The Conceptual Framework as a Coherent System for the Development of Accounting Standards

The Financial Accounting Standards Board (FASB) visualized a conceptual accounting framework as a ‘coherent system of interrelated objectives and fundamentals that can lead to consistent standards that prescribes the nature, function, and limits of financial accounting and financial statements’ (FASB, 1976). To Australian standard setters, the primary purpose of the conceptual framework (CF) was only to be used as a ‘guide’ in developing and reviewing accounting standards (AASB, 1995, para. 5). The International Accounting Standards Committee (IASC) diminished the role of a conceptual framework even further by openly acknowledging that some standards are inconsistent with the guidelines offered by the framework (IASC, 1989 para. 12). Even though the Australian Accounting Standards Board (AASB) supposedly pursues a policy of harmonization of conceptual frameworks and accounting standards, there are also acknowledged inconsistencies in the conceptual frameworks of the IASC.

The aim of this article is to assess the coherence of the Australian (and IASC) conceptual framework. This analysis identifies confusion in drafting or construction of the conceptual framework, internal inconsistencies, and inconsistency with the legal framework within which business entities operate. Accordingly it is suggested that the adoption of a conceptual framework will not lead to consistent accounting standards, and inevitably the conceptual framework will lack credibility so long as it is inconsistent with legislation.

Key words: Accounting; Concepts; Standards.

ESSENTIAL CHARACTERISTICS

Assets
From SAC 4 (AASB, 1992) in terms of essential characteristics, assets are defined as (para. 14): (a) future economic benefits, and (b) controlled by the entity as a result of past transactions or other past events. Future economic benefits can be described as the capacity to provide benefits (future economic benefits) to the entities which control them (para. 18). An asset should be recognized in a statement of financial position when and only when (para. 38):
CT AND DEVELOPING STANDARDS

(a) it is probable that the future economic benefits embodied in the asset will eventuate; and
(b) the asset possesses a cost or other value that can be measured reliably.

In contrast, the IASC framework defines assets as (para. 49): (a) resources; (b) controlled by an entity as a result of past events; from which (c) future economic benefits are expected to flow to the entity.

**Assets as ‘Rights’ or Future Economic Benefits**  Are assets ‘rights’, from which an entity can expect to derive future economic benefits, or are assets the future economic benefits per se? Returning to SAC 4, if assets are defined as future economic benefits, the first criterion for the recognition of future economic benefits in a statement of financial position may be re-expressed as follows: ‘Future economic benefits should be recognized in a statement of financial position if it is probable that the future economic benefits embodied in the asset will eventuate.’

Since future economic benefits are also described as the scarce capacity to provide benefits (SAC 4, para. 18), an alternative expression of the criterion may be: ‘A scarce capacity to provide economic benefits should be recognized in a statement of financial position if it is probable that the scarce capacity to provide economic benefits embodied in the scarce capacity to provide economic benefits will eventuate.’

The circularity is obvious. It is not surprising, therefore, that such poor drafting in the conceptual framework (CF) is associated with internal inconsistencies in subsequently issued accounting standards and in practice.

A right is recognized as an asset if it is reported on, or incorporated in amounts reported on, the face of the financial statements of an entity (whether or not further disclosure of the item is made in notes thereto) (SAC 4, para. 10). Not all rights are recognized as assets.

Some rights, which are recognized as assets in a statement of financial position, are not controlled by an entity. Even though goodwill is defined as comprising the future benefits from unidentifiable intangibles, these unidentifiables are identified in Australian accounting standards as including market penetration, effective advertising, good labour relations and a superior operating team (AASB 1013, para. 5.1.1). Market penetration and a superior operating team are not rights, which could be described as being controlled by an entity. The ‘possession’ of these unidentifiable attributes by an entity or by an operating segment of an entity causes the value of the entity or its operating segment to be greater than the fair value of identifiable net attributes. An entity, however, cannot have the unidentifiable attributes of ineffective market penetration, ineffective advertising, poor labour relations or an inferior operating team. If the value of an entity or an operating segment is less than the fair value of identifiable net attributes, the cause is overvalued specific types of identifiable attributes (AASB 1013, para. 8.1).

