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16 August 2013

Ms Stephenie Fox
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto
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CANADA

Dear Ms Fox

IPSASB Exposure Draft *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Presentation in General Purpose Financial Reports*

The Australian Accounting Standards Board (AASB) is pleased to provide its comments on the above named Exposure Draft (ED). In formulating its comments, the AASB considered the views received from Australian constituents.

General Comments

The AASB's general comments on the IPSASB ED are very similar to those made in the AASB's submissions (dated 15 May 2013 and 3 June 2013) on the IPSASB Conceptual Framework EDs *Elements and Recognition in Financial Statements* and *Measurement of Assets and Liabilities in Financial Statements*, as they are generally pertinent to the IPSASB's Conceptual Framework project in its entirety.

Due process

The AASB recommends that the IPSASB issues an omnibus ED incorporating its proposed Conceptual Framework after it has redeliberated all of its Conceptual Framework EDs, rather than finalising its Conceptual Framework without further consultation. An omnibus ED would enable the IPSASB's constituents to comment on the IPSASB's latest thinking on all of its proposals in its Conceptual Framework project, and to have regard to recent developments in financial reporting (including developments in the Conceptual Framework project of the International Accounting Standards Board [IASB]). This would enable the IPSASB's constituents to gain a holistic perspective together with greater context, and this should facilitate both internal consistency within the IPSASB's Conceptual Framework and either alignment with, or understanding of reasoning for differences from, the IASB Conceptual Framework.

Subsequent review and update of the IPSASB Conceptual Framework

The AASB recommends that the IPSASB should regard its Conceptual Framework as a living document, and thus should commit to reviewing and updating it from time to time in light of subsequent developments in financial reporting. The timing of such reviews should reflect the IPSASB's resources and priorities, and developments in conceptual thinking. Such developments would include any changes in thinking about concepts occurring in the development of recent IPSASs, in addition to developments in Conceptual Frameworks of other standard setters. This approach would be particularly beneficial, for example, in respect of concepts of presentation and disclosure. The AASB considers that thinking on these concepts is still in the early stages of development, on the part of the IPSASB, the IASB and the international financial reporting community generally. Therefore, it seems likely that thinking on concepts of presentation and disclosure will continue to evolve further. Under circumstances such as these, it is important not to treat the IPSASB Conceptual Framework as an immutable document. Specific comments on the importance of revisiting the topics of presentation and disclosure in the IPSASB Conceptual Framework are set out further below in this letter.

Relationship between the IPSASB and IASB Conceptual Framework projects

The AASB recommends that the IPSASB maximises its liaison with the IASB regarding those Boards' respective Conceptual Framework projects, in the context of the Memorandum of Understanding between the International Federation of Accountants and the IASB dated 22 November 2011.

Ideally, the IPSASB and IASB Conceptual Frameworks would be complementary, where the only differences are those warranted by differences in circumstances. This would support the development of IPSASs and International Financial Reporting Standards (IFRSs) that differ only where necessary to deal with different economic phenomena. This approach is also likely to assist users of general purpose financial reports (GPFRs) who read financial reports across all sectors in the economy, which is important given the fundamental objective of general purpose financial reporting to meet users' information needs.

In relation to presentation and disclosure in particular, the AASB's encouragement of complementary concepts of the IPSASB and IASB is premised on the assumption that the IASB develops comprehensive concepts for presentation and disclosure, either within its current Conceptual Framework project or in revisiting those topics as conceptual thinking evolves.

The AASB's arguments in relation to the IPSASB ED in this submission are mainly focused on technical issues, and not primarily on whether the IPSASB's proposals are consistent with the tentative thinking of the IASB in its Conceptual Framework project.

Specific Comments

The AASB's most significant specific comments regarding the issues in the ED are set out below and elaborated on in Appendix A.

Conditional support for the proposed Presentation chapter of the IPSASB Conceptual Framework

The AASB congratulates the IPSASB for addressing the topic of presentation without the assistance of a well-developed standard setting literature on the topic, and for producing an ED that is well-structured and concise.

As explained previously, the AASB considers that the ED should be regarded as an evolutionary document and therefore should only form the basis of a Conceptual Framework chapter on Presentation if the IPSASB commits to reviewing and updating that chapter on a timely basis in light of the outcomes of various international projects on presentation and/or disclosure currently in progress (including the IASB's work on concepts for presentation and disclosure as part of its Conceptual Framework project). An IPSASB chapter based on the ED should be considered as an interim stage of the IPSASB's concepts on Presentation, because the ED does not include sufficient principles that would be useful in answering the Presentation questions the ED identifies. These comments are elaborated on below.

<u>Adequacy of proposed principles</u>

Although the IPSASB Conceptual Framework indicates its role is primarily to set out concepts that the IPSASB will apply in developing IPSASs and Recommended Practice Guidelines (RPGs), the ED does not appear to contain sufficient principles to assist the IPSASB in making decisions about presentation, display or disclosure in the development or review of IPSASs and RPGs.

The principles in the ED seem to essentially be limited to those set out elsewhere in the finalised and proposed chapters of the IPSASB Conceptual Framework. The AASB considers that the finalised chapter on Presentation should indicate which parts of its content are simply consequences of other chapters of the IPSASB Conceptual Framework and which parts (if any) cover new or separate aspects.

