable prices in an active market. On the other hand, fair value accounting prohibits the accumulation of potential and unrecognised gains on assets that can easily be sold, which is inherent in cost based accounting. As such gains can be realised at the will of management in any subsequent period and offset losses that would otherwise be reported in that subsequent period, some stakeholders consider that the use of cost-based accounting for certain assets is not necessarily more prudent than fair value accounting.

7. Although the basic method is that items recognised in the financial statements shall be measured in accordance with the principle of purchase price or production cost, alternative measurement bases (fair value accounting and revaluation basis) are permitted in certain circumstances where such alternative bases provide information that can be of more relevance to the users of financial statements than purchase price or production cost-based information. Information based on a fair value measurement can be of more relevance to the users than a purchase or production cost measurement only where it reflects faithfully the business activities that are associated with the assets or liabilities measured on that basis and helps to determine the expected cash flows that will result from those business activities[127].

8. The business activities that are more faithfully represented by fair value measurement are those where the asset (or the liability) will usually be realised by sale or by transfer to a third party during its economic or contractual life, rather than held until maturity to collect (or repay) the capital (liability)and the related income (or expense).

9. Measurement is the process of quantifying, in monetary terms, information about an entity's assets, liabilities, equity, income and expenses. A measure is the result of measuring an asset, a liability, equity or an item of income or expense on a specified measurement basis. A measurement basis is an identified feature of an item being measured (for example, historical cost, fair value or fulfilment value). Applying a measurement basis to an asset or a liability creates a measure for that asset or liability and for any related income or expense[128].

## Section 2 - Description of possible Measurement bases and the information they provide

### 2.1. Historical cost[129]

[127] (Recital 19) The need for comparability of financial information throughout the Union makes it necessary to require Member States to allow a system of fair value accounting for certain financial instruments. Furthermore, systems of fair value accounting provide information that can be of more relevance to the users of financial statements than purchase price or production cost-based information. (Art 8.1) Accordingly, Member States should permit the adoption of a fair value system of accounting by all undertakings or classes of undertaking, other than micro-undertakings making use of the exemptions provided for in this Directive, in respect of both annual and consolidated financial statements or, if a Member State so chooses, in respect of consolidated financial statements only.
[128] CF 6.2
[129] From agenda paper 10C of December 2016 (from paragraphs 6.6 to 6.13)

10. Historical cost is another way to qualify measurements made in accordance with the principle of purchase price or production cost. Measures based on historical cost provide monetary information about assets, liabilities and related income and expenses, using information derived, from the transaction or other event that create or generate them.

11. The historical cost of an asset at the time of the asset's acquisition or construction is the value of all the costs incurred in acquiring or constructing the asset, including both the consideration given and the transaction costs incurred. Reporting at historical cost an asset is justifiable as it reflects all the costs incurred and as it is reasonable to assume, in the absence of evidence to the contrary, that the asset will provide economic benefits that at least recover its cost.

12. 'Production cost' means the purchase price of raw materials, consumables and other costs directly attributable to the item to be measured. It includes a reasonable proportion of fixed or variable overhead costs indirectly attributable to the item in question, to the extent that they relate to the period of production. Distribution costs shall not be included[130].

13. The historical cost of a liability at the time it is incurred is the value of the consideration received to incur that liability, comprising the consideration less the transaction costs incurred in taking it on. Reporting at historical cost a liability that has been assumed in exchange for consideration is justifiable as it is reasonable to assume, in the absence of evidence to the contrary, that the transaction was on an arm's length basis and the liability is no more than the consideration received. If however it appears that the consideration received is less than the amount that will be needed to fulfill the liability (or dispose of it), the transaction is onerous and the higher amount should be recorded as a liability.

14. When the fulfilment of the liability, or its repayment to the holder of the claim, will take place in the future and the effect of the time value of money is material, the liability is presented in the financial statements at the present value using an appropriate discount rate. This discounting should be applied with prudence when the date of fulfillment or repayment is uncertain.

15. The carrying amount of a non-financial asset reported at historical cost is adjusted over time to depict, if and when applicable:

    a) the consumption of the economic resource that constitutes the asset (depreciation or amortisation); and

    b) the effect of events that cause part of the historical cost of the asset to be no longer recoverable (impairment).

16. The carrying amount of a non-financial liability reported at historical cost is adjusted over time to depict, if and when applicable:

    a) accrual of interest for the time value of money;

    b) fulfilment of the liability; and

[130] Article 27

c) the effect of events that increase the estimated cash outflows required to fulfil the liability so that the historical cost no longer faithfully represents the liability (onerous liabilities).

17. The subsequent carrying amount of financial assets and financial liabilities measured at historical cost reflects subsequent changes such as the accrual of interest, changes in the estimates of cash flows (including the impairment of financial assets) and payments or receipts. This is sometimes referred to as amortised cost.

18. Historical cost does not reflect changes in prices, other than those caused by the factors identified in paragraphs 13-15 above.

19. Where assets are acquired, or liabilities are incurred as a result of an event other than a transaction on arms-length terms, it may not be possible to readily identify a cost, or the cost may not faithfully represent the asset or liability. In such cases, a current value is sometimes used as a proxy for cost (deemed cost) on initial measurement and that deemed cost is then used as a starting point for subsequent measurement. In such a circumstance, it may be necessary to confirm that the deemed cost of the asset is recoverable (or that the amount of the liability is not greater that the deemed cost).

20. The purchase price or production cost of fixed assets with limited useful economic lives shall be reduced by value adjustments calculated to write off the value of such assets systematically over their useful economic lives[131].

21. The depreciation method[132] used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

22. The depreciable amount of a tangible or an intangible asset is its cost less its estimated residual value.

23. In compliance with the requirement of a prudent basis of accounting, assets which are not measured at fair value should be carried in the statement of financial position at no more than their recoverable amount[133]. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through its sale (market value) or its use (value in use). If this is the case, the asset is impaired and an impairment loss (negative value adjustment) must be recognised.

24. Except when otherwise prescribed, impairments (negative value adjustments) should be reversed[134] when there is sufficient evidence that the cause of the impairment has disappeared. Such evidence needs to be assessed with prudence.

25. For the purpose of these above assessments, the determination of the way in which the cost of the asset will be recovered takes into account the business model of the undertaking.

[131] Article 12.5
[132] IAS 16. 60
[133] IAS 36
[134] Article 11.6 (d) measurement at the lower of the values provided for in points (a) and (b) may not continue if the reasons for which the value adjustments were made have ceased to apply; this provision shall not apply to value adjustments made in respect of goodwill.

26. The environmental risks can also impact the current assessment of the net realisable value of certain assets (so-called "stranded" assets) and the identification of contingent liabilities. Therefore, they should be considered when preparing in a prudent manner the financial statements in relation with the identification of the need for impairments of assets and disclosure of contingent liabilities.

### 2.2. Current values

27. Measures based on current value provide monetary information about assets, liabilities and related income and expenses using information updated to reflect conditions at the measurement date. Because of the updating, current values of assets and liabilities reflect changes, since the previous measurement date, in estimates of cash flows and other factors reflected in those current values[135].

28. Current value measurement bases include[136]:

   a) fair value;

   b) value in use for assets and fulfilment value for liabilities; and

   c) current cost.

### 2.3. Fair value

29. Fair value is the price that would be received to sell an asset, or paid to transfer a liability at the measurement date, in an orderly transaction between participants on an active and efficient market[137]. For a market price to be reliable and the transaction to be orderly, the market on which the instrument is traded needs to be sufficiently active and efficient and the participants to the transactions need to be acting on the most advantageous market for the asset and not under forced liquidation or distressed sales conditions.

30. Fair value reflects the perspective of market participants (participants in a market to which the entity has access). That is, the asset or the liability is measured using the same assumptions that market participants would use when pricing the asset or the liability if those market participants act in their economic best interest[138].

31. Fair value reflects the following factors[139]:

   a) estimates of future cash flows.

   b) possible variations in the estimated amount and timing of future cash flows for the asset or the liability being measured, caused by the uncertainty inherent in the cash flows.

   c) the time value of money.

[135] CF 6.19
[136] CF 6.20
[137] CF 6.21
[138] CF 6.22
[139] From agenda paper 10C of December 2016 (from paragraphs 6.18 to 6.20)



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d) the price for bearing the uncertainty inherent in the cash flows (i.e. a risk premium or risk discount). The price for bearing that uncertainty depends on the extent of that uncertainty. It also reflects the fact that investors would generally pay less for an asset (generally expect to receive more for taking on a liability) that has uncertain cash flows than for an asset (liability) whose cash flows are certain.

e) other factors, such as liquidity, that market participants would take into account in the circumstances.

32. For a liability, the factors include the possibility that the entity may fail to fulfil the liability (own credit risk).

33. The fair value of:

a) an asset is not increased by the transaction costs incurred when acquiring the asset. Nor is it decreased by the transaction costs that would be incurred on selling the asset.

b) a liability is not decreased by the transaction costs arising when the liability is incurred.Nor is it increased by the transaction costs that would be incurred on transferring the liability.

34. The fair value shall be determined by reference to one of the following values[140]:

a) in the case of financial instruments for which a reliable market can readily be identified, the market value. Where the market value is not readily identifiable for an instrument but can be identified for its components or for a similar instrument, the market value may be derived from that of its components or of the similar instrument;

b) in the case of financial instruments for which a reliable market cannot be readily identified, a value resulting from generally accepted valuation models and techniques, provided that such valuation models and techniques ensure a reasonable approximation of the market value.

35. Financial instruments that cannot be measured reliably by any of the methods described in points (a) and (b) of the above paragraph shall be measured in accordance with the principle of purchase price or production cost in so far as measurement on that basis is possible.

36. Liabilities can be measured either at fair value or at fulfilment value, which can be a present (discounted) value taking into account the time value of money.

37. Measurement at fair value shall apply only to the following liabilities: liabilities held as part of a trading portfolio; and derivative financial instruments.