It seems likely that the concept of an asset as future economic benefits has not led to the goodwill accounting standard. Rather, the preconception of the goodwill accounting standard has led to the concept of an asset as future economic benefits in the CF. The identified unidentifiables do not qualify either as a ‘right’ or as future
economic benefits, which can be controlled by an entity. It is thus perhaps preferable that accounting for goodwill should be accepted as one of accounting’s many anomalies, rather than attempting to mould the framework to accommodate it.

If goodwill is eliminated from any consideration, at any reporting date, the only benefits controlled by an entity are the current economic benefits at that date. The equivalent economic benefits of a right at the reporting date, plus the potential incremental economic benefits to be derived from the use or exploitation of the right, are the future economic benefits to be derived from the control of that right. The incremental economic benefits, which may be derived from the future exploitation of a right, are not derived through control of the right at the reporting date. The incremental benefits are derived through the future economic benefits sacrificed in any production, marketing and administration activities subsequent to the reporting date. At a reporting date, it is difficult to understand how an entity can control the potential incremental benefits at that date. It would seem rather that, at a reporting date, an entity is unable to control probable future economic benefits, but is able to control only the ‘rights’ to current economic benefits at that date.

Past Transactions or Events In terms of SAC 4, the future economic benefits controlled by an entity at a reporting date must have arisen ‘as a result of past transactions or other past events’—a similar definition to that contained in the FASB CON6 (1985). Since the reference is to ‘other past events’, a transaction must be another type of past event. Thus the future economic benefits must have arisen ‘as a result of past events or other past events’. The international framework adopts a ‘belt and braces’ approach in defining the control of assets arising ‘as a result of past events’ (para. 49) and as a result of ‘past transactions and other events’ (para. 58).

Transactions are often distinguished from events on the basis of their effect on financial statements. The effects of an event, which enables an entity to control a right, may or may not be recognized. If the effects are recognized, the event is called a transaction. Effects are recognized if those effects are ‘reported on, or incorporated in amounts reported on, the face of the financial statements of the entity (whether or not further disclosure of the item is made in the notes thereto)’ (SAC 4, para. 10). Thus transactions are only special classes of events.

If, at a reporting date, an entity has been affected by a past event, regardless of whether that event is a special event or some other event, control over any economic benefits, present or future, must exist in the conditions at the reporting date. Thus it would seem much simpler to accept as a characteristic that a right must be controlled by an entity in the conditions existing at the reporting date.

The Capacity to Control In relation to an individual right, an entity has the capacity to control that right if it has the capacity ‘to benefit from the right in the pursuit of the entity’s objectives and to deny or regulate the access of others to that benefit’ (SAC 4, para. 14). Although the concept of the capacity to control is adopted as an essential characteristic in the identification and recognition of most rights, it is not the essential characteristic determining the accounting for leases.
There is no fundamental difference between the different types of leases. In every lease, the lessee acquires the capacity to control leased asset services over the lease term, even though the lessor retains ownership of the asset over this period. If financial information is to be both relevant and reliable, reporting must be based on the substance of transactions rather than their legal form (SAC 4, para. 24). The lease agreement may or may not be structured in such a way that the lessee also bears the risks and rewards of ownership of the leased asset subsequent to the lease term.

Ownership, however, is not an essential characteristic of an asset, since an entity does not have to own an asset in order to control its benefits (SAC 4, para. 26). Accounting standards, however, distinguish between various types of leases on the basis of characteristics incident to ownership of the leased property (AASB 1008, para. 20). Since ownership is not an essential characteristic of an asset, the distinction between various types of leases based on an ownership would seem to be more in the nature of a ‘political patch’ than any fundamental concept. The aim of the distinction may be to reduce the complexity of reporting, in the statements of financial position and performance, through the elimination of the asset/liability effects of a comparatively large number of immaterial lease transactions. The aim may also be to introduce a specific set of rules to circumvent the necessity to apply judgment in determining the substance of a lease transaction or to allow accountants to develop innovative accounting practices.

