The International Accounting Standards Board's Search for a General Purpose Accounting Model

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Abstract

In setting its standards, the International Accounting Standards Board (IASB) uses its 1989 'Framework for the Preparation and Presentation of Financial Statements'. Given developments since 1989, the Framework looks increasingly out-of-date. The authors argue that any new Framework should address the choice of income measurement. The general purpose accounting model would differ substantially from its predecessor, favouring 'fair value' as a valuation base within a 'mixed measurement' model. However, inadequate guidance may still be provided on the choice of capital maintenance concept and therefore, the search for a general purpose accounting model will continue.

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Introduction

The International Accounting Standards Board (IASB), which was instituted in London, UK, in 2001, adopted many of the regulations of its predecessor, the International Accounting Standards Committee (IASC), most noticeably the 1989 'Framework for the Preparation and Presentation of Financial Statements' (henceforth the 'Framework'). Interestingly, despite the fact that standard-setters themselves recognise that the Framework is increasingly out-of-date given recent changes in the field of financial reporting (Lennard 2003), correspondence between the authors and the IASB in December 2003 suggested that there are currently no formal plans to rework the Framework. However, it may be argued that the lack of a coherent international conceptual framework (CF) has seriously impeded progress towards the convergence of national accounting standards. As such, it appears that although the revision of the Framework is not on any formal agenda, the IASB plans to pay due consideration to the issue at some point in the future. In fact, on 2nd August 2001, the IASB announced its initial agenda of nine technical projects, some of which made references to the Framework. For example, the aim of the 'Accounting for Insurance Contracts' project is to develop a standard 'that is consistent with the conceptual framework definitions of assets and liabilities' (IASB 2001a). Similarly, the IASB's project on 'Definitions of Elements of Financial Statements' will compare similarities and differences in national standard setters' definitions of key accounting concepts with the possibility of revising the Framework (IASB 2001a). More importantly, it is intended that the IASB/Canadian Accounting Standards Board (AcSB) joint research project on measurement will provide the basis for amending the Framework and conceptually reviewing the measurement requirements of International Financial Reporting Standards (IFRSs). This paper argues that the Framework is in desperate need of redevelopment within the next decade and provides a critical review of the changes that are likely to be imposed in relation to the choice of a general purpose accounting model.

Differences between the IASB Framework and the UK Accounting Standard Board (ASB) Statement

It could be argued that the Framework (issued in 1989) reflects the accounting thought at the time of its creation, at which point all G4 members, with the exception of the UK, (Australia, Canada and the US) had published their own national CFs. It seems that the initial impetus for the Framework came from a desire to reflect the G4 members' developments in this area. The preface to the Framework states 'the IASC is committed to narrowing (these) differences by seeking to harmonise regulations, accounting standards and procedures ... ' (p.1). Perhaps the IASC thought that international accounting standards would have more credibility if the Framework were in place. The UK's delay in issuing a conceptual framework may be due to the failure of the current cost accounting experiment in the 1980's and the critical report by Macve (1981). The UK finally issued its 'Statement of Principles' (henceforth the 'Statement') in 1999. The differences between the Framework and the Statement are interesting because they reflect accounting developments over the ten years from 1989 to 1999. For example, the UK ASB acknowledges that the fact that the 'probable' test is included in the Framework, but it is not included in the Statement, because of developments in accounting thought post 1989 (ASB 1999, appendix II, paragraph 11). This illustrates how CFs should move alongside accounting thought,

and suggests that the Framework may perhaps be outdated. In order to identify any other areas in which the Framework may be obsolete, a comparison is now made between the Framework and the more contemporary, UK ASB's Statement.

UK	ASB Chapter	Differences
1.	Objectives of Financial	Investor group has user primacy in Statement
	Statements	
2.	Reporting Entity	No reference to boundary of reporting entity in
		Framework
3.	Qualitative	Statement favours relevance over reliability if the
	Characteristics of	two concepts are in conflict
	Financial Information	
4.	Elements of Financial	No major differences
	Statements	
5.	Recognition in Financial	'Probable' test included in Framework, but not in
	Statements	Statement
6.	Measurement in	Major differences identified – see Tables 2 to 5
	Financial Statements	
7.	Presentation of Financial	Not in Framework but covered by IAS 1
	Information	
8.	Accounting for Interests	Not in Framework
	in Other Entities	