38. Liabilities should be measured at fair value only if:

a) It faithfully represents the business activity of an entity, or

[140] Article 8.7

b) Such measurement avoids a distortion ("measurement mismatch") with the measurement at fair value of assets that are contractually or economically linked to those liabilities as a result of the entity's business model.

39. However, to provide a true and fair view of the entity's performance, gains or losses that result from the changes in the assessment of the entity's own credit risk by market participants should not be reported in the profit or loss statement.

### 2.4. Value in use and fulfilment value[141]

40. Value in use and fulfilment value are entity-specific values. Value in use is the present value of the cash flows that an entity expects to derive from the continuing use of an asset and from its ultimate disposal. Fulfilment value is the present value of the cash flows that an entity expects to incur as it fulfils a liability.

41. Value in use and fulfilment value are based on entity-specific assumptions rather than assumptions by market participants. However, there may sometimes be little difference between the assumptions that market participants would use and those that the entity itself uses. In that case, a market participant perspective and the entity's perspective are likely to produce similar measures.

42. Value in use and fulfilment value cannot be directly observed and are determined using cash-flow-based measurement techniques. In principle, value in use and fulfilment value reflect the same factors as for fair value, except that, for a liability, the entity's non-performance risk may be excluded from fulfilment value.

43. Value in use reflects the present value of the transaction costs that the entity expects to incur on the ultimate disposal of the asset.

44. Fulfilment value includes not only the present value of the amounts to be transferred to the liability counterparty, but also the present value of the amounts that the entity expects to transfer to other parties to enable it to fulfil the liability. Thus, it also includes the present value of transaction costs (if any) that the entity expects to incur in undertaking transactions that enable it to fulfil the liability.

### 2.5. Definition of current cost

45. The current cost[142] of an asset (liability) is the cost of (proceeds from) an equivalent asset (liability) at the measurement date. Current cost, like historical cost, is an entry value: it reflects values in the market in which the entity acquires the asset or incurs the liability (although it is based on economic circumstances prevailing at the measurement date).

[141] From agenda paper 10C of December 2016 (from paragraphs 6.21 to 6.25)
[142] From agenda paper 10C of December 2016 - paragraphs 6.26



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### 2.6. Revaluation basis for fixed assets[143]

46. If permitted, or when required, an undertaking shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to in a consistent manner within each class of fixed assets. Such revaluations shall only occur under specific circumstances and conditions defined by applicable legislations. Since such revaluations generally disrupt the principles of consistency and comparability, appropriate disclosures are required.

47. Where such measurement method is applied, the amount of the difference between measurement on a purchase price or production cost basis and measurement on a revaluation basis shall be entered in the balance sheet in the revaluation reserve classified as equity. The revaluation reserve may be capitalised in whole or in part at any time[144].

48. The revaluation or restatement of assets give rise to increases in equity. While these increases may meet the definition of income and expenses, they are not included in the profit and loss statement on the basis of prudence and are included in equity as capital maintenance adjustments or revaluation reserves[145].

49. The revaluation reserve shall be reduced where the amounts transferred to that reserve are no longer necessary for the implementation of the revaluation basis of accounting. Transfers to the profit and loss account from the revaluation reserve may be made only where the amounts transferred have been entered as an expense in the profit and loss account or reflect increases in value which have actually been realised. No part of the revaluation reserve may be distributed, either directly or indirectly, unless it represents a gain actually realised[144].

### 2.7. Classification of assets on the basis of the business purpose (business model)

50. Whether particular assets are to be shown as fixed assets or current assets shall depend upon the purpose for which they are intended[146]. This distinction is important as fixed assets may be carried at revalued amounts and are subject to amortization/depreciation over their useful life.

## Section 3 - Factors to consider when selecting a measurement basis

### 3.1. General principles

51. The basic measurement method is the purchase price or production cost. It is therefore necessary to specify the factors to be considered when choosing an alternative measurement basis.

[143] (Article 7.1) By way of derogation from point (i) of Article 6(1), Member States may permit or require, in respect of all undertakings or any classes of undertaking, the measurement of fixed assets at revalued amounts. Where national law provides for the revaluation basis of measurement, it shall define its content and limits and the rules for its application.
[144] Article 7.2
[145] CF 8.10
[146] Article 12.3

52. Consideration of the qualitative characteristics of useful financial information and of the cost constraint is likely to result in the selection of different measurement bases for different assets, liabilities, income and expenses[147].

53. From a general standpoint, the qualitative characteristics of useful financial information depend upon the type of activities the financial information purports to reflect faithfully. Considerations related to the business model(s) or business activities of the undertakings as well as considerations related to the relevant business cycle(s) (for instance, short term / long term) are vital to select an appropriate measurement. The assets that are needed for the production and sale of goods and services are generally better reflected under the historical cost measurement basis. At the opposite, trading activities of financial and non-financial assets are generally better reflected under the fair value measurement basis. By contrast, financial assets that are managed substantially to collect principal and interest payments are generally better reflected under the amortised cost basis when they are held in a long term perspective, i.e. for instance until maturity.

54. Sometimes, it may be appropriate to report the economic effects of the resources and claims following two measurement bases. The benefits and drawbacks of using a dual measurement are discussed in section 4.

55. Additional guidance may be needed to describe how to implement the measurement basis (or bases) selected. That description could include:

    a) specifying techniques that may or must be used to estimate a measure on a particular measurement basis;

    b) specifying a simplified measurement approach that is likely to provide information similar to that provided by a preferred measurement basis; or

    c) modifying a measurement basis, for example by excluding from the fulfilment value of a liability the effect of the possibility that the entity may fail to fulfil that liability (own credit risk).

### 3.2. Additional comments

56. When selecting a measurement basis[148], it is important to consider the information that measurement basis will produce in both the statement of financial position and the statement of financial performance.

57. The most efficient and effective process for applying the fundamental qualitative characteristics is to identify the information about an economic phenomenon that would be most relevant if it is available and if it can be provided in a way that faithfully represents the underlying economic phenomenon. If that information is not available or cannot be provided in a way that faithfully represents the underlying economic phenomenon, the next most relevant type of information is considered.

[147] CF 6.3
[148] From agenda paper 10C of December 2016 - paragraphs 6..45,to 6.60



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58. Measures of assets, liabilities and related income and expenses are used when recognising items and can also be used in the notes when disclosing information about recognised and unrecognised items. The following discussion also applies in selecting a measurement basis for information provided in the notes.

59. Initial measurement and subsequent measurement cannot be considered separately. If the initial measurement basis and subsequent measurement basis are not consistent, income and expenses will be recognised solely because of the change in measurement basis. Recognising such income or expenses might appear to depict a transaction or other event when, in fact, no such transaction or event has occurred. Hence, the choice of measurement basis for an asset or a liability and the related income or expenses is determined by considering both the initial measurement and the subsequent measurement.

60. In addition to considerations related to the business model(s) and to the business cycle(s) of the undertakings, the relevance of a measurement basis depends on the characteristics of the asset or liability, in particular, whether the cash flows are highly variable and whether the value is sensitive to market factors or other risks.

61. If the cash flows of a financial asset or financial liability are variable (particularly if they comprise substantially more than principal and interest) amortised cost may not provide relevant information. Amortised cost allocates interest revenue or expense to the relevant period, based on contractual cash flows or the calculation of an effective interest rate.

62. If the value of an asset or liability is sensitive to identifiable market factors or other risks, and when a fixed asset has been acquired in a distant past, its historical cost might be significantly different from its current value at the reporting date. That current value of assets or liabilities may provide information that is more relevant than historical cost for the user's assessment of the following features:

    a) the reporting entity's financial strengths and weaknesses;

    b) the entity's liquidity and solvency;

    c) the entity's need for additional financing and how successful it is likely to be in obtaining that financing; and

    d) the management's stewardship of the entity's economic resources.

63. Some economic resources produce cash flows directly; in other cases, economic resources are used in combination to produce cash flows indirectly. How economic resources are used and hence how assets and liabilities produce cash flows depends on the nature of the business model(s) or activities conducted by the entity.

64. The importance of the assessment of the prospects for future cash inflows by the users of financial information justifies that, for certain classes of assets that are managed under a business model in which the realisation of economic benefits will mostly take the form of sale, alternative measurement methods (revalued amounts or fair value) may be more relevant than the amortised cost model.

65. For assets and liabilities that produce cash flows directly, such as assets that can be sold independently, without a significant economic penalty, a measurement basis that reflects the present value of the future cash flows (fair value or value in use and for liabilities, fulfilment value) is likely to be relevant. Even if an asset is capable of being sold separately, when the entity's business activity is such that the asset is used for production and sale of goods or services, the profit arising on sale only be recognised when realised.

66. When a business activity involves the use of several resources that generate cash flows indirectly, by being used in combination to produce and market goods or services to customers, a cost-based measurement basis is likely to provide relevant information. The expense reported will then reflect the cost of assets consumed in a period, and a comparison of that expense with the revenue of the period provides information on the margins achieved in the period. Information about margins can be used as some of the inputs needed to predict future margins and hence in assessing the entity's prospects for future cash flows

67. Where assets and liabilities are held as part of a business activity that is managed with a view to collecting contractual cash flows, a cost-based measurement basis may provide relevant information on the margin between the contractual yield and the entity's cost of borrowing. However, if the cash flows of a financial asset or financial liability are changed by factors other than principal and interest, the reported margin on an amortised cost basis would include the effect of those other changes, which may make it less relevant.

68. When assets and liabilities are related in some way using different measurement bases for those assets and liabilities can create a measurement inconsistency (an 'accounting mismatch'). Measurement inconsistencies can result in financial statements that do not faithfully represent the entity's financial position and financial performance. Consequently, in some circumstances, using the same measurement basis for related assets or liabilities may provide more useful information for users of financial statements than using dissimilar measurement bases would provide. This may be particularly likely when the cash flows from one item are substantially linked to the cash flows from another item (one example is when an entity incurs a liability that contractually has a variable remuneration which is linked to the performance of a pool of assets held by the entity; another example, where there is a non-contractual link, is an entity which incurs long-term liabilities and which invests the proceeds in assets that have similar durations, risk profiles and variability of cash-flows with a view to create an economic hedged relationship).