In the case of investment rights, the concept of capacity to control as a guide in determining accounting standards is extended from the asset of the investor (the investment) to the investee. In terms of AASB 1024, an investor with the rights flowing from an equity investment in an entity has the capacity to control that investee, its controlled entity or subsidiary, if it has the capacity to: (a) dominate decision making, directly or indirectly, in relation to the financial and operating policies of the investee; so as to (b) enable that investee to operate with it in pursuing the objectives of the controlling investor (AASB 1024, para. 9). Under the corresponding International standard, the phrase ‘to enable that other entity (the investee) to operate with it in pursuing the objectives of the controlling entity’ is replaced by the simpler ‘to obtain benefits from its [the investee] activities’ (IAS 27, para. 6).

The problem with AASB 1024 arises from the attempt to extend the concept of control to make it the criterion for determining whether a set of consolidated accounts should be prepared. The concept of control is dispensed with in the case of stapled securities, where another ‘political patch’ is applied to solve the problem. Where the securities of two separate legal entities are stapled, a ‘reporting entity’ is ‘deemed’ to exist, comprising the entities with the stapled securities, thus requiring a set of consolidated accounts to be prepared (Urgent Issues Group, 2000). Rather than apply ‘patches’ to solve specific issues, it would seem preferable to formulate an accounting standard for stapled securities based on the conceptual objectives set out in SAC 2. Under SAC 2, general purpose financial reports shall disclose information ‘relevant to the assessment of performance, financial position, and financing and investing, including information about compliance’ (para. 45). In the case of stapled securities used as a vehicle in development activities,
consolidation would appear to be essential for the production of ‘information relevant to performance’.

In terms of AASB 1016, an investor with rights flowing from an equity investment in an entity has the capacity to exert significant influence if it has the power ‘to affect substantially (but not control) the financial and operating policies of the investee, termed its associate’ (AASB 1016, para. 9).

As in the case of any shareholder, an investor only has the capacity to control or exert significant influence through the exercise of votes in general meetings of a company. If an investor has the capacity to dominate or substantially influence the financial and operating policies of an investee, it can only have that capacity through having the board of the investee, or members of that board, act in accordance with its instructions. Corporations law defines a director as, inter alia, a ‘person in accordance with whose directions or instructions the members of the body’s Board are instructed to act’ (s. 60(c)(iii)). Where, as is likely, the nominee directors appointed by the investor or other investee board directors are accustomed to act on directions or instructions of the investor, or the investor imposes his own financial reporting system, the investor is a shadow director of the investee. An investor that consolidates a controlled entity or equity accounts an associate, in accordance with the conditions of AASB 1024 and AASB 1016, therefore, must be a shadow director of those entities.

In AASB 1024, the stated aim of the capacity to control or significantly influence is to enable the controlled entity ‘to operate with it [the controlling entity] in pursuing the objectives of the controlling entity’ (para. 9). Once appointed to a board, however, a director’s fiduciary duties of good faith and loyalty, and duties of skill and care, are owed to the company, rather than to the individual shareholders of that company (see, e.g., Walker v Wimborne (1976) 137 CLR 1). Even if the investor acts as a shadow director in dominating the operating and financial policies of the controlled entity, as a director of the company, it cannot act in pursuit of the objectives of one of the shareholders of the company. Situations may arise where the capacity to control is acquired with only 20 per cent of the voting power. The investee could only ‘pursue the objectives of the controlling entity’ if that entity’s objectives were those of the other 80 per cent shareholding. In a limited partnership, the general partner may be a corporate controlled entity with minimal or no equity interest in the partnership. It would be in breach of Corporations Law to pursue the objectives of a minimal equity interest unless that interest coincided with the interests of the limited partners.

**Asset Recognition Criteria** In terms of SAC 4, an asset should be **recognized** in a statement of financial position when and only when: (a) it is probable that the future economic benefits embodied in the asset will eventuate; and (b) the asset possesses a cost or other value that can be measured reliably. Similar criteria for recognition are set out in the International framework.

**Probability of Future Economic Benefits** For most rights, the chance of deriving future economic benefits must be ‘more likely rather than less likely’ with the likelihood ‘that which can be expected on the basis of available evidence or logic’
Based on the events, which have unfolded in the recent corporate collapses, directors’ and auditors’ interpretation of ‘available evidence and logic’ is not always going to result in reliable measures of probability. In accounting standards, however, this basic test of more likely than less likely is not always used for the recognition of assets.

