

CONCEPTUAL FRAMEWORK TO NATIONAL ACCOUNTING STANDARDS FOR COMMERCIAL ORGANISATIONS

GENERAL PROVISIONS

Purpose of the Conceptual Framework

1. The Conceptual Framework is based on Framework for Preparation and Presentation of Financial Statements developed and published by the IASB
2. This framework does not stipulate any specific accounting or reporting requirements as these are provided in individual National Accounting Standards for Commercial Organizations (NASCO). However, NASCOs must be prepared taking into account the principles and provisions contained in this Conceptual Framework.
3. The purpose of this Conceptual Framework is to set out the fundamental principles to be used in the preparation of financial statements in compliance with National Accounting Standards for Commercial Organisations (NASCOs) and establish a coherent framework of fundamental accounting principles to be used as guidance by:
 - a. the preparers of the NASCOs in its preparation and further changes;
 - b. the preparers of financial statements in its preparation in conformity with the NASCOs
 - c. the users of financial statements prepared in conformity with NASCOs for its further analyzing

Purpose of Conceptual Framework

4. The Conceptual Framework aims to establish transparency and accountability in financial reporting.
5. Transparency implies an environment where information on enterprise's current conditions, decisions and activity are made accessible and understandable to the users of financial statements.
6. Accountability implies a justification of activity and decisions made by preparers and users of the financial statements and responsibility for such decisions.

Scope

7. The scope of this framework covers the basic principles to be applied in the preparation and using of the Income Statement, the Cash Flow Statement and the Changes in Equity Statement and notes, comments and other statements derived from these four primary statements.
8. In the case of conflict between the requirements of individual NASCOs and this Conceptual Framework, the requirements of the individual NASCO will prevail.

The Objective of Financial Statements

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

Users of Financial Statements

10. The users of financial statements include management of the enterprise, investors, lenders and creditors, employees, business analysts and advisors, the business contact group including trade creditors and customers, the government and the public. These groups and their informational needs can be described as:
 - a. Equity Investor Group. This group comprises existing and potential owners plus, if it is applicable, holders of convertible securities, options and share warrants. This group requires information to allow them to decide whether to buy, sell or hold the investment.
 - b. Lenders and Creditors. This group comprises existing and potential holders of debentures and loan stock plus providers of short term secured and unsecured loans. Lenders require sufficient information that enables them to determine whether their loans and the interest attaching to them, will be paid when due.
 - c. Employee Group. This group comprises existing, potential and past employees. This group is interested in information about the stability of the enterprise and its ability to provide remuneration, retirement benefits and employment opportunities.
 - ç. Analyst/Adviser Group including financial analysts and researchers. This group requires an evaluation of the potential ability of an enterprise to generate future profit and cash flow.
 - d. Business Contact Group, this includes customers, trade creditors, suppliers and similar business parties.
 - e. The Government, including tax authorities, local government and all regulatory bodies concerned with supervising business. This group requires appropriate information to regulate the enterprise.
 - ə. The Public, including broad group of society interested and involved in activity of the reporting enterprise. Financial Statements may assist the public by providing information about the trends and recent developments in prosperity of the reporting enterprise or the range of its activities. .

Assumptions Underlying National Accounting Standards for Commercial Organisations

The Accrual Basis

11. Income and expenses should be recognised as a result of transactions carried out or other events when they occur rather than when cash or its equivalents is received or paid.

Going Concern

12. The concept of going concern implies that an enterprise will continue in operation and that it has neither the intention nor the need to liquidate or curtail materially the scale of its operations.
13. Financial Statements are usually prepared on the basis of the historical cost measurement of assets and liabilities. The principle of Going Concern is a prerequisite for the application of historical cost measurement.
14. When an enterprise is assumed to be liquidated, then it would be better to measure assets at their realisable value (i.e., at their sale price less cost of sales) rather than at the cost of their acquisition. In other words, when an enterprise is expected to terminate its operation in the near future, the realisable value of its assets would provide with more reliable information on the cash that could be expected to be generated by an enterprise to pay its liabilities.
15. The depreciation policy of an enterprise becomes reasonable and relevant only if it is assumed that the operation of an enterprise will continue in stable manner. When liquidation is imminent, the classification of assets as current and non-current would become meaningless as they would all become short-term assets to be liquidated.