Table 1: Comparison of IASB Framework and UK ASB Statement Chapters

It is evident from the above table that the main differences between the UK ASB Statement and the IASB Framework lie in the areas of the reporting entity, measurement in financial statements, and the presentation of financial information (Chapters 2, 6 and 7). This study focuses upon the issue of measurement in an attempt to contribute towards the highly debated subject of the choice of an internationally agreed, general purpose accounting model. The subject of CF's has been discussed extensively in the pertinent literature (for example, Ijiri 1973, Doupuch and Sunder 1980, Macve 1981, Peasnell 1982, Solomons 1986, Mumford 1989, and Hines 1991). The choice of a general purpose accounting model also has a long history, with landmarks such as: Edwards and Bell (1961), the Financial Accounting Standards Board's (FASB) Measurement Statement (1984), the Institute of Chartered Accountants in Scotland's radical CF (1988), and Solomons' 'real gains' system (1988). The choice of general purpose accounting model rests on three decisions - the unit of currency to be adopted, the manner in which assets and liabilities are to be valued, and the type of capital that is to be maintained. The following section explores the three determinants of income in relation to the IASB Framework and the UK ASB Statement.

Measurement in Financial Statements - Unit of Currency

The choice of currency unit is the first choice in determining income. Two options are available – the nominal unit and the constant purchasing power unit. Table 2 suggests that the unit of currency choice is considered as part of the issue of capital maintenance in both CFs. However, the constant purchasing power unit could potentially be added to any system of income measurement. For example, comparative current cost accounts could be updated by a general inflation index to provide more meaningful comparisons over time. The UK ASB claims that if the effect of specific price changes is 'acute, it will be necessary to adopt a system of accounting that informs the user of the significance of specific price changes for the entity's financial performance and financial position' (paragraph 6.42). Similarly, if the effect of changes in general prices are acute, 'an approach will need to be adopted that involves recognising profit only after adjustments have been made to maintain the purchasing power of the entity's financial capital' (paragraph 6.42). The authors believe that the above distinction is problematic in practice, as specific and general price changes may be interrelated and are likely to occur at the same time.

Item	Differences
Distinction between a nominal unit of	Not mentioned in either CF
currency and a current purchasing power	
unit or constant unit	
The use of a current unit of measure	Mentioned in both CFs as part of
	financial capital maintenance

 Table 2: Measurement in Financial Statements – Unit of Currency

One would perhaps expect the Framework to consider accounting for price level changes in great detail, given that inflation is still a major problem in some of its constituent countries. For example, Zimbabwe's RPI rose by approximately 300% in 2003 (www.zse.co.zw). Furthermore, there are two IASs that promote the use of 'current purchasing power' (CPP) accounting – IAS 21 'Foreign Currency' (IASC 1993) and IAS 29 'Financial Reporting in Hyperinflationary Economies' (IASC

1994). It is somewhat strange that there is no mention of CPP in the Framework, yet it forms the basis of the only IFRS on inflation accounting. Interestingly, the UK ASB has incorporated IAS 21 into its revision of Statement of Standard Accounting Practice Number 20 (SSAP 20) as part of its convergence project. Subsequently, CPP accounting seems to be the most likely alternative to the current 'mixed measurement' system in the case of hyperinflationary economies. With regard to the first determinant of income measurement, one can therefore conclude that although the 'current' unit of measure forms the basis of the IASB's standards, it is not referred to in the Framework. Such an omission is clearly an anomaly!

Measurement in Financial Statements – Valuation of Assets and Liabilities

Tables 3 and 4 summarise the measurement criteria for the valuation of assets and liabilities, respectively, according to the IASB Framework and the UK ASB Statement. The data highlight the manner in which different terminology has been used in various jurisdictions to describe identical measurement bases, and how similar terms have been defined in different ways. For example, present value is listed in the Framework as if it were a separate measurement basis, which is contrary to the UK ASB's stance that present value is a methodology that can be used to estimate measurements under several different bases. To illustrate this point, the UK ASB's standard on deferred tax (ASB 1999) allows deferred tax liabilities and assets to be discounted to provide a fair value.