Research and development expenditure may be recognized as an asset only if, beyond any reasonable doubt, an entity may expect to derive future economic benefits (AASB 1011, para. 31). A deferred tax asset may be recognized in respect of a loss carried forward, where there is ‘convincing or other evidence’ that the future economic benefits will be derived (AASB 1020, para. 7.3.9). Prior to the issue of the amended AASB 1020 in 1999, ‘convincing or other evidence’ was defined as ‘virtual certainty’. If >50% probability is a measure of more likely than less likely, what are the measures of ‘beyond reasonable doubt’ and ‘convincing or other evidence’? As mathematical measures, could beyond reasonable doubt be >90% with convincing or other evidence >99%? In the case of exploration and evaluation costs, the test is ‘expected to be recouped’ (AASB 1022, para. 11(a))—perhaps a weak probability test of >40%? No guidelines are provided in SAC 4 and even if there were guidelines, the measures adopted by directors would be subjective.

Where rights are acquired, the test for the probability of deriving future economic benefits may be an ex ante or an ex post test. In the case of most rights, the test is an ex ante one—made at the time economic benefits are sacrificed to acquire rights. In respect of exploration and pre-production development sacrifices of economic benefits, the tests may be ex ante or ex post. The cost of acquiring the rights from exploration and pre-production may be recognized as an expense at the date of sacrifice if directors are of the opinion that, at that date, it is not possible to determine whether the expected benefits are probable and reliably measurable. Alternatively, the asset/expense decision may be deferred until the exploration and evaluation activities have reached the stage where a reasonable assessment of recoverability can be made (AASB 1022, para. 11(b)).

Revision of Probabilities A right may fail the relevant probability test in one period but meet the test in a subsequent period (SAC 4, para. 43). Thus an entity may write off exploration and pre-production costs as an expense at the time the benefits are sacrificed if the deemed probability of recovery is <50%, resurrect those expensed costs as an asset (and a profit) in the following period if deemed probability of recovery is ≥50%, and expense them again in the next period if the deemed probability is again <50%. In the case of research and development costs, however, benefits sacrificed in one period cannot be resurrected in a later period (AASB 1011, para. 50). Of all rights acquired or in the process of acquisition, the rights from a research and development program would appear to be the most likely to fail the probability test during the research and development period. Why single out the rights arising from a research and development program for a divergent treatment?

The ability to write off costs in one period on the basis of a subjective weak probability test and subsequently resurrect those costs as an asset on an equally
weak subjective probability test would seem an open invitation to directors and auditors to manipulate (‘manage’) accounting data.

The Possession of a Cost or Value That Can be Measured Reliably In terms of SAC 4, assets are future economic benefits. The cost or value of an asset is not a measure of the future economic benefits to be derived from the asset. The cost or value of an asset is a measure of some property or characteristic, possessed in the past or at present. If the essence of an asset is the present existence of probable future economic benefits, it would seem to follow that any reliable measurement test should be made in terms of these probable future economic benefits and not in terms of the benefits sacrificed.

It is probable that the reliable measurement test is focused on a cost or value to exclude internally developed goodwill from a statement of financial position. The ‘concept of goodwill as an asset is the same regardless of whether it has been purchased in an exchange transaction or generated internally. However, purchased goodwill can be measured more reliably, on the basis of the amount paid for it, than can internally generated goodwill which is not capable of being measured reliably’ (AASB 1013, para. 5.1.2). Here again is an example of circular reasoning in which the accounting concept of reliable measurement appears to have been derived from a predetermined accounting standard purportedly derived from the concept.

In the case of a non-current asset (and, in fact, any asset), the carrying amount reported in a statement of financial position as a cost, deemed cost, residual cost, value or residual value cannot exceed its recoverable amount (AASB 1010, para. 5.1). The recoverable amount of an asset is the ‘net amount expected to be recovered through the cash inflows and outflows arising from its continued use and subsequent disposal’ (AASB 1010, para. 9.1). Thus the recoverable amount of an asset is that portion of the carrying amount that will probably be recovered from the net future economic benefits to be derived from its use or disposal.