16. As regard to liabilities the traditional classification of liabilities as current and non-current becomes inappropriate as users may find it useful to see a classification in terms of creditor payment priority.

Qualitative Characteristics of Financial Statements

- 17 The following qualitative characteristics are the attributes that make the information provided in financial statements useful to users.

Relevance

Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events. The relevance of information is affected by its nature and materiality. In some cases, nature of information is sufficient to determine its relevance. In other cases, both the nature of and the materiality should be taken into account.

Materiality

Information is material if its omission or misstatement could influence the decisions of users taken on the basis of the financial statements. Materiality depends on the size or nature of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality is estimated with quantitative characteristics of materiality of information rather than qualitative.

Reliability

Information is reliable when it is free from material error and bias. That is, users may rely on such information to represent faithfully that which it should represent, or could reasonably be expected to represent. To be reliable, information should have following qualities: faithful representation, neutrality, prudence and completeness.

Faithful representation

Faithful representation of information implies that financial statements should portray the financial position and financial performance of an enterprise objectively to such extent as it is possible, based on the substance over form concept and being free from bias, distortion, manipulation or concealment of material facts. Generally it means that financial statements should faithfully represent the transactions and other events resulting in assets, liabilities, equity, expenses and revenues of the enterprise at the reporting date or the reporting period, which meet the recognition criteria of this Conceptual Framework or individual NASCOs.

Substance over Form

To reflect faithfully the transactions and other events in the financial statements, it is necessary that they are presented in accordance with their economic reality over their legal form.

Neutrality

To be reliable, the information contained in financial statements must be neutral, that is, free from bias. Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgment in order to achieve a predetermined outcome.

Prudence

Prudence is the exercise of caution when making estimates in conditions of uncertainty to ensure that assets or income are not overstated and liabilities or expenses are not understated. Generally, this means that in cases of uncertainty, the lower of possible estimates of asset values and income and the higher estimates of liabilities and expenses should be selected. However, the exercise of prudence does not justify the creation

of hidden reserves or excessive provisions, the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses.

Completeness

To be reliable, the information in financial statements must be complete within the bounds of materiality and cost.

Comparability

The information is considered to be comparable in the case, when the users are provided with the possibilities to identify and evaluate the similarities and differences in the financial statements.

Comparability provides the users with the possibility to compare financial statements of an enterprise and financial statements of different enterprises over time in order to identify trends in its financial position and performance.

Consistency

Consistency is one of the major characteristics of information that is comparable. Comparability normally requires that the information presented in the financial statements be recognized, measured and presented in a consistent manner from period to period.

Consistency means that an enterprise uses over time the same method of accounting for similar events. However, the application of the consistency principle should not prevent the changes in accounting policies that improve the relevance, reliability or understandability of financial statements.

An important implication of comparability and consistency is that users should be informed of the accounting policies employed in the preparation of financial statements. If any changes are made to the policies, these must be clearly disclosed together with the effects of such changes.

Understandability

It is necessary that the essence of the information provided in the financial statements is understandable by users. Users of financial statements are assumed to have a reasonable knowledge of business activities and accounting and a willingness to study the information with reasonable diligence. Relevant information should not be excluded from the financial statements on the grounds that it is believed to be too complex for the users to understand.

Constraints on Relevant and Reliable Information

Balance between Timeliness and Reliability

- 18 Information is considered to be relevant only if it is presented in time. If there is undue delay in the reporting of information it may lose its relevance. However, to provide information on a timely basis it may be often necessary to report before all aspects of a transaction or other event are fully known. This may have an adverse effect on the reliability of the information. And on the contrary, if reporting is delayed until all aspects are known, the information may be highly reliable but be of little use to users who have had to make their decisions far earlier. The management of the enterprise should try to achieve a balance between the relative merits of timely reporting of information and its reliability. Generally, this means that financial statements must be submitted within the stipulated deadline of the relevant NASCOs.

Balance between Benefit and Cost

19. The benefits derived from information should exceed the cost of providing it. Therefore, there is no need to provide non-material information in financial statements.

