Gaps in the Conceptual Framework

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Motivation

What makes a good Framework?

- Guides the development of Standards (and practice) that leads to information about assets, liabilities, equity, income and expenses that helps users of that information assess the prospects for future net cash inflows to the entity and assess management’s stewardship of the entity’s resources.
- It is not designed to value the entity, but to provide information to help investors value the entity

Weaknesses in the current (and proposed Framework)

- Insufficiently constrained – could have full fair value or full cost based accounting
- Does not deal with simple cases (inventory or property, plant and equipment)

Central Claim

The major gap in the Framework is the incomplete specification of the purpose of accrual accounting

- The balance sheet arises from accruals, adjusting cash flows to capture periodicity

There are several different types of accruals (departures from cash accounting)

- Recognising transactions before the cash exchange
- Allocating transactions to different accounting periods
- Measuring an item at a current value

Current value accruals focus on the balance sheet – the income statement captures the consequence

Transaction-based accruals focus on the income statement with the balance sheet capturing the consequence

Income Statement focused

IAS 2 Inventories

IAS 20 Accounting for Government Grants and Disclosure of Government Assistance

IAS 23 Borrowing Costs

IAS 27 Separate Financial Statements

IAS 28 Investments in Associates and Joint Ventures

IAS 37 Provisions, Contingent Liabilities and Contingent Assets

IAS 38 Intangible Assets

IFRS 15 Revenue from Contracts with Customers

IFRS 16 Leases

Balance sheet focused

IAS 40 Investment Property

IAS 41 Agriculture

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

Mixed	
IFRS 9 Financial Instruments	Income for amortised cost model and balance sheet focused for FVTPL and FVOCI model.
IAS 16 Property, Plant and Equipment	Has a revaluation option.
IAS 19 Employee Benefits	
IFRS 2 Share based Payments	
Other	
IAS 36 Impairment of Assets	Uses a current value, but its purpose is to test the assumption that the carrying amount of an asset measured from an income statement focused requirement will be recovered. If there is an impairment it effectively "re-sets" the cost.
IAS 12 Income Taxes	Uses a balance-sheet approach, but it captures differences between accounting and tax requirements. Hence, many of these differences are simply differences between the tax accruals and the accounting accruals.
IFRS 3 **IFRS 9**	Several Standards require assets or liabilities to be measured initially at fair value. However, in many cases this because a transaction price for the specific asset or liability is not available or observable and the fair value is a proxy for the entry price. That fair value is then deemed to be the cost. IFRS 3 Business Combinations and IAS 16's requirements for assets acquired in a non-monetary exchange.

What is Missing?

Value is created through different business models, which underpin different valuation models, with variation in

- The purpose of the transaction
- The context within which the transaction is undertaken
- IFRS 9 provides a good example

Consider the following …

- Lower of cost and market value for inventory does not follow from the Framework; cost recoverability is a better explanation
- Depreciated historical cost of PPE is likewise unrecovered cost
- Entity-specific cost recovery differs from market-perspective fair value (eg IAS 23) – a unit of account question

Definition of Elements → **Purpose of Accruals** → Recognition and Measurement

Consequences (a different way of thinking)

- Changes in assets / liabilities or income and expenses are consequences of the attributes or actions of an entity.
- Therefore, initial measurement should be neutral – ie the same starting point
- Accruals help you think about which costs should be aggregated (unit of account) rather than relying solely on measurement
- It is a more neutral way to assess which accruals provide better information for investors – an asset and liability measurement focus implies that current values are the default.
- It links more closely with the (unstated) purposes of the income statement and the balance sheet