Item	IASB Framework	UK ASB Statement
Fair Value	Not mentioned	Defined as both historical cost

		and current value at point of
		initial recognition (6.13)
Historical Cost	Defined (paragraph 100a)	Defined (paragraph 6.2)
Replacement Cost	Defined and referred to as	Part of 'value to the business'
	'current cost' (paragraph	
	100b)	
Net Realisable Value	Defined (paragraph 100c)	Part of 'value to the business'
Present Value	Defined (paragraph 100d)	Referred to as 'value in use'
		and is part of 'value to the
		business'
Value to the Business	Not mentioned	Defined and referred to in four
or Deprival Value		paragraphs and one diagram
		(paragraphs 6.6-6.9)

 Table 3: Measurement in Financial Statements – Valuation of Assets

Item	IASB Framework	UK ASB Statement
Historical Cost	Defined (paragraph 100a)	Defined
Replacement Cost	Defined and referred to as	Defined as 'the amount that
	'current cost' (paragraph	the entity could currently raise
	100b)	by issuing a similar debt
		security'
Net Realisable Value	Defined (paragraph 100c)	Defined as 'cost of
		discharging liability'
Present Value	Defined (paragraph 100d)	Not mentioned
Relief Value	Not mentioned	Defined as 'the lowest amount

at which the liability could,
hypothetically, be settled'
(paragraph 6.09). Diagram in
1995 draft, but omitted in final
Statement

Table 4 - Measurement in Financial Statements – Valuation of Liabilities

It is evident that the UK ASB favours the eclectic rule of 'value to the business' (VTB), or 'deprival value', for assets and 'relief value' for liabilities, whereas the international Framework lists the options but fails to recommend a preferred measurement technique. Furthermore, the Statement compares 'single, consistent' systems with 'mixed' systems (paragraph 6.2), whereas the Framework states that 'the measurement basis most commonly adopted by enterprises in preparing their financial statements is historical cost' (paragraph 101). There is therefore no formal recognition of a 'mixed measurement' system in the Framework, which may suggest that it was written in an era when there was a search for 'one' system of income measurement. This approach was abandoned by the UK ASB in favour of a 'mixed measurement' system, which is 'flexible in that the mix of historical cost and current value can be changed as accounting thought develops and markets evolve' (ASB 1999, appendix III, paragraph 55). This implies that the use of current value will become more prevalent with the growth and development of more sophisticated markets.

Interestingly, despite the fact that many existing (and proposed) IFRSs are based on the concept of 'fair value', it is not referred to in the Framework. Again, such an omission suggests that the international CF's measurement provisions are limited and alarmingly out-of-date. Before examining the third and final determinant of income, capital maintenance, the following section therefore examines the concept of fair value in relation to the valuation of assets and liabilities.

What is Fair Value?

Fair value is generally seen to be the value of an asset or liability in an 'arm's length transaction'. The IASB states that 'the best evidence of fair value at initial recognition is the transaction price' (IASB, Improvements to IAS 39, October 2003). Similarly, the UK ASB claims that 'it can generally be assumed that, in the absence of evidence to the contrary, a transaction has been carried out at fair value' (ASB 1999, paragraph 6.14). Furthermore, the ASB claims that fair value is normally the market price under a 'current value' measurement system, highlighting its faith in an unbiased market price:

'Most transactions take place at fair value. Rational buyers and sellers will ensure that this fair value reflects the time value of money and risk associated with the future expected cash flows, which means that market prices generally will reflect such factors.' (ASB 1999, paragraph 6.31)

However, it is not clear from the above quotations whether the UK ASB views fair value as the same as an 'input' market price, such as net replacement cost, or an 'output' market price, such as net realisable value.

IASB's Drive Towards Fair Value

There is plenty of evidence to suggest that the IASB is moving towards the concept of fair value. In October 2003, 'Board members generally agreed that fair value is the relevant measurable attribute' (IASB, Revenue Recognition Project Summary, 2003). However, preparers and auditors of financial information have expressed concerns about the adoption of fair value, given the limited availability of application guidance; a trend that is likely to continue given the IASB's principles-based, rather than rules-based, approach to standard setting (Jones 2003). Following on from this point is the question of how the international standard-setting process can be principles-based without an up-to-date Framework.