As an example of the application of this recoverability test, at each reporting date, the carrying amount of acquired goodwill must be reviewed to ensure that it is not in excess of its recoverable amount. The cost of acquiring the goodwill is not relevant to this determination and thus, subsequent to the date of acquisition and necessarily at the reporting date, has no relevance to the reliable measurement test. At every reporting date, a value has to be determined for the purchased goodwill, which, by definition, is the net future economic benefit to be derived from unidentifiable elements. As total goodwill comprises self-developed unidentifiable elements and acquired unidentifiable elements, the valuation of acquired goodwill must necessarily involve identifying and distinguishing the future economic benefits derived from acquired unidentifiables—surely a daunting task. If a value can be determined for acquired goodwill, it can be determined for internally developed goodwill.

The conceptual framework does not specify the property or characteristic of assets that should be measured in financial reporting—and it is likely to lead to consistency in the setting of standards. Due to the lack of such a concept, in various circumstances, amounts reported as assets values in a statement of financial position have been:
1. *market entry values*, being costs at the dates of acquisitions or current replacement costs, or residuals of market entry values;
2. *market exit values* for assets to be disposed of in the market, being net disposal values;
3. *opportunity costs*, being net disposal values for assets, which are not intended for disposal in the market, as in the case of agricultural produce which is to be converted into secondary products; or
4. *deemed costs*, being a composite of market exit values and market entry values, as in the case of agricultural assets, which are dependent assets—dependent for value on their environment.

Apart from the rights that are recognized as assets on some valuation basis, there are rights which are not recognized because of the issue of accounting standards that are deliberately designed to ensure non-recognition—leased assets and the rights to the results of successful research and development projects. The useful lives of depreciable assets are uncertain, with the assets often continuing in use after being written off. Although a depreciable asset, other than deferred research and development costs, may be resurrected as an asset, there is no requirement for its recognition.

If the focus is moved to the future economic benefits that an entity expects to derive from a resource right, value then becomes determinable in terms of those future economic benefits. Only if the future economic benefits can be measured reliably can an asset have a value that can be measured reliably.

*Liabilities*
From SAC 4, in terms of essential characteristics, liabilities are defined as (para. 48): ‘future sacrifices of economic benefits, that the entity is presently obliged to make to other entities as a result of past transactions or events’.

A liability is recognized in the statement of financial position when and only when (para. 65):

(a) it is probable that the future sacrifice of economic benefits will be required; and
(b) the amount of the liability can be measured reliably.

As the characteristics and recognition criteria are expressed: A future sacrifice of economic benefits that an entity is presently obliged to make to other entities as a result of past transactions or events is recognized as a liability if it is probable that the future sacrifice of economic benefits will be required and the amount of the sacrifice can be measured reliably.

As the essential characteristic of a liability is the existence of a present obligation (para. 51), perhaps a clearer expression would be: An obligation to sacrifice future economic benefits, that an entity has to other entities as a result of past transactions or events, is recognized as a liability if it is probable that the future sacrifice of economic benefits will be required and the amount of the sacrifice can be measured reliably.

*Obligations, Liabilities and Sacrifices* As in the case of assets, a clear distinction should be made between present obligations and liabilities. All present obligations are not necessarily recognized as liabilities. For a present obligation to be recognized
as a liability, it must meet certain recognition criteria. From paragraph 65 of SAC 4, if a liability is recognized when certain criteria are met, there is the implication that there are other liabilities, which are not recognized. There is also a distinction between the present obligation, which is a duty or responsibility of an entity to act in a certain way (para. 51), and the sacrifice of economic benefits that is expected to result from that obligation.

Do present obligations necessarily involve ‘other entities’, which appear to be defined as ‘external parties’ (para. 60)? This particular concept seems to have been invoked to deny the recognition of part or all of an annual overhaul of property, plant and equipment as a liability. The sacrifice of future economic benefits to overhaul property, plant and equipment is not a liability, since there is no ‘present obligation to an external party’ (para. 60). The anticipated costs of restructuring an acquired entity are recognized as a liability if there is a demonstrable commitment to restructuring (Urgent Issues Group, 1996), although the mere intention to sacrifice economic benefits in the future is not sufficient to give rise to a liability (SAC 4, para. 59). An entity must have little discretion to avoid the sacrifice of future economic benefits.

