



NZ ACCOUNTING
STANDARDS
BOARD

New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* (2018 NZ Conceptual Framework)

Issued May 2018

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This New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* (2018 NZ Conceptual Framework) has been issued as a result of a new international conceptual framework.

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2018 NZ CONCEPTUAL FRAMEWORK

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Introduction

- 1.1 The objective of general purpose financial reporting forms the foundation of the 2018 *NZ Conceptual Framework*. Other aspects of the 2018 *NZ Conceptual Framework*—the qualitative characteristics of, and the cost constraint on, useful financial information, a reporting entity concept, elements of financial statements, recognition and derecognition, measurement, presentation and disclosure—flow logically from the objective.

Objective, usefulness and limitations of general purpose financial reporting

- 1.2 The objective of general purpose financial reporting¹ is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.² Those decisions involve decisions about:
- (a) buying, selling or holding equity and debt instruments;
 - (b) providing or settling loans and other forms of credit; or
 - (c) exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.
- 1.3 The decisions described in paragraph 1.2 depend on the returns that existing and potential investors, lenders and other creditors expect, for example, dividends, principal and interest payments or market price increases. 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. Existing and potential investors, lenders and other creditors need information to help them make those assessments.
- 1.4 To make the assessments described in paragraph 1.3, existing and potential investors, lenders and other creditors need information about:
- (a) the economic resources of the entity, claims against the entity and changes in those resources and claims (see paragraphs 1.12–1.21); and
 - (b) how efficiently and effectively the entity's management and governing board³ have discharged their responsibilities to use the entity's economic resources (see paragraphs 1.22–1.23).
- 1.5 Many existing and potential investors, lenders and other creditors 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.⁴
- 1.6 However, general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors 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.
- 1.7 General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity.
- 1.8 Individual primary users have different, and possibly conflicting, information needs and desires. The Board, in developing Standards, will seek to provide the information set that will meet the needs of the maximum number of primary users. However, focusing on common information needs does not prevent the reporting entity from including additional information that is most useful to a particular subset of primary users.
- 1.9 The management of a reporting entity is also interested in financial information about the entity. However, management need not rely on general purpose financial reports because it is able to obtain the financial information it needs internally.

¹ Throughout the 2018 *NZ Conceptual Framework*, the terms 'financial reports' and 'financial reporting' refer to general purpose financial reports and general purpose financial reporting unless specifically indicated otherwise.

² Throughout the 2018 *NZ Conceptual Framework*, the term 'entity' refers to the reporting entity unless specifically indicated otherwise.

³ Throughout the 2018 *NZ Conceptual Framework*, the term 'management' refers to management and the governing board of an entity unless specifically indicated otherwise.

⁴ Throughout the 2018 *NZ Conceptual Framework*, the terms 'primary users' and 'users' refer to those existing and potential investors, lenders and other creditors who must rely on general purpose financial reports for much of the financial information they need.

Introduction

- 2.1 The qualitative characteristics of useful financial information discussed in this chapter identify the types of information that are likely to be most useful to the existing and potential investors, lenders and other creditors for making decisions about the reporting entity on the basis of information in its financial report (financial information).
- 2.2 Financial reports provide information about the reporting entity's economic resources, claims against the reporting entity and the effects of transactions and other events and conditions that change those resources and claims. (This information is referred to in the 2018 *NZ Conceptual Framework* as information about the economic phenomena.) Some financial reports also include explanatory material about management's expectations and strategies for the reporting entity, and other types of forward-looking information.
- 2.3 The qualitative characteristics of useful financial information⁵ apply to financial information provided in financial statements, as well as to financial information provided in other ways. 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.

Qualitative characteristics of useful financial information

- 2.4 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.

Fundamental qualitative characteristics

- 2.5 The fundamental qualitative characteristics are relevance and faithful representation.

Relevance

- 2.6 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.
- 2.7 Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.
- 2.8 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.
- 2.9 Financial information has confirmatory value if it provides feedback about (confirms or changes) previous evaluations.
- 2.10 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.

Materiality

- 2.11 Information is material if omitting it or misstating it could influence decisions that the primary users of general purpose financial reports (see paragraph 1.5) make on the basis of those reports, which provide financial information about a specific reporting entity. In other words, 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

⁵ Throughout the 2018 *NZ Conceptual Framework*, the terms 'qualitative characteristics' and 'cost constraint' refer to the qualitative characteristics of, and the cost constraint on, useful financial information.

context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

Faithful representation

- 2.12 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. In many circumstances, the substance of an economic phenomenon and its legal form are the same. If they are not the same, providing information only about the legal form would not faithfully represent the economic phenomenon (see paragraphs 4.59–4.62).
- 2.13 To be a perfectly faithful representation, a depiction would have three characteristics. It would be complete, neutral and free from error. Of course, perfection is seldom, if ever, achievable. The Board's objective is to maximise those qualities to the extent possible.
- 2.14 A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations. For example, 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.
- 2.15 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.
- 2.16 Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. The exercise of prudence means that assets and income are not overstated and liabilities and expenses are not understated.⁶ 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.
- 2.17 The exercise of prudence does not imply a need for asymmetry, for example, a systematic need for more persuasive evidence to support the recognition of assets or income than the recognition of liabilities or expenses. Such asymmetry is not a qualitative characteristic of useful financial information. Nevertheless, particular Standards 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.
- 2.18 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.
- 2.19 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 necessarily prevent such an estimate from providing useful information (see paragraph 2.22).

