Making a statement

In the second of his two-part article, Tom Clendon looks at how the revised framework measures assets and liabilities, and considers the role or the statement of other comprehensive income. This stuff you need to know

In last month's article we saw that the IASB's conceptual framework for financial reporting provides a set of principles on which International Financial Reporting Standards are based. The article explained that the framework had been revised and resulted in a new definition of the key elements of assets and liabilities and changed their recognition criteria.

In addition, the revised framework also saw it extended. It lays down new guidance as to how assets and liabilities should be measured and suggests when they should be measured at historical cost or be revalued. The revised framework broke new territory in exploring the principles as to when gains and losses should be included in the statement of profit or loss and when in other comprehensive income.

Measurement

The previous framework did not include much guidance on how to measure assets and liabilities. In developing the revised framework the IASB even considered whether just a single measurement basis should be mandated. In other words, whether all assets and all liabilities should be either at cost or re-measured to value.

The conclusion was that different measurement bases could provide useful information to users in different circumstances. Thus the framework promotes the mixed measurement approach. Two categories of measurement basis were identified. Historical cost and current value. But when to use cost and when to use value? Consistent with the rest of the framework, guidance is based on considering what is the most relevant and faithful representation basis to use in any one given situation.

Let me make up an example to illustrate. It's acknowledged that the use of current value always seems relevant, because it is forward-looking in predicting what the asset might be sold for. However, if an item of property plant and equipment is never going to be sold but will be written off over it's useful life, it can be strongly argued that it is not relevant to use current value and the most faithful representation is to measure the asset at cost less depreciation.

The role of other comprehensive income

For the first time, the revised framework attempts to give guidance for the IASB to take into account when creating future standards that have to adjudicate on the classification of income and expenses between the statement of profit or loss and other comprehensive income.

In principle, the revised framework has, as a default, that all income and expenses be included in the statement of profit or loss. However, it does acknowledge that there are exceptional circumstances where gains and losses should be included in other comprehensive income! It will be interesting to see in the long run whether this "clarification" actually results in changes to existing standards.

What can we expect in an exam?

While ACCA aims to test practical application of the framework and the accounting standards, it is important that students can explain the theory behind the revised framework and its implications on any financial statements under review.

Conclusion

The objective of the IASB in revising its framework is to have an up-to-date and comprehensive framework; to assist in producing coherent and consistent accounting standards, that in turn will achieve the goal of improving the quality and clarity of financial reporting. Laudable aims; but only time will tell whether the IASB achieves this goal! PQ

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