FASB's Drive Towards Fair Value

Similar remarks have been made about the FASB's increasing requirement for fair value measurements and the limited conceptual guidance provided by its *Concepts Statement No. 5, Recognition and Measurement in Financial Statements of Business Enterprises* (FASB 1984). In June 2003, the FASB therefore initiated a project to develop a 'Fair Value Statement', establishing a framework for measuring fair value. As part of this project, the FASB has revised its definition of fair value in many of its accounting pronouncements to refer to:

'The amount at which an asset or liability could be exchanged in a current transaction between knowledgeable and unrelated willing parties when neither is acting under compulsion.' (FASB 2003)

Ultimately, the FASB hopes to improve its CF, providing guidance on 'when' rather than 'how' fair value should be applied, with consideration being paid to the qualitative characteristics of relevance and reliability. As part of their joint *Business Combinations* project, the FASB and the IASB agreed to use fair value as the measurement base for valuing the assets acquired and liabilities assumed in any business combination. The Boards also agreed that the resulting exposure drafts of this project should provide guidance for measuring fair value to ensure consistent application of the principle. The FASB has therefore developed a fair value hierarchy that prioritises the market inputs that should be used for all estimates of fair value in three levels:

Level 1: The estimate of fair value should be determined by reference to observable (quoted) market prices for identical assets or liabilities at or near the measurement date, whenever those prices are available.

Level 2: If observable (quoted) market prices for identical assets or liabilities are not available, the estimate of fair value should be determined by reference to observable (quoted) market prices for similar assets or liabilities at or near the measurement date.

Level 3: If observable (quoted) market prices for identical or similar assets or liabilities are not available, the estimate of fair value should be determined based on the results of multiple other valuation techniques (IASB Update, June 2002).

The FASB guidance seems to imply that value to the business, current cost, value-inuse and net realisable value are all acceptable at level three.

AcSB's Drive Towards Fair Value

In 2002, the IASB and its eight national standard-setting partners commissioned the AcSB to undertake a joint research project on measurement bases for financial accounting, to provide the foundations for the future revision and expansion of the measurement objectives of national CFs (Paul 2003). The establishment of coherent national CFs should ultimately result in an improvement in the measurement requirements of national financial reporting standards. At present, there is much inconsistency between existing measurement standards and practices. In particular, differences prevail between accounting standards globally, while at the national level, certain standards permit a choice between fundamentally different measurement bases. For example, the IASB's 'Reporting Comprehensive Income' project allows historical cost or a 'remeasurement system'. The existence of arbitrary mixed measurement systems clearly reflects conflicting views on appropriate measurement bases (Paul 2003).

To date, the AcSB has undertaken a preliminary investigation into appropriate measurement bases for the initial recognition of assets and liabilities (as opposed to remeasurement or asset impairment). The alternative measurement bases and their respective definitions are similar to those presented in Tables 3 and 4, but also include 'reproduction cost'. Reproduction cost is similar to net replacement cost and is defined as 'the most economic current acquisition cost of replacing an existing asset with an asset of equivalent productive capacity or service potential' (Paul 2003). As part of its analysis, the AcSB considers two dimensions that underlie the differences between alternative measurement bases: market versus entity-specific measurement

objectives and entry versus exit values (see Paul 2003). These are two important unresolved issues and are discussed below.

Although the final draft of the AcSB's discussion paper was not availableat the time of writing, a summary of its preliminary findings was available on the IASB website. It appears that the AcSB favours 'fair value' as an appropriate measurement basis for the initial recognition of assets and liabilities. As previously mentioned, the fundamental objective of fair value is to reflect the market price of an asset or liability on the measurement date. If there is no observable market price, the objective is to estimate what the market price would be if a market existed. But how does one make a reliable estimation of the market price if there is no directly observable single market price? Such practical implications remain unresolved and require much attention before the AcSB issues its final recommendations. There is also the need to maintain consistent thinking about fair value in the FASB and AcSB projects that address the issue.

The UKASB's Adherence to the VTB Concept

There is extensive literature on the merits and downfalls of different measurement bases (ASC 1986; Riahi-Belkoui 2000). Although there is much evidence to support the use of fair value, the UK has a tradition of favouring the VTB concept, which has a long history (Baxter 2003, p. 23) and is seen as providing useful information to different user groups (Mattessich 1998). The VTB concept was adopted by the UK Accounting Standards Committee (ASC) in the late 1970's to accommodate circumstances where 'value in use' (or present value) seemed the most reasonable valuation.