There would seem to be no substantial difference between a demonstrable commitment to restructure and a demonstrable commitment to overhaul property, plant and equipment. The obligation to overhaul property, plant and equipment arises as a result of past events and is thus a present obligation. It is an obligation because an entity has a responsibility to perform the overhaul.

An executory contract involves an exchange of promises and does not give rise to obligations, which would satisfy the criteria for recognition as liabilities. There is no present obligation to sacrifice future economic benefits. Liabilities may arise from a breach of an executory contract but not from the contract. Contracts for the lease of rights are not executory contracts and do involve present obligations. A lessee acquires control of the leased rights over the lease term in exchange for a present obligation to sacrifice future economic benefits equivalent to the lease rental commitments. A range of leased rights has been denied recognition as assets through the simple device of substituting ownership for control as a criterion. The adoption of ownership as a criterion has allowed the more entrepreneurial directors (and auditors) to adopt a form over substance approach to the recognition of leased rights and thus deny the recognition of a wide range of leased rights as assets.

In order to deny recognition of the present obligation for lease rentals as a liability, there would need to be a change in the characteristics and recognition criteria set out in SAC 4. In some financial reports, the obligations recognized as liabilities are substantially less than the obligations that should be, but are not, recognized as liabilities. The involvement of a lessor may only involve the provision of a finance facility, as in the case of a direct financing lease. Although borrowing costs include finance charges in respect of lease liabilities (AASB 1036, para. 11.1.2), the finance facility provided by a lessor is not necessarily considered a finance facility to the lessee. An entity must disclose its used and unused loan facilities at the reporting date (AASB 1026, para. 12.2) but, in many financial reports, these disclosures appear to be restricted to bank loan facilities.
Past Transactions or Events  If, at a reporting date, an entity has been affected by a past event, regardless of whether that event is a special event or some other event, the present obligation to sacrifice economic benefits must exist in the conditions at the reporting date. Thus, as in the case of liabilities, it would seem much simpler to accept as a characteristic that a present obligation must exist in the conditions existing at the reporting date.

Revenues and Expenses
In terms of SAC 4, revenues are defined as (para. 111): ‘inflows or other enhancements, or savings in outflows, of future economic benefits that result in an increase in equity during the reporting period; in the form of increases in assets or reductions in liabilities of the entity; other than those relating to contributions by owners, that result in an increase in equity during the reporting period’. Revenues are recognized when and only when (para. 125):

(a) it is probable that the inflow or other enhancement or saving in outflows of future economic benefits has occurred; and
(b) those inflow or other enhancement or saving in outflows of future economic benefits can be measured reliably.

Revenues and Gains and Losses  There is no distinction made between the revenues from the major ongoing activities, the gains and losses from peripheral activities, and the gains and losses from organizational changes. The IAS framework distinguishes between the revenue from major ongoing activities and the gains and losses from peripheral activities (paras 74 and 75). In SAC 4, the focus is said to be on the gross inflows or other enhancements of future economic benefits and gross savings in outflows (para. 112). Following this approach, the redemption of $10,000,000 in debenture borrowings at a loss of $10,000 would see $10,000,000 reported as debenture revenue and $10,010,000 reported as debenture expense. In appraising the performance of an entity, it could be expected that the initial focus of an investor is on the statement of financial performance. The inclusion in profits from ordinary activities of profits from continuing operations, peripheral gains and losses and gains and losses from organizational changes hardly leads to relevant information being provided to an investor. Surely it is not up to the investor to rummage through notes to a statement to extract relevant information.