### 3.3. Faithful representation and measurement uncertainty[149]

69. Measurement uncertainty affects whether information provided by a measurement basis provides a true and fair view of an entity's financial position and financial performance. In combination with other factors, measurement uncertainty also affects whether an asset or liability is recognised. A high level of measurement uncertainty does not prevent the use of a measurement basis that provides the most relevant information.

[149] From agenda paper 10C of December 2016 - paragraphs 6.62,to 6.64 and 6.71

However, in some cases the level of measurement uncertainty is so high that information provided by a measurement basis may not provide a faithful representation, in which case it is appropriate to select a different measurement basis that results in relevant information. This is in particular the case in a fair value measurement context when active markets do not exist, when volatility on active markets is abnormal or when proxys or models used for the valuation rely heavily on judgemental and sensitive assumptions.

70. Measurement uncertainty is different from outcome uncertainty. For example, if the fair value of an asset is observable in an active market, no uncertainty is associated with the measurement of that fair value, even though it is uncertain how much cash the asset will ultimately produce. Nevertheless, outcome uncertainty may sometimes contribute to measurement uncertainty. For example, there may be a high level of uncertainty about the cash flows that a unique asset will produce (outcome uncertainty) and estimating a current value of that asset may depend on a model whose validity is untested and that requires inputs that are difficult to verify (measurement uncertainty).

71. Verifiability is enhanced by using measurement bases that result in measures that can be independently corroborated either directly, such as by observing prices, or indirectly, such as by checking inputs to a model. If a measure cannot be verified, users of financial statements may need explanatory information to enable them to understand how the measure was determined. In some such cases, it may be necessary to specify the use of a different measurement basis.

### 3.4. Historical cost[150]

72. In many situations, it is simpler and hence less costly to provide information about historical cost than it is to provide information using a current value measurement basis. In addition, measures prepared using a historical cost measurement basis are generally well understood and, in many cases, verifiable. They also reflect faithfully many of the production and service activities performed by undertakings.

73. However, estimating consumption and identifying and measuring impairment losses or onerous liabilities can be subjective as they necessitate to make assumptions about the future. Hence, the amortised historical cost of an asset or a liability can sometimes be as difficult to estimate as a current value. Such situations should lead to a prudent approach in order to comfort or reduce the carrying amount by comparison with the current value.

74. Using a historical cost measurement basis, similar assets or liabilities acquired or incurred at different times can be reported in the financial statements at different amounts. This can reduce comparability, both between reporting entities and within the same reporting entity. Additional disclosures of the current values improve comparability.

[150] From agenda paper 10C of December 2016 - paragraphs 6.72,to 6.74 and 6.56



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75. Furthermore, if historical cost is used, changes in value are not reported when that value changes, but only on the occurrence of an event such as disposal, impairment or fulfilment.

    This could be incorrectly interpreted as implying that all the income and expenses recognised at the time of that event arose then, rather than from events in the periods during which the asset or liability was held. Appropriate value adjustments (impairments) should reflect the risks arising from holding the asset or liability and additional disclosures of the current values inform about the unrecorded changes in value.

### 3.5. Fair value, value in use and fulfilment value[151]

76. Fair value is determined from the perspective of market participants, instead of from an entity-specific perspective, and is independent of when the asset or the liability was acquired or incurred, identical assets measured at fair value will, in principle, be measured at the same amount by entities that have access to the same markets. This can enhance comparability both between reporting entities and within the same reporting entity.

77. If the fair value of an asset or a liability can be observed in an active market, the process of fair value measurement is low-cost, simple and easy to understand, and the fair value is verifiable. Considerations related to the characteristics of that active market may have to be disclosed since all markets do not have similar depth and liquidity.

78. Valuation techniques (sometimes including the use of cash-flow-based measurements) may be needed to estimate fair value when it cannot be observed in an active market, and are generally needed when determining value in use and fulfilment value. Depending on the techniques used:

    a) the estimation process may be costly and complex.

    b) the inputs into the process may be subjective and it may be difficult to verify both the inputs and the validity of the process itself. Consequently, the measures of identical assets or liabilities may differ, which reduces comparability.

79. For many assets used in combination with other assets, value in use cannot be determined meaningfully for individual assets. Instead, the value in use is determined for a group of assets and the result may then need to be allocated to individual assets. This process can be subjective and arbitrary. In addition, in determining value in use for an asset, it may be difficult to exclude the effect of synergies with other assets in the group. Hence, determining the value in use of an asset used in combination with other assets can be a costly process and its complexity and subjectivity reduces verifiability. For these reasons, value in use may not be a practical measurement basis for regular remeasurements of such assets at each reporting date. However, it may be useful for occasional remeasurements of assets (for example, when it is used in an impairment test to determine whether historical cost is fully recoverable).

[151] From agenda paper 10C of December 2016 - paragraphs 6.75,to 6.78

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### 3.6. Current cost[152]

80. Application of current cost can be complex and subjective. For example, if prices are available only for new assets, the current cost of a used asset might be estimated by adjusting the price of a new asset to reflect the current age and condition of the asset that is held by the entity. Furthermore, because of changes in technology and business practices, many assets would not be replaced with identical assets, so a further subjective adjustment to the price of a new asset would be required in order to estimate the current cost of the existing asset. Furthermore, the disaggregation of changes in current cost carrying amounts between holding gains and losses and the cost of consumption may be complex and require arbitrary assumptions. Because of these difficulties, current cost measures may lack verifiability and understandability.

### 3.7. Additional factors specific to initial measurement

81. At initial recognition, the cost of an asset acquired or a liability incurred is normally similar to its fair value at that date, except if transaction costs are significant. Nevertheless, even if those two amounts are similar, it is necessary to describe what measurement basis is used at initial recognition. If historical cost will be used subsequently, that basis is also normally appropriate at initial recognition. Similarly, if a current value will be used subsequently, it is also normally appropriate at initial measurement, thus avoiding an unnecessary change at the first subsequent measurement[153].

82. When an entity acquires an asset, or incurs a liability, in exchange for transferring another asset or liability, the initial measure of the asset acquired (or the liability incurred) should reflect the most relevant and reliable value of the asset or liability transferred or of the asset or liability received. It also determines whether any income or expenses arise on the transfer of the other asset or liability[154].

83. Assets may be acquired, or liabilities incurred, as a result of an event that is not a transaction on market terms. For example:

    a) the transaction price may be affected by relationships between the parties, or by financial distress or other duress of one of the parties;

    b) an asset may be granted to the entity free of charge by a government or donated to the entity by another party;

    c) a liability may be imposed by legislation or regulation; or

    d) a liability to pay compensation or a penalty may arise from an act of wrongdoing.

[152] From agenda paper 10C of December 2016 - paragraphs 6.79
[153] CF 6.67
[154] CF 6.66



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84. In such cases, measuring the asset acquired, or the liability incurred, at its historical cost may not provide a faithful representation of the assets and liabilities of the entity and of any income or expenses arising from the transaction or other event. Hence, it may be appropriate to measure the assets acquired, or the liability incurred, at a current value and to recognise the difference between that amount and any consideration given or received as income or expenses. That current value could be used as the deemed cost for subsequent measurement of the asset or liability.

85. When assets are acquired or liabilities incurred as a result of a transaction or event that is not a transaction on market terms, all relevant aspects of the transaction or event need to be identified: for example, there may be assets, liabilities, contributions from holders of equity claims or distributions to holders of equity claims that need to be reflected to faithfully represent the substance of the effect of the transaction or event on the entity's financial position and financial performance.

## Section 4 – Using more than one measurement basis

86. Sometimes, having considered the factors described in the paragraphs above more than one measurement basis is deemed necessary to provide relevant information[155].

87. In most cases, the most understandable way to provide that information is[156]:

    a) to use a single measurement basis for the asset or liability both in the statement of financial position and for related income and expenses in the statement(s) of financial performance; and

    b) to disclose in the notes additional information using a different measurement basis.

88. However, in some cases, because of the way in which an asset or a liability contributes to future cash flows or because of the characteristics of the asset or the liability[157] or because of the nature of the business activities conducted by the undertaking, the information should be prepared under different measurement bases:

    a) a basic historical or amortised measurement basis for the income and expenses in the statement of profit or loss; and

    b) an alternative measurement basis, such as a current value measurement basis, for the asset or the liability in the statement of financial position.

    Such cases are often referred to as dual measurement cases.

[155] CF 6.74
[156] CF 6.75
[157] CF 6.76

89. In such cases, the change in the current value reflected in the statement of financial position is split into two components[158]:

    a) the statement of profit or loss, which includes the income or expenses measured using the measurement basis selected for that statement; and

    b) the other items deemed to be related to performance (sometimes called other comprehensive income), which represent the difference between the measurements in the profit and loss and in the statement of financial position arising during the period.

    As a result, the accumulated other items deemed to be related to performance (OCI) or future profit and loss items (see discussion on alternative views in Chapter 6, section 5) related to that asset or that liability equals the difference between the carrying amount of the asset or liability in the statement of financial position and the carrying amount that would have been determined for the asset or liability using the measurement basis selected for the statement of profit or loss.

90. Except for some duly justified cases, the other comprehensive income or future profit and loss items are to be subsequently recycled into the profit and loss statement at the time of recognition determined in accordance with the basic recognition principle, generally the historical or amortised cost basis.

91. A dual measurement represents a trade-off between two equally relevant measurement bases.

## Section 5 – Definition and Recognition of assets

92. An asset is a present economic resource controlled by the entity as a result of past events[159]. An economic resource is a right that has the potential to produce economic benefits[160].