For example, suppose a company purchases a specialised machine for £10m, which because of its unique nature, only has a net realisable value of £6m. For simplicity, depreciation is ignored. Further assume that the machine has a present value of £12m when purchased, so the purchase is a good commercial decision. VTB and historical cost measurement would ascribe a £10m value at the point of initial recognition. If the present value of the machine fell to £8m because of changes in the industry, the asset would be written down to £8m under the VTB rules and to £6m under FASB's fair value rules. In other words, the VTB allows a valuation which is internally generated and unique to the company, the present value, whereas the fair value rule insists on a market value. As identified in the AcSB project on measurement (Paul 2003), this seems to be a major issue in the decision over the measurement basis to be adopted in any future Framework.

As noted above the UK ASB perceives fair value as the same as historical cost at the time of initial recognition. However, when an asset or liability needs to be remeasured the UK ASB favours the VTB rule, which suggests that it assumes that markets are perfect when a transaction occurs but imperfect when remeasurement is required. Lennard (2003) argues that fair value is derived from the perfect markets hypothesis, where there is a single price for any good and no possibility of making a return greater than a normal return. On the other hand, VTB is part of the imperfect markets way of thinking, where profitable businesses are possible and exchange creates value. In an imperfect market there is division of labour, different

preferences, different values of goods for various market participants, comparative advantage and barriers to entry (Lennard 2003). Lennard (2003) cites the Nobel prize-winner Akerlof and his famous paper 'The Market for Lemons' (Akerlof 1970) as evidence to support VTB over fair value. Akerlof's paper describes a form of market failure where there is information asymmetry and only sellers know the value of their assets. Thus the paper can be viewed as strong support for VTB.

Despite the recent drive towards fair value, it is interesting to note that the IASB appears to use the VTB concept in its impairment rules (IASB 1998). The impairment test compares the higher of value-in-use (or present value) and net realisable value with the carrying value. If the asset is carried at its net replacement cost then the impairment rule is the same as the VTB rule. It could therefore be argued that impairment testing and the requirement to carry assets at their fair value are contradictory. In relation to the above example, the IASB's impairment rules would reduce the asset to its value-in-use of £8m, whereas the FASB fair value rules would require a £6m valuation.

To conclude, with regard to the measurement bases used to value assets and liabilities, there appears to be a general drive towards fair value among the IASB, the FASB and the AcSB. However, the VTB rule is still favoured by the UK ASB and as mentioned earlier, appears to be embedded in the IASB's impairment rules. Issues surrounding the second determinant of income therefore remain unresolved.

Capital Maintenance

The type of capital that is to be maintained is the third and final determinant of income. The concept of capital maintenance has existed in the accounting literature for many years (Pigou 1935, Gynther 1970, Lorig 1973, Revsine 1981, Tweedie and Whittington 1984, Guttierrez and Whittington 1997). Perhaps the most well-known capital maintenance quote comes from Hicks (1939, p.172) who stated that;

'The purpose of income calculations in practical affairs is to give people an indication of the amount they can consume without impoverishing themselves. Following out this idea, it would seem that we ought to define a man's income as the maximum value which he can consume during a week, and still expect to be as well off at the end of the week as he was at the beginning.'

Table 5 summarises the main capital maintenance concepts; financial capital maintenance supports the proprietorship view of companies, whilst physical and operating capacity maintenance supports the entity view of companies (Lemke 1982). In the UK, the entity view was given a fillip by the Sandilands Committee report (Sandilands 1975) and was incorporated into the UK's only current cost accounting standard, the doomed SSAP 16, which was introduced in 1980, made non-mandatory in 1983, and finally withdrawn in 1986. The entity view is still used by standard setters to justify certain choices, for example, the UK ASB refers to it to support full consolidation; 'the Statement regards the entity view as providing the most useful information' (ASB 1999, appendix III, paragraph 16). Given this endorsement, it is strange that the UK ASB does not refer to the entity view when discussing capital Instead, standard setters seem to ignore the choice of capital maintenance. maintenance concept. As a result, the concept of money capital is used, which is the basis of company law, where the cash injected by equity and debt holders cannot be distributed as income.