Not all enhancements of assets are recognized as revenues even if those enhancements are probable and can be measured reliably. The enhancements of grapevines in a vineyard are recognized as revenue if those enhancements are probable and can be measured reliably (AASB 1037, para. 5.4). The enhancements of vineyard land and other vineyard non-vine assets cannot be recognized as revenue even though they can be measured reliably (AASB 1040, para. 6.2). This seems an illogical application of an accounting concept aimed at preserving a traditional method of accounting in the case of certain non-current assets whilst applying the basic concepts to other non-current assets. It is particularly illogical in its application to vineyards, where the enhancement in the net market value of vines is recognized as revenue in spite of the vines not having a market value, with any attributed value being dependent on the value attributed to the vineyard land.
Recognition of Inflows or Other Enhancements or Savings in Outflows  The recognition of revenue involves the recognition of an asset or enhancement of an asset, or the settlement or reduction of a liability. Thus it would seem to follow that, for revenue to be recognized, the criteria for the recognition of an asset or liability must also be met. If revenue recognition involves the enhancement of a right, the revenue will be recognized, and the enhancement of the right will be recognized, if it is probable that the enhancement will be derived and the enhancement has a cost or value that can be measured reliably.

EXPENSES

In terms of SAC 4, expenses are defined as (para. 117): ‘consumptions or losses of future economic benefits in the form of reductions in assets or increases in liabilities of the entity, other than those relating to distributions to owners, that result in a decrease in equity during the reporting period’. Expenses are recognized when and only when (para. 132):

(a) it is probable that the consumption or loss of future economic benefits resulting in a reduction in assets and/or an increase in liabilities has occurred; and
(b) the consumption or loss of future economic benefits can be measured reliably.

Again there is no distinction between the expenses incurred in the ongoing major operations of an entity and the losses incurred in peripheral activities and from organizational changes.

CONCLUDING COMMENTS

Accepting the general thrust of the statement of accounting concepts SAC 4, there seem to some fundamental problems in construction and application.

1. Certain concepts in the statement appear to have been constructed to justify traditional preconceived accounting standards—an approach that must inevitably lead to inconsistencies in accounting standards.
2. The concepts are disregarded in the setting of specific accounting standards, as in the case of leases, without any supportable justification.
3. In endeavouring to establish conceptual criteria for the ‘logical’ derivation of an accounting standard, there also seems to be a disregard of specific sections of the Corporations Law.

Although the primary purpose of the CF is its function as a guide in developing and reviewing accounting standards, the framework will be ineffective if inconsistent traditional accounting is accommodated through a series of political patches. A number of suggested amendments to SAC 4 are set out Appendix A. The amendments do not alter the thrust of the CF, but are intended to eliminate ‘concepts’ set in place to justify certain traditional practices and to bring the concepts of assets into harmony with other concepts. With these amendments, certain items, such as acquired goodwill, which are currently reported as assets, would no longer be
reported as such. The rights acquired from all material leasing contracts would be reported as assets.

REFERENCES


## APPENDIX A

### CHARACTERISTICS AND RECOGNITION CRITERIA: STATEMENT OF FINANCIAL POSITION

<table>
<thead>
<tr>
<th>SAC 4</th>
<th>IAS framework</th>
<th>Suggested amendment</th>
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<tr>
<td><strong>Panel A: Assets</strong></td>
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<tr>
<td>Essential characteristics</td>
<td>Essential characteristics</td>
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<tr>
<td>(a) Future economic benefits</td>
<td>(a) Resource</td>
<td>(a) Rights;</td>
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<td>(b) Controlled by the entity</td>
<td>(b) Controlled by the enterprise</td>
<td>(b) Controlled by the entity;</td>
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<td>(c) As a result of past transactions or other past events</td>
<td>(c) As a result of past events, from which</td>
<td>(c) In the conditions at the reporting date; from which</td>
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<td>(d) Future economic benefits are expected to flow to the enterprise</td>
<td>(d) Identifiable future economic benefits are expected to flow to the entity</td>
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<td>Recognition criteria</td>
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<td>(a) Probable that the future economic benefits embodied in the asset will eventuate; and the asset</td>
<td>(a) Probable that the future economic benefits will flow to the enterprise; and the asset</td>
<td>(a) Probable that identifiable future economic benefits will flow to the entity; and</td>
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<td>(b) Possesses a cost or other value that can be measured reliably</td>
<td>(b) Has a cost or value that can be measured reliably</td>
<td>(b) The amount of the future economic benefits can be measured reliably</td>
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| **Panel B: Liabilities** | | |
| Essential characteristics | Essential characteristics | Essential characteristics |
| (a) Future sacrifices of economic benefits | (a) Obligations | (a) Present obligations |
| (b) Entity presently obliged to make to other entities | (b) Presently owed by the enterprise | (b) Incurred or assumed by an entity |
| (c) As a result of past transactions or other past events | (c) As a result of past events | (c) In the conditions at the reporting date |
| (d) Resulting in the expected sacrifice of future economic benefits | (d) Resulting in the expected sacrifice of future economic benefits | (d) To sacrifice of future economic benefits |
| Recognition criteria | Recognition criteria | Recognition criteria |
| (a) Probable that the future sacrifice economic benefits will be required; and | (a) Probable that a sacrifice of future economic benefits will result from settlement of the obligation; and | (a) Probable that future economic benefits will be sacrificed by the entity; and |
| (b) The amount of the sacrifice can be measured reliably | (b) The amount of the sacrifice can be measured reliably | (b) The amount of the sacrifice can be measured reliably |