### 5.1 Types of rights

93. Rights that constitute economic resources take the following forms[161]:

    a) rights established by contract, legislation or similar means, such as:

       i. rights arising from a financial instrument, for example, an investment in a debt instrument or in an equity instrument.

       ii. rights over physical objects, such as property, plant and equipment or inventories. Such rights may include ownership of a physical object, the right to use a physical object or the right to the residual value of a leased object.

[158] CF 6.77
[159] CF 4.5
[160] CF 4.6
[161] CF 4.8

iii. rights to exchange economic resources with another party on favourable terms, for example, a forward contract to buy an economic resource (see paragraphs 4.40–4.42) or an option to buy an economic resource.

iv. rights to benefit from the obligations of another party to stand ready to transfer an economic resource if an uncertain future event occurs.

v. rights to receive goods or services.

vi. intellectual property rights, for example, registered patents.

b) rights arising from a constructive obligation of another party; and

c) other rights that give the entity the potential to receive future economic benefits that are not available to all other parties, for example, rights to the economic benefits that may be produced by items such as know-how not in the public domain or by customer or supplier relationships.

94. Many rights are legally enforceable, having been established by contract, legislation or similar means, such as rights from:

a) owning or leasing a physical object,

b) owning a debt instrument or an equity instrument,

c) from owning a registered patent,

d) through a constructive obligation of another party,

e) or by having the present ability to keep secret know-how that is not in the public domain, even if that know-how is not protected by a registered patent.

95. If an entity has rights that are identical to those held by all other parties, those rights do not give the entity the potential to receive economic benefits beyond those available to all other parties. For example, rights of access to public goods, such as roads, or knowledge that is in the public domain are not economic resources for the entity if similar rights are available to all parties without significant cost[162].

96. In principle, each of an entity's rights is a separate asset. However, for accounting purposes, related rights are often treated as a single asset that forms a single unit of account. For example, legal ownership of a physical object gives rise to several rights, such as[163]:

a) the right to use the object;

b) the right to sell rights over the object;

c) the right to pledge rights over the object; and

d) other rights not listed in a)–c).

[162] CF 4.10
[163] CF 4.12

97. In many cases, the set of rights arising from legal ownership of a physical object is accounted for as a single asset. Conceptually, the economic resource is the set of rights not the physical object. In certain cases, some rights may be unbundled and transferred to other parties while the entity retains substantial rights and does not derecognise in full the asset. Nevertheless, describing the set of rights as the physical object will generally provide a faithful representation of those rights in the concise and most understandable way.

98. In some cases, it is uncertain whether an entity has a right. For example, an entity and another party might dispute whether the entity has a right to receive economic benefits from that other party. Until that uncertainty is resolved—for example, by a court ruling—it is uncertain whether the entity has a right and, consequently, whether an asset exists.

99. Applying a prudent approach in the preparation of financial statements[164] means that uncertainty in the existence of an asset will generally prohibit its recognition.

100. An entity cannot have a right to receive economic benefits from itself[165]. Hence:

  a) debt instruments or equity instruments issued by the entity and repurchased and held by it—for example, treasury shares—are in principle not economic resources of that entity and should be either deducted from its equity or disclosed separately; and

  b) if a reporting entity comprises more than one legal entity, in consolidation, debt instruments or equity instruments issued by one of those legal entities and held by another of those legal entities are not economic resources of the reporting entity.

### 5.2 Potential to produce economic benefits

101. For the economic resource to have the potential to produce economic benefits, it need not be certain, or even probable, that the resource will produce economic benefits. It is only necessary that the economic resource already exists and that there is at least one circumstance in which it would produce economic benefits[166].

102. The economic benefits produced by an economic resource could include[167]:

  a) receiving contractual cash flows;

  b) receiving another economic resource or exchanging economic resources with another party on favourable terms;

  c) using the economic resource to produce cash inflows (or save cash outflows), for example;

    i. using the economic resource singly or in combination with other economic resources to produce goods or provide services;

    ii. using the economic resource to enhance the value of other economic resources;

    iii. pledging the economic resource to secure a loan;

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[164] Article 6.1
[165] CF 4.11
[166] CF 4.13
[167] CF 4.14

iv. leasing the economic resource to another party; or

v. receiving services to which the economic resource gives rights.

d) selling the economic resource in exchange for cash or other economic resources, or transferring the economic resource to fulfil liabilities; or

e) satisfying equity claims, in whole or in part, by distributing the economic resource to holders of equity claims.

103. Although an economic resource derives its value from its existing potential to produce future economic benefits, the economic resource is the existing right, not the future economic benefits. For example, a purchased option derives its value from its potential to produce economic benefits if the holder exercises the option. However, the economic resource is the existing right to exercise the option, not the future economic benefits that the holder will receive if the option is exercised[168].

104. There is a close association between making expenditure and acquiring assets, but the two do not necessarily coincide. Hence, when an entity incurs expenditure, this may provide evidence that the entity has sought future economic benefits, but is not conclusive proof that an asset has been obtained. Similarly, the absence of related expenditure does not preclude an item from meeting the definition of an asset. Assets can include, for example, rights that have been granted to the entity free of charge by a government or donated to the entity by another party[169].

105. Applying prudence in the recognition of assets means that expenditures incurred internally or with third parties by the entity do not represent assets unless there is sufficient evidence that a future economic benefit has been obtained and is controlled by the entity. For example, marketing, training, research and formation expenses[170] do not usually meet these conditions. Development costs should be recognised as assets if, and only if, the entity can demonstrate all of the following[171] :

a) The technical feasibility of completing the intangible asset so that it will be available for use or sale;

b) Its intention to complete the intangible asset and use or sell it;

c) Its ability to use or sell the intangible asset;

d) Its ability to generate probable future economic benefits from the intangible assets directly or in combination with other readily available resources;

e) The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset, and

[168] CF 4.15
[169] CF 4.16
[170] IAS 38.54: "No intangible asset arising from research (or from the research phase of an internal project) shall be recognized. Expenditure on research shall be recognised as an expense when it is incurred".
[171] IAS 38.57

f) Its ability to measure reliably the expenditure attributable to the intangible asset during its development.

106. Even if they are expected to produce economic benefits in the future, internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets.

### 5.3 Control of the resource

107. Control links an economic resource to an entity. Assessing control helps to identify what economic resource the entity should account for.[172]An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain any economic benefits that flow from it[173].

108. An entity has the present ability to direct the use of an economic resource if it has the right to deploy that economic resource in its activities, or to allow another party to deploy the economic resource in that other party's activities[174].

109. Although control of an economic resource usually arises from legal rights, it can also arise if an entity has the present ability to prevent all other parties from directing the use of the economic resource and obtaining any benefits that flow from it[175].

110. For an entity to control an economic resource, the economic benefits from that resource must flow to the entity (either directly or indirectly) rather than to another party. This aspect of control does not imply that the entity can ensure that the resource will produce economic benefits in all circumstances. Instead, it means that if the resource produces economic benefits, the entity is the party that will obtain them[176].

111. Having exposure to significant variations in the amount of the economic benefits produced by an economic resource may indicate that the entity controls the resource. However, it is only one factor to consider in the overall assessment of control[177].

### 5.4 Consideration of control when the entity is an agent

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[172] CF 4.17
[173] CF 4.18
[174] CF 4.19
[175] CF 4.20
[176] CF 4.21
[177] CF 4.22

112. An agent is a party that is engaged to act on behalf of, and for the benefit of, another party (principal). For example, a principal may engage an agent to arrange sales of the principal's goods or services. An entity acting as an agent may hold an economic resource that is controlled by the principal. That economic resource is not an asset of the agent. Furthermore, any obligation to transfer that economic resource to a third party is not a liability of the agent, because the economic resource to be transferred is controlled by the principal, not by the agent[178].

## Section 6 – Definition, Recognition of liabilities

113. All liabilities arising in the course of the financial year concerned or in the course of a previous financial year shall be recognised, even if such liabilities become apparent only between the balance sheet date and the date on which the balance sheet is drawn up[179].

### 6.1 Definition of a liability and conditions for recognition

114. For an entity to have a liability, it must have an obligation to transfer an economic resource as a result of past events. If one party has an obligation to transfer an economic resource (a liability), it follows that another party (or parties) has a right to receive that economic resource (an asset). The party (or parties) could be a specific person or entity, a group of people or entities, or society at large[180].

115. Many obligations are legally enforceable as a consequence of a contract, legislation or similar means. Obligations can also arise, however, from an entity's customary practices, published policies or specific statements that require the transfer of an economic resource. If the entity has no practical ability to act in a manner inconsistent with those practices, policies or statements, the entity has an obligation. The obligation that arises in such situations is often described as a constructive obligation[181].

116. An entity has a present obligation as a result of a past event only if it has already received the economic benefits, or conducted the activities, that establish the extent of its obligation. The economic benefits received could include, for example, goods or services. The action taken could include, for example, conducting particular activities, operating in a particular market or simply being in existence. If the economic benefits are received, or the actions are taken, over time, the resulting present obligation may accumulate over time[182].

117. [183]The enactment of a law (or the introduction of some other enforcement mechanism, policy or practice, or the making of a statement) is not in itself sufficient to give an entity a present obligation. The entity must have conducted an activity to which a present law (or other present enforcement mechanism, policy, practice or statement) applies.

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[178] CF 4.23
[179] Article 6.1 c
[180] CF 4.24 et CF 4.25
[181] CF 4.34
[182] CF 4.36
[183] Tentative Board decision November 2016



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118. A present obligation can exist even if the transfer of economic resources will not occur until some point in the future. For example, a financial liability may not require a payment to be made until a future date, but there is a present obligation[184].

119. An entity does not have a present obligation for the costs that the entity will incur only if it receives benefits, or only if it takes an action, in the future (for example, the costs of future operations), unless the entity has no practical ability to avoid taking that action. If the entity has entered into a contract that is still executory, the entity may have a present right and obligation to exchange economic resources in the future[185].