Balance between Qualitative Characteristics

20. In practice a balance, or trade-off, between qualitative characteristics is often necessary. Generally the aim is to achieve an appropriate balance among the characteristics in order to meet the objectives of financial statements. The relative importance of the characteristics in different cases is a matter of professional judgment.

The Elements of Financial Statements

The Balance Sheet Elements

21. **Assets** are resources controlled by the enterprise which arise as a result of past events and from which future economic benefits are expected to flow into the enterprise.
22. **Liabilities** are present obligations of the enterprise arising from past events the settlement of which is expected to result in an outflow of economic resources from the enterprise.
23. **Equity** is the portion of assets of the enterprise remaining after deducting all liabilities.
24. The future economic benefit embodied in an asset may flow to the enterprise as result of utilization or disposal of an asset in the following forms:
 - a the potential increasing of cash and cash equivalents to be expected to inflow to the enterprise;
 - b the potential decreasing of cash and cash equivalents to be expected to outflow from the enterprise.
25. The future economic benefit embodied in an asset can inflow to the enterprise as result of sale/disposal of an asset, its conversion into cash and cash equivalents or sale of goods produced through its using (for example, collection of receivables on interests earned). Future economic benefits derived from utilization of an asset can be embodied by decreasing of outflow of cash and cash equivalents. For example, receiving of savings derived in the form of decrease of penalties for environment pollution as result of waste disposal plant purchasing.

The Income Statement Elements

26. **Income** is defined as an increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.
27. **Expenses** are defined as a decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or increases of liabilities that result in decreases in equity, other than those relating to equity distributions between equity participants.

Capital maintenance adjustments

28. The revaluation and restatement of assets and liabilities gives rise to increases or decreases in equity. These increases or decreases can meet the definition of income or expenses under

certain cases, so they can be included in the income statement. In other cases, under certain concepts of capital maintenance, such increases or decreases should be recognized as capital maintenance adjustments and be disclosed in the Balance Sheet and in the Statement of Changes in Equity but not in the Income Statement.

Recognition of the Elements of Financial Statements

29. **Recognition of object in Financial Statements** means that items, which meet the recognition criteria should be incorporated in the Balance Sheet or Income Statement.
30. Items recognized in the Balance Sheet or Income Statement should satisfy the following recognition criteria:
 - a. Meet the definition of one of elements of the financial statements;
 - b. It is probable that any future economic benefit associated with the item will flow to or from the enterprise; and
 - c. The item's cost or value can be measured, estimated or calculated with reliability.
31. The failure to recognize such items that should be recognized in the Balance Sheet or Income Statement is not rectified by disclosure of the accounting policies used nor by notes and explanatory material.
32. If the item cannot be measured with reliability, it should be recognized on neither the Balance Sheet nor Income Statement. However, the item may warrant disclosure in the notes to the financial statements if it considered to be relevant to the evaluation of the financial position of the enterprise.

Recognition of Assets

33. An asset is only recognized when it is probable that the future economic benefits will flow to the enterprise and that the value of the asset can be reliably measured.

Recognition of Liabilities

34. A liability is recognized in the Balance Sheet when it is probable that an outflow of economic resources embodying future economic benefits will result from the settlement of a present obligation arising from a past event and the amount at which the settlement will take place can be measured reliably.
35. Future obligations are not recognized as liabilities if the event which is expected to give rise to an obligation is not a past event. For example, the obligation of the enterprise to buy assets in a future are generally not recognized as the present liability in the reporting period.

Recognition of income

36. Income is recognized when an increase in the future economic benefits related to an increase in an asset or a decrease of a liability has arisen and can be measured reliably.

Recognition of expenses

37. Expenses are recognized when a decrease in future economic benefits related to a decrease in an asset or increase of a liability has arisen that can be measured reliably.
38. Specific expenses frequently relate directly to specific revenues. In such circumstances both are to be recognized simultaneously under the matching concept.
39. Where expenses cannot be directly matched to income they should be apportioned on a systematic and consistent basis. The allocation procedure should recognize the expense in the periods in which the economic benefits are expected to occur.