Item	IASB Framework	UK ASB Statement
Financial Capital	Defined in both	Defined in both nominal and
Maintenance	nominal and general-	general-price adjusted terms
	price adjusted terms	(paragraph 6.42)
	(paragraph 104a)	The 'real terms' system was
		in the draft, but not the final
		Statement
Physical Capital	Defined (paragraph	Not mentioned
Maintenance	104b)	
Operating Capacity	Not mentioned	Not mentioned, but formed
Maintenance		the basis of SSAP 16 (1980)

 Table 5: Measurement in Financial Statements – Capital Maintenance Concepts

There appears to be much more discussion concerning alternative capital maintenance concepts in the Framework compared with the Statement, but neither recommends the adoption of one particular method of dealing with the problem of capital maintenance. In fact, the Framework remarked, *'at the present time it is not the intention of IASC to prescribe a particular model other than in exceptional circumstances, such as for those enterprises reporting in the currency of a hyperinflationary economy'* (IASC 1989, paragraph 110).

According to Lennard (2003), the IASB is not interested in the definition of distributable profits or the dividend decision, as such issues constitute part of the legal framework of individual countries. In the UK, the Companies Act rules on

distributable profits prohibit the payment of a dividend from capital where capital is defined as money capital invested. Realised gains are distributable and standard setters help the legal process by treating downward revisions of assets as 'realised' and upward revisions of assets as 'unrealised' even when they may be the same in nature. For example, under FRS 19 an unrealised pension deficit is treated as realised (ASB FRS19 paragraph 13). However, there is little international convergence with regard to taxation and regulations governing distributable profits. Although concepts of capital maintenance form part of the criteria for evaluating alternative measurement bases under the AcSB project (IASB April 2003), the above comments suggest that the IASB is not willing to tackle capital maintenance issues. As there will always be different tax and distributable profit rules around the world and the capital maintenance decision has no direct link to the law of distributable profits, the IASB's failure to decide on a capital maintenance concept is regrettable. The authors argue that until the IASB pays due regard to this particular issue, an entity's income will be indeterminable and thus the search for a general accounting model will continue.

	IASB Com	prehensive		UK	UK	UK	UK
	Income	Project	IASB	ASB	ASB	Sandilands	SSAP16
Profit and	Historical	HC re-		Real	Real	Current	Current
Loss	cost	measured	CPP	Gains	Gains	Cost	Cost
				'One-	'Compre-		
				line'	hensive'		
	£	£	£	£	£	£	£
Sales	200	200	200	200	200	200	200
Cost of Sales							
НС	(100)	0	0	0	0	0	0
Cost of Sales	<u>0</u>	<u>(125)</u>	<u>(105)</u>	<u>(125)</u>	<u>(125)</u>	<u>(125)</u>	<u>(125)</u>