120. An entity has no practical ability to avoid a transfer if, for example, the transfer is legally enforceable, or any action necessary to avoid the transfer would cause significant business disruption or would have economic consequences significantly more adverse than the transfer itself. It is not sufficient that the management of the entity intends to make the transfer or that the transfer is probable[186].

121. If an entity prepares financial statements on a going concern basis, the entity[187]:

    a) has no practical ability to avoid a transfer that could be avoided only by liquidating the entity or ceasing trading; but

    b) has the practical ability to avoid (and hence does not have a liability for) a transfer that would be required only on the liquidation of the entity or on the cessation of trading.

### 6.2 Provisions and uncertain liabilities

122. Provisions shall cover liabilities the nature of which is clearly defined and which at the balance sheet date are either likely to be incurred or certain to be incurred, but uncertain as to their amount or as to the date on which they will arise. At the balance sheet date, a provision shall represent the best estimate of the expenses likely to be incurred or, in the case of a liability, of the amount required to meet that liability. Provisions shall not be used to adjust the values of assets[188]. The amount required to meet the liability is sometimes described as a fulfilment value.

123. Liabilities or expenses should be recorded at the balance sheet date if they are either likely to be incurred (likely means more likely than not) or certain to be incurred. In the latter case, the only elements of uncertainty are the amount of the expense and the date on which the outflow of resources will occur.

124. When a liability is less than likely to be incurred, it should not be reported in the statement of financial position. However, when considering a group of similar liabilities, a portfolio approach can be used as a unit of account for the measurement of that group of items and to record it on a statistical basis. When the liability is not recognised, disclosure is usually provided in order to fully inform stakeholders about potential risks.

[184] CF 4.38
[185] CF 4.39
[186] CF 4.32
[187] CF 4.33
[188] Article 12.12

125. In some cases, it is uncertain whether an entity has an obligation. For example, if another party alleges that an entity has committed an act of wrongdoing and should compensate that other party for that act, it might be uncertain whether the act occurred, whether the entity committed it or how the law applies. Until that existence uncertainty is resolved—for example, by a court ruling—it is uncertain whether the entity has an obligation to the other party and, consequently, it is uncertain whether a liability exists[189]. Where the likelihood of the liability existing is higher than that of the liability not existing, prudence requires to account for the best estimate of the amount of that liability.

## Section 7 - Low probability of a flow of economic benefits

126. In some cases, the existence uncertainty, possibly combined with a low probability of inflows or outflows of economic benefits and an exceptionally wide range of possible outcomes, may mean that the recognition of a single amount would not provide relevant information. Whether or not the asset or liability is recognised, information about the uncertainties associated with it may need to be provided[190].

127. An asset or a liability can exist even if there is a low probability that there will be an inflow or outflow of economic benefits[191].

128. Even if the probability of an inflow or outflow of economic benefits is low, recognition of the asset or the liability may provide relevant information if the measurement of the asset or the liability reflects the low probability and is accompanied by explanatory disclosures[192].

## Section 8 - Executory Contracts

129. An executory contract is a contract (or a portion of a contract) that is equally unperformed: neither party has fulfilled any of its obligations nor both parties have fulfilled their obligations partially and to an equal extent[193].

130. An executory contract establishes a combined right and obligation to exchange economic resources. That right and obligation are interdependent and cannot be separated. Hence, the combined right and obligation constitute a single asset or liability. The entity has an asset if the terms of the exchange are currently favourable; it has a liability if the terms of the exchange are currently unfavourable. Whether the asset or the liability is included in the financial statements depends on both the recognition criteria and the measurement basis selected for the asset or liability including, if applicable, any test for whether the contract is onerous[194].

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[189] CF 5.16
[190] CF 4.35
[191] CF 5.17
[192] CF 5.18
[193] CF 4.40
[194] CF 4.41

131. If either party fulfils its obligations under a portion of the contract, that portion of the contract is no longer executory. If the reporting entity performs first under the contract, that performance is the event that changes the reporting entity's right and obligation to exchange economic resources into a right to receive an economic resource (ie an asset, such as for instance the right to receive cash). If the other party performs first, that performance is the event that changes the reporting entity's right and obligation to exchange economic resources into an obligation to transfer an economic resource (ie a liability)[195].

### Section 9 - Definition of income and expenses

132. Income arises out of revenue transactions (for instance, the delivery of goods and services, the right to interests or dividends on financial assets), out of, other events that increase the entity's resources (for instance, a grant), and out of value adjustments such as positive re-measurement of assets or negative re-measurement of liabilities, when such re-measurement is deemed to be a profit..

133. Expenses arise out of those outflows of resources that do not result in the acquisition or creation of an asset that can be recognised. Expenses are also caused by negative value adjustments to assets and liabilities, when such adjustment is deemed to be a loss and by the amortisation of the assets that reflect the economic consumption of those assets.

134. For many transactions, income results directly in an increase in cash balances and expenses result directly in a decrease in cash balances. In such cases, income and expenses are directly measured at the cash amount of the transaction.

135. However, when transactions are more complex, and when there is not an immediate cash settlement, it is necessary to identify the rights and obligations of the parties to the contracts and how they have changed in the period in order to determine whether an income or an expense has arisen. As a result:

    a) Income is increases in assets, or decreases in liabilities, that result in increases in profit, and therefore in equity other than those relating to contributions from holders of equity claims[196].

    b) Expenses are decreases in assets, or increases in liabilities, that result in decreases in profit, and therefore in equity other than those relating to distributions to holders of equity claims[197].

136. It follows from the definitions of income and expenses that contributions from holders of equity claims are not income and distributions to holders of equity claims are not expenses[198]. Hence, they should not be reported in the profit and loss statement or as other

[195] CF 4.42
[196] CF 4.48
[197] CF 4.49
[198] CF 4.50

comprehensive income or future profit and loss items[199], but explained in a statement of changes in equity or in notes to the financial statements.

137. Income and expenses are the elements that relate to an entity's financial performance. Users of financial statements need information about both an entity's financial position and its financial performance. Hence, although income and expenses are defined in terms of changes in assets and liabilities, information about income and expenses and about how they combine to contribute to performance is just as important as the information provided by assets and liabilities[200].

138. Different transactions and other events generate income and expenses with different characteristics. Therefore, providing information (either through a separate line item, or through explanations in the notes) about different income and expenses can help users of financial statements to understand the entity's financial performance.

## Section 10 - Definition and Measurement of Equity

139. Equity is the residual interest in the assets of the entity after deducting all its liabilities[201]. Equity claims are claims on the residual interest in the assets of the entity after deducting all its liabilities, i.e. they are claims against the entity that do not meet the definition of a liability. Such claims may be established by contract, legislation or similar means, and generally include (to the extent that they do not meet the definition of a liability)[202]:

a) shares of various types, issued by the entity; and

b) an obligation of the entity to issue another equity claim.

140. Another way to define equity is a positive definition whereby equity is the sum of the entity's paid-in capital and premiums, reserves and accumulated retained earnings, net of the amounts distributed or payable to holders of equity claims. Amounts payable to holders of equity claims should be deducted from equity and reported as a liability at the point in time when the appropriate authorisation for the distribution has been approved by the appropriate level of governance body, which depends on the applicable law.

141. Reserves include, amongst others, reserves as specified by law or by articles of incorporation, reevaluation reserves and accumulated other comprehensive income or accumulated future profit and loss items[203].

142. Different classes of equity claims may confer on their holders different rights, for example, rights to receive some or all of the following from the entity[204]:

a) dividends;

b) the proceeds of satisfying the equity claims, either in full on liquidation, or in part at other times; or

[199] See discussion in chapter 6, section 5
[200] CF 4.52
[201] CF 4.43
[202] CF 4.44
[203] See discussion in chapter 6, section 5
[204] CF 4.45

c) other equity claims.

143. The total carrying amount of equity in the statement of financial position (total equity) is measured indirectly; it equals the total of the carrying amounts of all recognised assets less the total of the carrying amounts of all recognised liabilities[205].

144. Because general purpose financial statements are not designed to show an entity's value, the total carrying amount of equity (the book value) will not generally equal[206]:

a) the aggregate market value of shares in the entity;

b) the amount that could be raised by selling the entity as a whole on a going concern basis; or

c) the amount that could be raised by selling all its assets after settling all its liabilities.

145. Although the total equity is not measured directly, some individual classes or categories of equity may be measured directly. The total amount attributed to individual classes or categories of equity may be positive or, in some circumstances, negative. Similarly, although total equity is generally positive, it can also be negative, depending on which assets and liabilities are recognised and on how they are measured[207].

146. In most cases, not all economic resources of an entity are recognised as assets, and only certain assets and liabilities are measured using current values. It results in the carrying amount of total equity being different from its current value. When individual classes of equity are measured at current value and the total equity is not, the measurement of the residual classes of equity does not reflect either the current value, or the cost based measurement, of those claims.

147. Therefore, the information about the current value of one or several classes of equity is usually only disclosed in the notes and not reflected in the statement of financial position.

## Section 11 - Conditions for de-recognition of assets and liabilities

148. Derecognition is the removal of all or part of a recognised asset or liability from an entity's statement of financial position. Derecognition normally occurs when that item no longer meets the definition of an asset or of a liability[208]:

a) for an asset, derecognition normally occurs when the entity loses control of all or part of the recognised asset; and

b) for a liability, derecognition normally occurs when the entity no longer has a present obligation for all or part of the recognised liability.

149. Accounting requirements for derecognition aim to faithfully represent both[209]:

[205] CF 6.78
[206] CF 6.79
[207] CF 6.80
[208] CF 5.25
[209] CF 5.26

a) any assets and liabilities retained after the transaction or other event that led to the derecognition (including any asset or liability acquired, incurred or created as part of the transaction or other event); and

b) the change in the entity's assets and liabilities as a result of that transaction or other event.