| **Panel C: Equity** | | |
| Essential characteristics | Essential characteristics | Essential characteristics |
| (a) Residual interest in the assets of an entity after deduction of its liabilities | (a) Residual interest in the assets of an enterprise after deducting all its liabilities | (a) Residual interest; |
| | | (b) In the conditions at the reporting date; |
| | | (c) In the net future economic benefits flowing from rights and obligations |
| Recognition criteria | Recognition criteria | Recognition criteria |
| (a) Assets and liabilities meet the tests for recognition | (a) Rights meet the tests for recognition as assets; and obligations meet the tests for recognition as liabilities. |
### Panel A: Revenues

**Essential characteristics**
- (a) Inflows or other enhancements, or savings in outflows, of future economic benefits;
- (b) In the form of increases in assets or reductions of liabilities of the entity;
- (c) Other than those relating to contributions by owners that result in an increase in equity during the reporting period.

**Recognition criteria**
- (a) Probable that the inflow or other enhancement or savings in outflows of future economic benefits has occurred; and
- (b) The amount of the inflow or other enhancement or savings of future economic benefits can be measured reliably.

**IAS framework**

- (a) Increases in economic benefits
- (b) Arising from ordinary activities during an accounting period;
- (c) In the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity;
- (d) Other than those relating to equity participants.

**Recognition criteria**
- (a) Increase in future economic benefits related to an increase in an asset or a decrease of a liability; and
- (b) Increase can be measured reliably.

**Suggested amendment**

- (a) Increases in the net assets of an entity;
- (b) From the major ongoing activities of the entity during the period ending on the reporting date;
- (c) Other than from transactions with the holders of equity interest

### Panel B: Expenses

**Essential characteristics**
- (a) Consumptions or losses of future economic benefits;
- (b) In the form of reductions in assets or increases in liabilities of the entity;
- (c) Other than those relating to distributions to owners that result in a decrease in equity during the reporting period.

**Recognition criteria**
- (a) Probable that the consumption or loss of future economic benefits has occurred; and
- (b) The amount of the consumption or loss of future economic benefits can be measured reliably.

**IAS framework**

- (a) Decreases in economic benefits
- (b) Arising from ordinary activities during an accounting period;
- (c) In the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity;
- (d) Other than those relating to equity participants.

**Recognition criteria**
- (a) Increase in future economic benefits related to an increase in an asset or a decrease of a liability; and
- (b) Increase can be measured reliably.

**Suggested amendment**

- (a) Decreases in the net assets of an entity;
- (b) From the major ongoing activities of the entity during the period ending on the reporting date;
- (c) Other than from transactions with the holders of equity interest
### Panel C: Gains and Losses

<table>
<thead>
<tr>
<th>SAC 4</th>
<th>IAS framework</th>
<th>Suggested amendment</th>
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<tr>
<td>Essential characteristics</td>
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<td>(a) Increase in the net assets of an entity;</td>
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<tr>
<td>No clear criteria</td>
<td>(b) From the peripheral activities of the entity and from organizational changes during the period ending on the reporting date;</td>
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<td></td>
<td>(c) Other than from transactions with the holders of the equity interest</td>
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<tr>
<td>Recognition criteria</td>
<td>Recognition criteria</td>
<td>(a) Conditions satisfied for recognition of changes in assets and liabilities.</td>
</tr>
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<td>No clear criteria</td>
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