remeasured							
Gross profit	100	75	95	75	75	75	75
Interest cost	<u>(4)</u>	<u>(4)</u>	<u>(4)</u>	<u>(4)</u>	<u>(4)</u>	<u>(4)</u>	<u>(4)</u>
Net profit	96	71	91	71	71	71	71
Monetary							
gain on debt	0	0	2	0	2	0	0
Realised							
holding gain							
on stock	<u>0</u>	<u>0</u>	<u>0</u>	<u>25</u>	<u>20</u>	<u>0</u>	<u>25</u>
Total gains	96	71	93	96	93	71	96
Capital							
Maintenance							
adjustment	<u>0</u>	<u>0</u>	<u>0</u>	<u>(3)</u>	<u>0</u>	<u>0</u>	<u>(15)</u>
Dividend							
Paid	<u>96</u>	<u>71</u>	<u>93</u>	<u>93</u>	<u>93</u>	<u>71</u>	<u>81</u>
Balance							
Balance Sheets	£	£	£	£	£	£	£
Balance Sheets Cash (£196	£	£	£	£	£	£	£
Balance Sheets Cash (£196 less dividend	£	£	£	£	£	£	£
Balance Sheets Cash (£196 less dividend paid)	£ 100	£ 125	£ 103	£ 103	£ 103	£ 125	£ 115
Balance Sheets Cash (£196 less dividend paid) Debt	£ 100 (40)	£ 125 (40)	£ 103 (40)	£ 103 (40)	£ 103 (40)	£ 125 (40)	£ 115 (40)
Balance Sheets Cash (£196 less dividend paid) Debt	£ 100 (40) <u>60</u>	£ 125 (40) <u>85</u>	£ 103 (40) <u>63</u>	£ 103 (40) <u>63</u>	£ 103 (40) <u>63</u>	£ 125 (40) <u>85</u>	£ 115 (40) <u>75</u>
Balance Sheets Cash (£196 less dividend paid) Debt	£ 100 (40) <u>60</u>	£ 125 (40) <u>85</u>	£ 103 (40) <u>63</u>	£ 103 (40) <u>63</u>	£ 103 (40) <u>63</u>	£ 125 (40) <u>85</u>	£ 115 (40) 75
Balance Sheets Cash (£196 less dividend paid) Debt Share Capital	£ 100 (40) 60	£ 125 (40) <u>85</u> 60	£ 103 (40) <u>63</u> 63	£ 103 (40) <u>63</u> 60	£ 103 (40) 63 60	£ 125 (40) <u>85</u> 60	£ 115 (40) <u>75</u> 60
Balance Sheets Cash (£196 less dividend paid) Debt Share Capital Revenue	£ 100 (40) 60	£ 125 (40) <u>85</u> 60	£ 103 (40) <u>63</u> 63	£ 103 (40) 63 60	£ 103 (40) 63 60	£ 125 (40) 85 60	£ 115 (40) 75 60
Balance Sheets Cash (£196 less dividend paid) Debt Share Capital Revenue reserve	£ 100 (40) 60 0	£ 125 (40) <u>85</u> 60 0	£ 103 (40) 63 63 0	£ 103 (40) 63 60 0	£ 103 (40) 63 60 0	£ 125 (40) <u>85</u> 60 0	£ 115 (40) 75 60 0
BalanceSheetsCash (£196less dividendpaid)DebtShareCapitalRevenuereserveCapital	£ 100 (40) 60 60 0	£ 125 (40) <u>85</u> 60 0	£ 103 (40) 63 63 0	£ 103 (40) 63 60 0	£ 103 (40) 63 60 0	£ 125 (40) <u>85</u> 60 0	£ 115 (40) 75 60 0
Balance Sheets Cash (£196 less dividend paid) Debt Share Capital Revenue reserve Capital reserve	£ 100 (40) 60 0 0	£ 125 (40) <u>85</u> 60 0 <u>25</u>	£ 103 (40) 63 63 0 0	£ 103 (40) 63 60 0 3	f 103 (40) 63 60 0 <u>3</u>		£ 115 (40) 75 60 0 <u>15</u>

Table Six - Comparison of general purpose income statements

To demonstrate the aforementioned issues a simple case study is presented in the table above. The case is taken from the appendix to chapter five of the UK ASB's draft Statement (UK ASB 1995, p. 94), which shows a 'real gains' income model. A company purchases stock for £100 on the first day of the financial year and sells the stock for £200 on the last day of the financial year. It is assumed that over the year general prices rise by 5% and the cost of stock increases by 25%. The company pays out all its income as a dividend. The first two columns, 'Historical cost' and 'historical cost remeasured' are based on the IASB's 'Reporting Comprehensive Income' project statement (Barker and Zaman 2003) which shows either a dividend of £96 (based on historical cost) or £71 (with remeasurement). The IASB's other solution to changes in prices, CPP (IAS 29), shows a dividend of £93. The 'real gains' system shows total gains of £96 less a real financial capital maintenance adjustment of £3 to yield a £93 dividend. The next column is based upon the original current cost accounting model of Sandilands with a £71 dividend. Finally, the method proposed under SSAP 16 is presented, yielding a dividend of £81. SSAP 16 allowed a 'gearing adjustment', which in this case is £10 or 40% of the realised holding gain on stock. After the dividend has been paid, CPP and real gains enable the company to have the same purchasing power at the beginning of the second year as the first, the IASB's remeasurement and Sandilands approach allow the stock to be repurchased thus maintaining physical capital, SSAP 16 allows the stock to be repurchased if debt rises to the opening gearing percentage, and the IASB's historical cost approach maintains money capital but does not maintain purchasing power or physical capital.

The IASB's project on comprehensive income (Baker and Zaman 2003) is important because it contains a hidden choice of capital maintenance concept. Income is either presented 'without remeasurement' or 'with remeasurement'. Thus, there is an implicit choice between historical cost and fair value. Any holding gain or loss caused by remeasurement is not added back to income to get a 'total gains' figure. Thus the IASB's 'remeasurement' system is closer to Sandiland's current cost than one might initially imagine, where capital maintenance is 'hidden' because the cost of sales adjustment goes straight to a capital reserve. Whether the IASB's choice of capital maintenance concept in its comprehensive income project is deliberate or an accident is unclear, as there is no reference to capital maintenance in the project summaries. The authors argue that the IASB should undertake a project on capital maintenance to make the choice between capital maintenance concepts more explicit. If physical capital or money capital were to be chosen, as the comprehensive income project implies, the other capital maintenance concepts will have been ignored.