Applying the fundamental qualitative characteristics

- 2.20 Information must both be relevant and provide a faithful representation of what it purports to represent if it is to be useful. Neither a faithful representation of an irrelevant phenomenon nor an unfaithful representation of a relevant phenomenon helps users make good decisions.
- 2.21 The most efficient and effective process for applying the fundamental qualitative characteristics would usually be as follows (subject to the effects of enhancing characteristics and the cost constraint, which are not

⁶ Assets, liabilities, income and expenses are defined in Table 4.1. They are the elements of financial statements.

considered in this example). First, identify an economic phenomenon, information about which is capable of being useful to users of the reporting entity's financial information. Second, identify the type of information about that phenomenon that would be most relevant. Third, determine whether that information is available and whether it can provide a faithful representation of the economic phenomenon. If so, the process of satisfying the fundamental qualitative characteristics ends at that point. If not, the process is repeated with the next most relevant type of information.

- 2.22 In some cases, a trade-off between the fundamental qualitative characteristics may need to be made in order to meet the objective of financial reporting, which is to provide useful information about economic phenomena. For example, the most relevant information about a phenomenon may be a highly uncertain estimate. In some cases, the level of measurement uncertainty involved in making that estimate may be so high that it may be questionable whether the estimate would provide a sufficiently faithful representation of that phenomenon. In some such cases, the most useful information may be the highly uncertain estimate, accompanied by a description of the estimate and an explanation of the uncertainties that affect it. In other such cases, if that information would not provide a sufficiently faithful representation of that phenomenon, the most useful information may include an estimate of another type that is slightly less relevant but is subject to lower measurement uncertainty. In limited circumstances, there may be no estimate that provides useful information. In those limited circumstances, it may be necessary to provide information that does not rely on an estimate.

Enhancing qualitative characteristics

- 2.23 Comparability, verifiability, timeliness and understandability are qualitative characteristics that enhance the usefulness of information that both is relevant and provides a faithful representation of what it purports to represent. The enhancing qualitative characteristics may also help determine which of two ways should be used to depict a phenomenon if both are considered to provide equally relevant information and an equally faithful representation of that phenomenon.

Comparability

- 2.24 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.
- 2.25 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. A comparison requires at least two items.
- 2.26 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.
- 2.27 Comparability is not uniformity. For information to be comparable, like things must look alike and different things must look different. Comparability of financial information is not enhanced by making unlike things look alike any more than it is enhanced by making like things look different.
- 2.28 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.
- 2.29 Although a single economic phenomenon can be faithfully represented in multiple ways, permitting alternative accounting methods for the same economic phenomenon diminishes comparability.

Verifiability

- 2.30 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. 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.
- 2.31 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

Financial statements

- 3.1 Chapters 1 and 2 discuss information provided in general purpose financial reports and Chapters 3–8 discuss information provided in general purpose financial statements, which are a particular form of general purpose financial reports. Financial statements⁷ provide information about economic resources of the reporting entity, claims against the entity, and changes in those resources and claims, that meet the definitions of the elements of financial statements (see Table 4.1).

Objective and scope of financial statements

- 3.2 The objective of financial statements is to provide financial information about the reporting entity's assets, liabilities, equity, income and expenses⁸ that is useful to users of financial statements in assessing the prospects for future net cash inflows to the reporting entity and in assessing management's stewardship of the entity's economic resources (see paragraph 1.3).
- 3.3 That information is provided:
- (a) in the statement of financial position, by recognising assets, liabilities and equity;
 - (b) in the statement(s) of financial performance,⁹ by recognising income and expenses; and
 - (c) in other statements and notes, by presenting and disclosing information about:
 - (i) recognised assets, liabilities, equity, income and expenses (see paragraph 5.1), including information about their nature and about the risks arising from those recognised assets and liabilities;
 - (ii) assets and liabilities that have not been recognised (see paragraph 5.6), including information about their nature and about the risks arising from them;
 - (iii) cash flows;
 - (iv) contributions from holders of equity claims and distributions to them; and
 - (v) the methods, assumptions and judgements used in estimating the amounts presented or disclosed, and changes in those methods, assumptions and judgements.

Reporting period

- 3.4 Financial statements are prepared for a specified period of time (reporting period) and provide information about:
- (a) assets and liabilities—including unrecognised assets and liabilities—and equity that existed at the end of the reporting period, or during the reporting period; and
 - (b) income and expenses for the reporting period.
- 3.5 To help users of financial statements to identify and assess changes and trends, financial statements also provide comparative information for at least one preceding reporting period.
- 3.6 Information about possible future transactions and other possible future events (forward-looking information) is included in financial statements if it:
- (a) relates to the entity's assets or liabilities—including unrecognised assets or liabilities—or equity that existed at the end of the reporting period, or during the reporting period, or to income or expenses for the reporting period; and
 - (b) is useful to users of financial statements.

For example, if an asset or liability is measured by estimating future cash flows, information about those estimated future cash flows may help users of financial statements to understand the reported measures. Financial statements do not typically provide other types of forward-looking information, for example, explanatory material about management's expectations and strategies for the reporting entity.

⁷ Throughout the 2018 NZ Conceptual Framework, the term 'financial statements' refers to general purpose financial statements.

⁸ Assets, liabilities, equity, income and expenses are defined in Table 4.1. They are the elements of financial statements.

⁹ The 2018 NZ Conceptual Framework does not specify whether the statement(s) of financial performance comprise(s) a single statement or two statements.