Comments on Conceptual Framework (CF) Papers

Gaps in the IFRS CF Articulation Profit or Loss, and OCI in the CF
Tom Scott, November 2017

The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board (the Board) or IFRS Foundation.

Copyright © IFRS Foundation. All rights reserved
General contributions—both papers

- Informative reviews of significant literature on conceptual alternatives for financial reporting
- The “clean surplus” relationship is important
  - Essentially that over an entity’s life cash flows (other than from providers of capital) and comprehensive income (accruals) should be equal
- That guidance on the choice of measurement method, especially historical cost versus current value (not just fair value) can be improved
- That measurement rests, in part, on business plans, and hence a business model
  - ‘business activities’ are used in CF rather than ‘business model’
Contributions—gaps paper Barker and Texeira

- That asset and liability changes leading to income and expenses are sometimes not one directional, as explained in the CF
  - assets and liabilities recognition is sometimes related to recognition of income and expenses
    - “reconciled back to it”
- Some important concepts remain, or are significantly developed, at the standards level
- Guidance on measurement method choice is incomplete
- Guidance on unit of account is incomplete
- Advocate for more emphasis on transactions
Contributions—articulation paper

• Useful history of alternate ways to decompose profit
• Clean surplus relationship does not hold for profit or loss
• Distinguishing allocation of performance elements between profit or loss and other comprehensive income (OCI) is incomplete
• Paper provides some useful analysis of these issues
• Advocate for the use of deprival values
Board’s view (versus myth one)—statement of financial position emphasis

- Assets and liabilities are the basic conceptual building blocks of the Conceptual Framework:
  - Income and expenses are derived from changes in assets and liabilities
  - Because this approach is the best way to capture income and expenses and financial performance
  - Assets and liabilities as basic elements do not imply a statement of financial position emphasis
Board’s view (versus myth two)—current values are optimal for balance sheet

• Assets and liabilities are the basic conceptual elements of the conceptual framework
  – CF allows for a mixed measurement approach
  – Based on relevance and faithful representation
  – assets and liabilities as basic elements do not imply that the assets and liabilities are best captured by measuring using current values (not just fair values) .
IFRS clarifications

• The sum of profit or loss and OCI (also known as comprehensive income) satisfies clean surplus

• Forecasting future cash flows, abnormal earnings, or ROE should always involve more than simply extrapolating from current profit or loss, comprehensive income, abnormal earnings, or cash flows.
  – Financial performance should be assessed broadly and selecting inputs to valuation models can use all information provided in all statements
Conceptual Framework—the big (ger) changes for future standard-setting

- Recognition & derecognition
- Uncertain liabilities
- Role of prudence and stewardship
- Measurement
- Use of OCI
Guidance on selecting a measurement basis

<table>
<thead>
<tr>
<th>Relevance</th>
<th>Faithful representation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Characteristics of the asset or liability</td>
<td>Measurement inconsistency (‘accounting mismatch’)</td>
</tr>
<tr>
<td>Contribution to future cash flows</td>
<td>Measurement uncertainty</td>
</tr>
</tbody>
</table>

Information in both the statement of financial position and the statement(s) of financial performance

Enhancing qualitative characteristics and cost constraint
## Guidance on selecting a measurement basis

<table>
<thead>
<tr>
<th>Elaborate on Relevance</th>
<th>Historical cost</th>
<th>Current value</th>
</tr>
</thead>
</table>
| Asset characteristics: | Stable CF and stable value | • Highly variable CF  
• High sensitivity to value changes |
| • sensitivity of value to market factors?  
• CF highly variable? | | |
| How asset is used: | Produce CF in combination/ measure cost of asset consumption | Produce CF directly |
| • Produce CF in combination or directly? | | |
| Then consider *faithful representation* | | |
| • accounting mismatch?  
• measurement uncertainty? | | |
| Cost-benefit concerns?  
Enhancing characteristics acceptable? | | |
# Profit or loss and OCI in CF

## Profit or loss
- Primary source of information about performance
- Default location for income and expenses—Historical cost-based measurements here

## Other comprehensive income
- Exceptional circumstances
- Only some changes in current values of assets and liabilities

## Classification into profit or loss and OCI and recycling
- Relevance
- Faithful representation

Only the Board can make decisions on OCI and recycling
Contact us

Keep up to date

@IFRSFoundation
IFRS Foundation
www.ifrs.org
IFRS Foundation

Comment on our work

go.ifrs.org/comment