If one extends the above example by changing the general price rise from 5% to 100%, then the IASB's rules on accounting in hyperinflationary countries (IAS 29) come into force. The historical cost system becomes the same as the CPP system but, interestingly, the 'remeasurement' system becomes the same as the 'real gains' system. This is because IAS 29 uses the stable unit or CPP system, which is a 'secondary' system, i.e., it can sit on top of any other system such as VTB and fair value. So the UK ASB's 'real gains' system is hidden in the IASB's proposals!

Relationship between Accounting Standards and CFs

At present, it appears that the 1989 Framework provides the reference point for the development of new or revised IFRSs:

'As, however, the Board of the IASC will be guided by the Framework in the development of future Standards and in its review of existing Standards, the number of cases of conflict between the Framework and International Accounting Standards will diminish through time' (IASC 1989, paragraph 3).

However, at the same time, the Framework is being reconsidered and is open to negotiation and future change. This is likely to result in confused accounting rules, as inconsistencies develop between the Framework and IFRSs. The IASB has itself acknowledged this problem:

'The Framework is not an International Accounting Standard and does not define standards for any particular measurement or disclosure issue. In a limited number of cases there may be a conflict between the Framework and a requirement within an International Accounting Standard. In those cases where there is a conflict, the requirements of the International Accounting Standard prevail over those of the Framework' (IASB 2001b).

A similar comment is to be found in the UK ASB's Statement, which suggests that the problem of discrepancies between the Framework and IFRSs is simply an extension of concerns at the national level, where differences arise between a country's CF and its accounting standards. Indeed, the reformulation of CFs appears to be fairly low down on most standard setters' lists of priorities, given the amount of work involved. The Institute of Chartered Accountants in England and Wales (ICAEW) claims that 'most of the reformers also show little appetite for the heavy work needed to revisit

and extend the conceptual frameworks of the accounting standard-setters or to develop alternatives' (ICAEW 2003, p.16).

It could be argued that if the IASB's movement towards convergence and worldwide adoption of IFRSs is to be successful, an agreed upon and consistent conceptual framework is necessary. Collaboration among the IASB and national standard setters on the issue of conceptual guidance for measurement objectives would be consistent with current convergence initiatives at the standards level. For example, the UK ASB's Statement was based on the IASB Framework but introduced new concepts, such as fair value, that have now been incorporated into IFRSs. However, there does not appear to have been any effort to converge national and international CFs and eliminate any discrepancies, despite the fact that logically this would be the best place to start!

As a result of the convergence of accounting standards, many conceptual issues are being inherently decided upon, which should surely influence any future international CF. However, if the IASB were to base any future international CF on existing national CFs, any differences between IFRSs and the international CF would be the same as those identified at the national level. Alternatively, if any future international CF were to be based on the international standards then there will be differences between national and international CFs. Whichever way one looks at it, problems will arise because the convergence of CFs was not dealt with in the first instance.

Conclusion

This paper suggests that the current international CF is increasingly out-of-date, as it ignores many of the developments that have been undertaken by national standard setters post 1989. The current IASB/AcSB measurement project will clearly influence any new CF by defining the second determinant of income, the manner in which assets and liabilities are valued. If one assumes that a new Framework will be issued at some point in the future, one can speculate as to which general accounting model it will reflect. It is evident from the UK ASB's Statement and newly developed IFRSs that a single value-based model is out-of-fashion and that a 'mixed measurement system' is favoured. However, the exact relationship between 'fair value' and 'current value' has yet to be established. There is no reference to the unit of currency and little reference to capital maintenance in the UK ASB's Statement, and so any new Framework is unlikely to devote much space to these two aspects of income measurement, particularly given that they attract very little political interest. To conclude, the authors believe that the nominal unit of currency, fair value and money capital would be the three most likely candidates for the three determinants of income. However, money capital maintenance does not easily fit with the IASB's proposed comprehensive income 'remeasurement' model, as it is not clear whether holding gains are to be treated as income or capital. Until this question is answered, the IASB will continue to search for a meaningful measure of performance.

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