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## Chapter 6 - Presentation of the financial statements and disclosure

### Section 1 - General Principles regarding useful presentation and disclosure

1. Presentation and disclosure is the process by which a reporting entity communicates information in its financial statements[210]. Additional information and explanatory comments on the financial information are included in the management report, and should be consistent with the financial statements.

2. Efficient and effective communication of information in financial statements improves its relevance and contributes to a faithful representation of an entity's assets, liabilities, equity, income and expenses. It also enhances the understandability and comparability of information in financial statements[211].

3. Efficient and effective communication of information in financial statements requires[212]:

   a) classifying information in a manner that groups similar items and separates dissimilar items;

   b) aggregating information in such a way that it is not obscured either by unnecessary detail or by excessive aggregation; and

   c) applying presentation and disclosure objectives and principles instead of focusing on rules in a mechanistic manner.

4. Classification is the sorting of assets, liabilities, equity, income or expenses on the basis of shared characteristics for presentation and disclosure purposes. Such characteristics include, but are not limited to, the nature of the item, its role (function) within the business activities conducted by the entity and how it is measured.

5. Classifying dissimilar assets, liabilities, equity, income or expenses together obscures relevant information, reduces understandability and generally does not result in useful information.

6. Classification is applied to the unit of account selected for assets, liabilities and equity. However, for income and expenses, it may sometimes be appropriate to split the total income or expenses arising from a change in the carrying amount of an asset or a liability into components and to classify those components separately.

7. Aggregation is the adding together of assets, liabilities, equity, income or expenses that have shared characteristics and are included in the same classification[213].

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[210] CF 7.10
[211] CF 7.12
[212] CF 7.11
[213] CF 7.14

8. Aggregation makes information more useful by summarising a large volume of detail. However, aggregation conceals some of that detail. Hence, a balance needs to be found so that relevant information is not obscured either by a large amount of insignificant detail or by excessive aggregation[214].

9. This balancing act is of particular importance in the preparation of consolidated financial statements and related disclosures, as the aggregation of the financial situation and performance of diverse entities that constitute a group is likely to obscure the fact that resources, claims, income and expenses belong to different legal entities that can be subject to different economic and legal environments, and whose equity claims can be held in different proportions by non-controlling interests. Hence, appropriate disclosures, or disaggregation on the face of the consolidated financial statements, should compensate for the loss of information caused by consolidation.

### Section 2 - Requirements regarding the layouts of the financial statements

10. The annual financial statements shall be drawn up clearly and in accordance with applicable accounting principles and standards[215].

11. The information presented in the balance sheet and in the profit and loss account should be supplemented by disclosures by way of notes to the financial statements[216].

12. A limited number of layouts for the balance sheet is necessary to allow users of financial statements to better compare the financial position of undertakings within the Union[217]. Legislations derived from this framework should therefore specify the required format(s) of the layouts to be used. The layouts may differ for different categories or classes of undertakings. They may also distinguish between current and non-current items.

13. A limited number of layouts for the profit and loss statement is also necessary to allow users of financial statements to better compare the financial performance of undertakings within the Union. Legislations derived from this framework should therefore specify the required format(s) of the profit and loss layouts to be used. A profit and loss account layout showing the nature of expenses and a profit and loss account layout showing the function of expenses should be permitted.

14. By way of derogation[218], legislations may permit or require all undertakings, or any classes of undertaking, to present a statement of other comprehensive income or future profit and loss items (see discussion in section 5 below) in addition to the presentation of the profit and loss items, provided that the information given is at least equivalent.

[214] CF 7.15
[215] Article 4.2
[216] Recital 23
[217] Recital 20
[218] Article 4.1, Directive

## Section 3 - Disclosures in the notes and in the management reports

15. Disclosure in respect of accounting policies is one of the key elements of the notes to the financial statements. Such disclosure should include, in particular, the measurement bases applied to various items, a statement on the conformity of those accounting policies with the going concern concept and any significant changes to the accounting policies adopted[219].

16. Users of financial statements prepared by medium-sized and large undertakings typically have more sophisticated needs. Therefore, further disclosures should be provided in certain areas. Exemption from certain disclosure obligations is justified where such disclosure would be prejudicial to certain persons or to the undertaking[220].

17. The nature and extent of the disclosures published by the entities should be commensurate to their size and to the complexity of their business activities.[221]

18. The role[222] of the primary financial statements is to provide a structured and comparable summary of an entity's recognised assets, liabilities, equity, income and expenses, which is useful for:

    a) obtaining an overview of the entity's assets, liabilities, equity, income and expenses;

    b) making comparisons between entities and reporting periods; and

    c) identifying items or areas within the financial statements about which users of the financial statements will seek additional information in the notes.

19. The role[223] of the notes is to:

    a) provide further information necessary to disaggregate, reconcile and explain the items recognised in the primary financial statements; and

    b) supplement the primary financial statements with other information that is necessary to meet the objective of financial statements.

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[219] Recital 24
[220] Recital 25
[221] Recital 10
[222] Discussion paper Principles of Disclosures – paragraph 3.22
[223] See Discussion paper Principles of Disclosures – paragraph 3.28

20. The management report and the consolidated management report are important elements of financial reporting. A fair review of the development of the business and of its position should be provided, in a manner consistent with the size and complexity of the business. The information should not be restricted to the financial aspects of the undertaking's business, and there should be an analysis of environmental and social aspects of the business necessary for an understanding of the undertaking's development, performance or position. In cases where the consolidated management report and the parent undertaking management report are presented in a single report, it may be appropriate to give greater emphasis to those matters which are significant to the undertakings included in the consolidation taken as a whole.[224]

## Section 4 - Criteria for a useful profit and loss statement:

### 4.1 Classification of income and expenses

21. Classification is applied to[225]:

a) income and expenses resulting from or related to the unit of account selected for an asset or a liability; or

b) components of such income and expenses if those components have different characteristics and are separately identified. For example, a change in a current value measure of an asset can comprise the financial effects of changes in prices, changes in estimates of cash flows and accrual of interest. It is appropriate to classify those components separately when doing so would enhance the usefulness of the resulting financial information.

22. In order to communicate information about an entity's financial performance efficiently and effectively, all existing and future income and expense items are classified so that they are included in[226]:

a) the statement of profit or loss; or

b) the statement of other comprehensive income or future profit and loss items, when authorised.

### 4.2 The use of subtotals to describe the financial performance:

23. The purpose of the statement of profit or loss is to[227]:

a) depict the return that an entity has made on its economic resources during the period; and

b) provide information that is helpful in assessing prospects for future cash flows and in assessing management's stewardship of the entity's resources.

[224] Recital 26
[225] CF 7.11
[226] CF 7.19
[227] CF 7.20

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24. Hence, income and expenses included in the statement of profit or loss are the primary source of information about an entity's financial performance for the period[228].

25. The total for profit or loss provides a highly summarised depiction of the entity's financial performance for the period. Many users incorporate that total in their analysis of the entity's financial performance for the period and in their analysis of management's stewardship of the entity's resources, using it either as a starting point for further analysis or as the main indicator of the entity's financial performance for the period[229]. The layout(s) may prescribes sub-totals based on generally accepted concepts such as, inter alia, pre-tax profit or loss, operational profit or loss, earnings before interests and taxes (EBIT), earnings before interests, taxes, depreciation and amortisation (EBITDA), added value... Due to variety in implementation of these concepts, in the interest of relevance, consistency and comparability, such subtotals should be precisely defined by legislations derived from this framework. Derived legislations may also prescribe to disclose such subtotals in the notes.

## Section 5 - Presenting other comprehensive income (OCI) or future profit and loss items (FPLI) outside profit and loss

26. *CAVEAT: Unlike in the other parts of this draft Framework and as a consequence of an on-going debate in the Union on this specific topic, the authors have chosen to describe in a neutral manner the two different views which prevail and which they think should be debated further to determine which is the best option for the Union. This section discusses the presentation of the items that increase or decrease the net assets of an entity and the conditions for a classification outside of the profit and loss statement*.

27. To achieve clarity in the preparation of financial statements, it is first important to distinguish between three categories of changes in an entity's net assets. The changes result from:

    a) its business activities during the period,

    b) those caused by re-measurements of assets and liabilities and which do not result from the conduct of its business activities during the period (i.e. the revaluation of fixed assets, the effect of using dual measurement bases, or the effect of changes in discount rates or currency exchange rates that are expected to reverse in subsequent periods), and

    c) the transactions that took place with the holders of its equity claims.

28. As the adoption of an entity perspective (see Chapter 3, Section 2) results in presenting the assets, liabilities, income and expenses of the entity separately from those of its equity claims holders, it flows logically that transactions between the entity and the holders of its equity claims should be reported directly as movements in its equity and clearly identified as such. A symmetric accounting treatment is not required, as a distribution of dividends reported by an entity as an equity reduction can be reported as financial income by the holder of equity claims who receives it, except when the distribution represents a repayment of the capital.

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[228] CF 7.21
[229] CF 7.22

29. In this context, there is a debate about the status of the category of changes in an entity's net assets described above: should such re-measurements be presented as an additional element of financial performance "on top" of the reported profit and loss, or as a particular source of changes in equity? Under these two opposite conceptual views, it is generally agreed that, due to the « dual » nature of those changes, a separate presentation is required anyway; however, the terminology to be used needs to be carefully considered to reflect their specific nature and, on this point also, views differ among European constituents: "other comprehensive income", "future profit and loss items", "dual measurement items", "changes in fair value reserves"? At this stage, the authors have provisionally chosen to use a neutral terminology which has been used for some time by entities that report under IFRSs: Statement of other comprehensive income (OCI) or future profit and loss items (FPLI).