40. An expense is recognized immediately in the Income Statement when expenditure produces no future economic benefits or when future economic benefits do not satisfy recognition criteria or cease to satisfy these criteria in the Balance Sheet as an asset.
41. An expense is also recognized in the Income Statement when a liability is incurred without the simultaneous recognition of an asset.

Measurement of the Elements of Financial Statements

42. Measurement is the determination of the monetary value at which an item will be disclosed on either the Balance Sheet or the Income Statement.
43. The following bases might be used for measurement:

a. Historical Cost

The historical cost measurement means that assets are recorded at the amount of cash or cash equivalents paid or the fair value of any other consideration, such as non-monetary assets transferred or obligations assumed, issued share capital, given to acquire them at the time of their acquisition.

The measurement of liabilities on the basis of its historical cost implies a measurement of such liabilities at the amount of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business or at the amount of cash or cash equivalents received in exchange of obligations or at fair value of any other means received.

b. Current Cost

The current cost measurement means that assets are carried at the amount of cash or cash equivalents that would have to be paid if the equivalent assets were to be acquired currently.

Measurement of liabilities at current amount implies its measurement at nominal amount (undiscounted) of cash and cash equivalents that would be paid to settle the obligation.

c. Realizable value

Realizable value measurement means that assets are carried at the amount of cash or cash equivalents that could be obtained by selling those assets in normal course of business.

Measurement of liabilities at realizable value implies measurement of cash or cash equivalents expected to be paid at its nominal amount (undiscounted) to discharge the liability in the normal course of business.

Ç Present Value (discounted value)

Present value measurement means that an asset is carried at the present discounted value of the future net cash inflows the asset is expected to generate in the normal course of business over the asset's expected economic life.

Measurement of liabilities at present value implies measurement of the future net cash outflows at the present discounted value expected to be emerged from settlement the obligation in the normal course of business.

d. Fair Value

Fair value means the measurement at the amount that an asset could be exchanged for or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Measurement of liabilities at fair value implies the measurement at amount required to settle liabilities between knowledgeable, willing parties in an arm's length transaction.

44. A number of different measurement bases may be used in the financial statements of an enterprise and, depending on the item, will be determined by the requirements of individual NASCOs.
45. NASCOs allow the use of a Mixed Measurement Basis (Modified Historical Cost). In these cases, different measurement bases can be applied to individual items in the same accounting period.

Concepts of Capital Maintenance

46. The capital of an enterprise may be considered as following:

Financial capital of enterprise, that is the amount of invested money (referred to as the concept of nominal financial capital) or the invested purchasing power (referred to as the concept of real financial capital), which is equal to net assets (or equity) of the enterprise;

Physical productive capacity of an enterprise or the resources or funds needed to achieve that capacity (concept of physical capital maintenance).

47. According to these definitions two main concepts of capital maintenance can be stated:
 - a. Financial Capital Maintenance (or the value of investment in the enterprise); and
 - b. Physical Capital Maintenance (or the operating capability of the enterprise).
48. Under the concept of financial capital maintenance, if capital is defined in terms of nominal monetary units, the increase in nominal money capital over the period is recognized as a profit. Thus, increases in the price of assets held over the period, conventionally referred to as holding gains are, conceptually, profits. However, in practice they must not be recognized until the assets are disposed of in an exchange transaction.
49. If the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period is recognized as a profit. Thus, only that part of the increase in the price of assets that exceeds the increase attributed to the general level of price inflation is regarded as profit. The rest of the increase is treated as a capital maintenance adjustment and, hence, as part of equity.
50. Under the concept of physical capital maintenance, capital is defined in terms of the physical productive capacity of an enterprise, and profit represents the increase in that capital over the period is recognized as a profit. Otherwise, all price changes affecting the assets and liabilities of the enterprise are viewed as changes in the measurement of the physical productive capacity of the enterprise and are treated as capital maintenance adjustments that are part of equity and not profit.
51. The selection of the measurement bases and the concept of capital maintenance to be applied will determine the accounting model used in the preparation of the financial statements and provide with relevance and reliability of financial statements. The management of the enterprise must seek a balance between relevance and reliability.
52. The accounting model to be applied by the preparers of financial statements is determined within the provisions contained in the individual NASCOs.