### 5.1 Conditions for an initial classification of elements outside profit and loss

30. It is generally accepted that profit (or loss) is often used as a measure of performance or as a basis for other financial measures, such as return on investment or earnings per share. Most users find it useful to assess the future revenues, expenses and cash flows using the historical financial statements as a starting point, and to find in a separate place the elements that have little or no predictive value. Different types of income and gains, or expenses and losses, should be presented separately as they reflect different phenomena and can have a different likelihood of recurrence, hence a different predictive value, or a different nature in terms of assessing management's stewardship.

31. Different approaches are possible to define which re-measurement changes should be initially included in profit and loss and which ones should be presented elsewhere. Indeed, some re-measurements are considered by certain national standards as directly related to business activities in accordance with the business model of the entity, and therefore considered as part of the profit and loss statement, while other re-measurements are required by those standards to be presented outside profit and loss in a specific statement due to their « dual » nature.

32. For those items which should be presented outside profit and loss, approaches to their description depend on the way the performance of an entity is defined. As explained below, two views of performance coexist and influence the presentation in the financial statements of the elements that are to be classified outside profit and loss.

33. One extensive view of performance is that all changes in the measurement of assets and liabilities, whatever the measurement method used, should be considered as components of the financial performance in the period and reflected in profit and loss, and that appropriate subtotals and disclosures are sufficient to allow users to analyse and understand the financial statements. Under this view, OCI is a sub-total in a statement of financial performance, following profit and loss.

34. Another completely opposite view is that only those elements that result directly from an entity's ordinary business activities should be included in profit and loss, and that most of the changes in the carrying amount of an asset or liability after the initial recognition are not representative of the entity's performance until such time they can be recognised in profit and loss. Under this view, performance is depicted by the profit and loss stricto sensu, and everything else is reported as changes in equity.

35. Most users of financial information consider that a more balanced approach than the two presented above is preferable. However, it is difficult to propose a universal definition of financial performance, as different entities conduct different economic activities (i.e. production of goods or supply of services, financial activities, trading of commodities, etc.) or they may have different business models for a given type of economic activity. Also, different classes of users (i.e. investors in capital or lenders) may have a different understanding of the financial performance for a specific entity. For instance, for a financial entity, under a business model that involves a long term holding of its assets together with a stability in its sources of long term financing, the long term trends in the value changes have more economic importance for its providers of financial resources than the short term variations in market prices and interest rates. By contrast, short term variations in interest rates are more important for an entity's business model where most of the originated assets are securitised and activities are financed through short term borrowings.

36. Because the statement of profit or loss is the primary source of information about an entity's financial performance for the period, in principle, all revenue and expenses are included in that statement, as well as gains and losses. However, as explained above, applicable legislations or standards define circumstances under which gains or losses arising from a change in the current value of an asset or a liability should be included in other comprehensive income, when doing so results in the statement of profit or loss and the balance sheet providing relevant information under two different measurements bases (historical cost for profit and loss, current value for the balance sheet).

37. Income and expenses that arise on a historical cost measurement basis are normally included in the statement of profit or loss as historical cost is the basic measurement basis. That is also the case when a dual measurement basis is applied, i.e. such income and expenses are separately identified as a component of the change in the current value of an asset or liability.

38. An initial classification outside profit and loss provides useful information in situations where it makes the presentation of profit and loss more relevant in the context of an entity's business activities. Examples of such situations are:

    a) differences caused by the use of a dual measurement basis for assets or liabilities,

    b) temporary changes in the current value caused by variations in discount rates or foreign exchange translation differences,

    c) changes in fair value for financial assets that are not held with a view to selling them in the short term, where such changes can be expected to reverse in subsequent periods,

    d) revaluations of assets that are not indicative of the result of business activities,

    e) correction of a recognition mismatch, such as when a hedging instrument is accounted for at current value and the corresponding hedged position cannot be recognised in the financial statements,

    f) elimination of a counter-intuitive effect in relation to changes in own credit risk, when certain liabilities are measured at market value.

39. Considering that the measurements at current value (fair value, revaluation or present value) can create material variations in net assets and volatility, which should be understood by users when they assess the financial condition of an undertaking, it is desirable that a further conceptual discussion takes place with the objective of providing a clear guidance for the presentation of those elements that increase or decrease the net assets of an entity and that are not considered as elements of the profit and loss statement, and to further harmonise the reporting of financial performance.

40. Presenting certain elements outside the profit and loss statement does not necessarily mean that an undertaking's management should not be held accountable for the causes of those elements, and it is not contrary to the objective of assessing management's stewardship. Certain economic factors that create changes in current values are capable of being hedged at an acceptable cost by the use of different techniques, while others are not. The management's decisions to protect, or not, the entity against the effect of those factors depend on the business model and on the strategy agreed between the entity and its stakeholders.

### 5.2 Identification and presentation of the items that should be reported outside profit and loss

41. Two views coexist about the nature of the other components of financial performance and the way they should be presented in the financial statements.

**View A** (the comprehensive performance view)

42. Under view A, an entity's overall financial performance in an accounting period is depicted by the sum of:

a) its net profit (or loss), that depicts the results of the entity's business activities, and

b) the net result of other changes, or components of change, in the carrying amount of certain assets and liabilities which are more appropriately reported outside of profit and loss because they have a lower predictive value and can distort the analysis of performance in the current year. Such elements can include temporary changes in carrying amounts that are expected to reverse or increase in subsequent accounting periods before they ultimately result in the realisation of profit and loss. They also include changes in the carrying amount of assets and liabilities that are not expected to be realised in the future (for instance, because the liability is normally not repurchased or transferred to a third party, or because the unit of account selected for measuring a group of items is such that the aggregate liability will not extinguish in a foreseeable future).

43. Those elements that are not classified as direct movements in equity[230] and that are characterised as components of "other comprehensive income", are presented outside of the profit and loss statement, either in a separate "statement of other comprehensive income" or in a separate section of a single "statement of comprehensive income" that can be presented in lieu of the two separate statements.

[230] IAS 1

44. View A is considered to be consistent with the entity perspective explained above, and considers that a statement of other comprehensive income (or a specific section of a single performance statement) that includes such items is an integral part of the comprehensive financial performance of the entity; consequently, it is the total amount of comprehensive income (the result in the performance statement) that creates an increase or decrease in equity in the reporting period.

45. However, due to the special status of the elements presented outside the profit or loss, and in order to facilitate the tracking of information needed for a subsequent reclassification when it is required, the net amount of other comprehensive income for the period is allocated to a specific reserve in the balance sheet.

46. The co-existence of items of different natures in the category (b) in paragraph 44 above creates complexity and is not well understood by some users. It also raises difficult questions as to whether, and under what conditions, the items initially classified outside of profit and loss should be subsequently reclassified into it. The conditions for the subsequent reclassification into profit and loss are discussed further below.

47. A terminology consistent with view A could be the following: “statement of profit and loss”, “other comprehensive income”, “statement of comprehensive income”, or “statement of performance[231]”.

**View B** (the business activities view or dual measurement reserve view)

48. Under view B, changes that result from certain re-measurements are considered by applicable legislations or standards as more appropriately presented outside the profit and loss statement because they are of a different nature than the profits and losses that result from an entity’s business activities. View B considers, like in view A, that they have informative value but little predictive value to help users estimate the future performance of an entity. View B also considers that they should not be considered to be part of an entity’s financial performance for the reporting period because of their very nature. In essence, they are akin to a form of revaluation of an entity’s assets and liabilities, the objective of which is to re-measure, at least in part, its equity. Hence, they should be recorded directly as a movement in equity and shown separately in a specific fair value reserve.

49. Indeed, most of these items result from the difference between a measurement based on historical or amortised cost (as reflected in the profit and loss) and a fair value or a current value measurement (reflected in the balance sheet). For instance, the dual measurement basis of financial assets (see Chapter 5, Section 4) reflects an element of potential equity that should be recognised as such in the balance sheet, but at the same time it considers that the entity’s business activities are reflected in a more relevant manner in the statement of profit and loss when using a measurement based on historical cost.

[231] Article 13.2 of the Directive includes an option: “By way of derogation from Article 4(1), Member States may permit or require all undertakings, or any classes of undertaking, to present a statement of their performance instead of the presentation of profit and loss items”

Other re-measurements relate to liabilities that will be subsequently fulfilled or repaid and for which the time value of money component of their measurement tends to become nil as the maturity date approaches. Finally, other re-measurements will result in subsequent profits or losses only if a subsequent and hypothetical transaction takes place, which is not contemplated at the time the financial statements are prepared (i.e. the possible future loss of control of an investment in a consolidated subsidiary whose financial statements are prepared in a foreign currency).

50. Hence, whereas a majority of the items that are classified in other comprehensive income / FPLI can be described as representing profits or losses that will be realised in the future, there are exceptions.

51. View B fully acknowledges that not all re-measurements should be accounted for directly in the fair value reserves, as some of them faithfully reflect, in accordance with applicable legislations or standards, the effect of the business activities. In particular[232] , where a financial instrument is measured at fair value, a change in value shall be included in the profit and loss account, except in the following cases, where such a change shall be included directly in a fair value reserve:

    a) the instrument accounted for is a hedging instrument under a system of hedge accounting that allows some or all of the change in value not to be shown in the profit and loss account; or

    b) the change in value relates to an exchange difference arising on a monetary item that forms part of an undertaking's net investment in a foreign entity.

    A change in the value of an available for sale financial asset, other than a derivative financial instrument, may also be included directly in a fair value reserve.

52. View B puts less emphasis than view A on limiting the type of transactions that can be recorded directly as movements in equity.

53. A terminology consistent with view B could be the following: "statement of changes in fair value reserve", "statement of dual measurement items", "statement of future profit and loss items /FPLI".

### 5.3 Reclassification from the fair value reserve or from accumulated other comprehensive income[233] to profit and loss

54. In principle, income and expenses included in future profit and loss items in one period are reclassified (recycled) into the statement of profit or loss in a future period. Such reclassification is expected to result in the statement of profit or loss providing more relevant information and a more faithful representation of the entity's business activities in that subsequent period.

[232] Article 8.8
[233] AOCI is the terminology used by IFRSs

55. In general, the reclassification (recycling) in a subsequent period should occur at the time, and for an amount, deemed appropriate to reflect in a relevant manner the profits or the losses realised and to facilitate an understanding of the entity's business activities in that period. It takes into account particularly the ultimate realisation of the related asset (for instance, the exchange of that asset for cash or equivalent resources) or de-recognition of the related liability.

56. In other words, in most cases, the de-recognition of an asset or liability (through its sale, fulfilment or otherwise) should result in a reclassification to profit and loss of all the potential gain (or loss) that has been recognised up to that point outside profit and loss.

57. In certain circumstances, a reclassification made before the date on which the de-recognition event occurs can provide relevant information about the business activities, but only when there is no uncertainty about the occurrence of that event and on the amount of profit or loss that will result from it.

58. However, under rare circumstances, for example if there is no clear basis for identifying the period in which the reclassification would have the expected information result or the amount that should be reclassified, standards or legislations may prescribe that it is not appropriate that gains and losses included in other comprehensive income / FPLI be subsequently reclassified. Most of the time, such circumstances occur when it is considered more practical to not reclassify, even if it is not satisfactory from a conceptual standpoint.

59. The nature of the event that caused the reclassification from the fair value reserve or accumulated other comprehensive income / FPLI, and an explanation of how amounts reclassified in the period have been determined, should be disclosed in the notes.

60. The authors believe that it would be useful to further discuss the two above approaches, in the context of an effort to better define performance and in order to provide guidance on the use of other comprehensive income / FPLI or a statement of performance.

61. Nevertheless, in both cases, detailed information should be provided, either on the face of the financial statements or in the notes, about those elements reported outside profit and loss, the carrying amounts of assets and liabilities not measured at amortised cost and the evolution of their carrying amounts from period to period.

## Section 6 - Financial performance reflected by past cash flows and presenting a Statement of cash flows

62. Information about a reporting entity's cash flows during a period also helps users to assess the entity's ability to generate future net cash inflows and to assess management's stewardship of the entity's economic resources. It indicates how the reporting entity obtains and spends cash, including information about its borrowing and repayment of debt, cash dividends or other cash distributions to investors, and other factors that may affect the entity's liquidity or solvency. Information about cash flows helps users understand a reporting entity's operations, evaluate its financing and investing activities, assess its liquidity or solvency and interpret other information about financial performance[234].

[234] CF 1.20

63. Therefore, a statement of cash flows (also sometimes described as a statement of sources and application of funds) which is a useful summary of the entity's activities should be presented as an element of the financial statements except when it is not considered relevant for a depiction of the business activities.

## Section 7 - General principles regarding the provision of disclosures in the notes to the financial statements

64. To facilitate efficient and effective communication of information in financial statements, a balance is needed in developing disclosure requirements in Standards between[235]:

    a) giving entities the flexibility to provide relevant information that faithfully represents the entity's assets, liabilities, equity, income and expenses; and

    b) requiring information that is comparable, both among entities and across reporting periods for a single entity.

65. Efficient and effective communication of information in financial statements is also supported by considering the following principles[236]:

    a) entity-specific information is more useful than standardised descriptions (sometimes known as 'boilerplate'); and

    b) duplication of information in different parts of the financial statements is usually unnecessary and usually makes financial statements less understandable.

66. From a general standpoint, disclosures should be organised in a coherent manner in order to enhance understandability and relevance. Any disclosure should therefore be placed in its context and made understandable in itself, for instance by regrouping in the same note the accounting policy followed, explanation about critical estimates and changes thereto, variations in the period, etc. The principles of consistency and materiality should also be followed when preparing disclosures.

## Section 8 - The impact of digital reporting on the communication of financial information

67. Electronic publication systems allow undertakings to file accounting data, including statutory financial statements, only once and in a form that allows multiple users to access and use the data easily[237].

[235] CF 7.17
[236] CF 7.18
[237] Recital 39



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68. Digital reporting allows users of financial and other information to carry out software supported analysis and comparison of large amounts of information and helps create a robust capital market in the EU. It also facilitates the creation of a central European repository system for regulatory filings, thereby making it easier and faster for investors to access information on a pan-European basis.[238]

69. Accounting standard should be develop in a way allowing to digitalise financial information. This implies a harmonised electronic format based upon appropriate layouts. Such systems should, however, not be burdensome to small and medium-sized undertakings and they leave sufficient room for undertakings to reasonably adapt and complement financial information to their business model(s).

70. The use of a machine-readable structured electronic format necessitates that a taxonomy is made available for" the tagging" of the financial statements, including the notes, and for other financial information. Such taxonomy should be adapted to the financial reporting framework that applies to the undertaking.

71. It is important that all the information that is communicated by the means of electronic channels has the same qualities and integrity as the information on paper support. Undertakings should put in place appropriate control systems and safeguards to ensure the traceability, integrity and proper storage of such information.

72. When reference is made in the financial statements to financial information available in other documents, such reference should summarise the nature and content of such information, allow easy and systematic access to such information via appropriate link and clarify the status of such information, i.e. whether it has been validated through governance and audit processes required for financial information.

73. Conversely, the status of any financial information communicated outside the financial statements or the management report should be made clear to the users. If governance and audit processes required for financial information have not been followed, such limitation should be specified.

[238] The Directive 2013/ 50/UE on Transparency, as amended in 2013, requires in its Article 4(b) the use of electronic filing of annual reports by listed entities as from 1st January, 2020. Regulatory proposals are being developed by the Commission and the European Supervisory Agencies[238], regarding the introduction of requirements for the electronic filing of the periodic financial statements by listed undertakings
Press Release 21st December 2016: "The European Securities and Markets Authority (ESMA) has today published a setting out the digital format which issuers in the European Union (EU) must use to report their company information from 1 January 2020. It concludes that Inline XBRL is the most suitable technology to meet the EU requirement for issuers to report their annual financial reports in a single electronic format because it enables both machine and human readability in one document".
https://www.esma.europa.eu/press-news/esma-news/esma-proposes-new-digital-format-issuers%E2%80%99-financial-reporting

## Chapter 7 – Guidelines for high quality non-financial information

1. Undertakings publish within their annual report and outside of it a wealth of other financial information, dealing with matters such as their commercial performance (market share, order backlog, etc.), their R&D efforts and their technological developments. They also increasingly publish non-financial information about their Environmental, Social and Governance strategies and activities, which are very important to provide a more holistic, coherent and comprehensive description of their general strategy and business activities and to increase investor, consumer and other stakeholders' trust, thereby supporting the long term sustainability of the undertaking.

2. To a large extent, the financial situation and performance, represented in the financial statements, must be assessed in the context of such additional financial and non-financial information published by the entity and by other sources.

3. In order to enhance the consistency[239] and comparability of non-financial information disclosed throughout the Union, certain large undertakings should prepare a non-financial statement containing information relating to at least environmental matters, social and employee-related matters, respect for human rights, anti-corruption and bribery matters. Such statement should include a description of the policies, outcomes and risks related to those matters and should be included in the management report of the undertaking concerned.

4. Large undertakings which are public-interest entities exceeding on their balance sheet dates a defined criterion of the average number of employees during the financial year shall include in the management report a non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including:

   a) a brief description of the undertaking's business model;

   b) a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented;

   c) the outcome of those policies;

   d) the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks;

   e) non-financial key performance indicators relevant to the particular business.

[239] Recital 6 of Directive 2014/95/EU: directive 2014/95/EU of the European parliament and of the council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups

5. Where possible, the non-financial statement referred to above shall also, where appropriate, include references to, and additional explanations of, amounts reported in the annual financial statements.

6. The same information should be provided on a consolidated basis for the groups the size of which exceeds a defined threshold[240].

7. Typically, but with varying emphasis that depends on the nature of the industry in which the undertaking is active and the severity of corresponding risks, non-financial information relates to the risks and opportunities that arise or can be foreseen in relation to the following matters, inter alia:

   a) Impact of, and entity's footprint on, climate change, carbon emissions, water and air pollution

   b) Responsible supply chains

   c) Eco-management and Natural Capital Protocol; Environmental footprint

   d) KPIs for Environmental, Social, Governance (ESG) matters[241]

   e) Business and Human rights

   f) Principles concerning multinational enterprises and social policies

   g) Gender diversity in management and governance structures

   h) Anti-corruption and anti-bribery policies.

8. Due to the growing sensitivity of investors to ESG and sustainability issues, the strategy and achievements of undertakings in those areas have a growing impact on their ability to access financial resources and on their valuation.

9. Connectivity and consistency between the financial statements, management reports, alternative performance measures and non-financial information described in the preceding paragraphs is important to convey a coherent, true and fair explanation of the undertaking's overall economic and social performance. The description of the entity's business model(s) is one of the links between financial performance and non-financial information.

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[240] Public-interest entities which are parent undertakings of a large group exceeding on its balance sheet dates, on a consolidated basis, the criterion of the average number of 500 employees during the financial year shall include in the consolidated management report a consolidated non-financial statement containing information to the extent necessary for an understanding of the group's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters…/….

[241] it should be noted that the European Federation of Financial Analysts Societies has published a Guideline for the integration of ESG into Financial Analysis and Corporate Valuation (www.effas-esg.com/wp-content/uploads/2009/04)

10. The key principles[242] that should apply to the disclosure of non-financial information are similar to those that apply to financial information i.e.:

    a) Materiality, understandability, comprehensiveness and conciseness,

    b) Consistency over time and coherence with other published information,

    c) Fair and balanced information,

    d) Strategic and forward-looking, with linkage to past and present achievements,

    e) Stakeholder oriented.

    Whenever an undertaking relies on an international, EU-based or national framework as a guideline in the disclosure of non-financial information, it should specify the framework it uses.

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[242] The European Commission has published on 26th June 2017 "Guidelines on non-financial reporting" (2017/C/215/01)