The AASB observes that international debate about the subject matter of the IPSASB ED is emerging and largely undeveloped. In this regard, in May 2013 the IASB issued a Feedback Statement (entitled *Discussion Forum—Financial Reporting Disclosure*) noting:

(a) the current projects of eight accounting bodies (or similar entities) [including the IASB, European Financial Reporting Advisory Group, US Financial Accounting Standards Board, the Institute of Chartered Accountants of Scotland and the New Zealand Institute of Chartered Accountants] dealing with presentation, display, disclosure and materiality, chiefly at a framework level; and

(b) the undeveloped nature of both the accounting literature and the international debate, regarding this general topic.

Another development with potential implications for the international debate regarding Presentation (and also for other parts of Conceptual Frameworks) is an Essay on a Disclosure and Presentation Framework published by the AASB on 14 August 2013 (copy attached). The essay contends there is a gap in the conceptual framework that, if filled, would improve our ability to provide accounting responses to users' needs, including through the development of a better, purpose-driven disclosure and presentation framework. The essay contends there are a limited number of generic types of information, termed "stocks" and "flows", that characterise all types of entities to one degree or another. The essay contends the gap in the framework falls between the objective level and the lower levels. Both the objective and the stocks and flows identified are part of entities' environments. The selections of qualitative characteristics, elements, measurement bases and presentation/disclosure approaches are seen as accounting responses aimed at satisfying users' needs for information for decision making (the "objective"). Specification of the relevant stocks and flows could also bring meaning to "financial position" and "performance", and potentially provide a way to define financial reporting, bounding it by the generic stocks and flows identified.

The AASB is not aware of any public sector specific considerations that would reduce the usefulness of the above-mentioned international debate in assisting the IPSASB to develop a more comprehensive revised chapter on Presentation for its Conceptual Framework.

For these reasons, the AASB strongly encourages the IPSASB to announce that, in view of the emerging but largely undeveloped international debate about presentation, it will review and update its Presentation chapter on a timely basis in light of the outcomes of various international projects on presentation and/or disclosure currently in progress. In addition, the AASB strongly encourages the IPSASB to participate in that debate.

Terminology

The AASB considers that, to avoid confusion and unnecessary change, 'presentation' should not be the overarching term that encompasses the selection, location and organisation of information in a GPFR. Instead, the AASB considers that either 'display' or 'disclosure' (whichever is more generally accepted) should be used, as these are more descriptive of the underlying notions in the ED. (Despite this view, this submission refers to the chapter on 'Presentation', for consistency with the IPSASB ED's expression.)

These comments are elaborated on below, and further in the AASB's response to Specific Matter for Comment 1 in Appendix A.

Distinction between 'display' and 'disclosure'

The AASB is pleased to note that the IPSASB has responded to the concern expressed by the AASB and others, regarding the IPSASB's Consultation Paper (CP) on Presentation, that 'core information' (i.e. information shown on the face of a financial statement) should not be treated as more important than 'supporting information' (i.e. information shown in a note). However, the AASB considers that the IPSASB has responded to that concern in an ambiguous manner. This is explained in the comments on Specific Matter for Comment 1 in Appendix A.

The AASB considers that the IPSASB Conceptual Framework chapter on Presentation should clarify more effectively than in the ED that, in serving the objective of financial reporting:

(a) some information in a GPFR is more critical than other information;

(b) how information is displayed can affect its interpretation by users; and

(c) information shown on the face of a financial statement is not necessarily more critical than information shown in a note.

The AASB's responses to all of the specific matters for comment in the ED are set out in Appendix A.

If you have any queries regarding matters in this submission, please contact me or Jim Paul (jpaul@aasb.gov.au).

Yours sincerely

K.M. Stevenson

Kevin Stevenson
Chairman and CEO

APPENDIX A

AASB's response to the Specific Matters for Comment on the ED

Specific Matter for Comment 1

Do you agree with the proposed descriptions of 'presentation', 'display' and 'disclosure' and the relationships between them in Section 1? If not, how would you modify them?

Summary

1 The AASB disagrees with the proposed descriptions of 'presentation', 'display' and 'disclosure' and the relationships between them in Section 1. In particular, the AASB considers that:

(a) 'presentation' should not be an overarching term; instead, 'display' or 'disclosure' (whichever is more generally accepted) would be a better term for that role; and

(b) the draft Framework chapter on Presentation should clarify that information shown on the face of a financial statement is not more important than information shown in the notes to the financial statements.

These aspects and related concerns are elaborated on in paragraphs 2 – 14 below.

Terminology

2 Consistent with the comments in the AASB's submission on the IPSASB's Presentation CP, the AASB does not support the ED's proposed meanings of 'presentation', 'display' and 'disclosure'. The AASB considers that, instead of giving 'presentation', 'display' and 'disclosure' the meanings in the ED, ideally 'display' should be used as the term encompassing the structure of financial reports, the nature and amount of information disclosed in financial reports and the manner in which those disclosures are presented. Furthermore, the AASB is of the view that it should be unnecessary to define 'presentation' and 'disclosure'. The AASB considers that the plain English meaning of 'display' seems appropriate for this part of the Conceptual Framework, and that 'display' has the advantage of less connotations relating to particular aspects of practice.

3 The AASB notes that the IASB's Discussion Paper DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting* (July 2013) refers to 'disclosure' and 'presentation'. The IASB DP describes 'disclosure' as "the process of providing useful financial information about the reporting entity to users" (paragraph 7.11) and 'presentation' as "the disclosure of financial information on the face of an entity's primary financial statements" (paragraph 7.10). Thus, the IASB DP treats 'disclosure' as an overarching term.

4 The AASB presently intends to express disagreement, in its submission on the IASB DP, with using ‘disclosure’ (rather than ‘display’) as an overarching term. However, because the AASB would not consider ‘display’ to be a fundamentally superior term to ‘disclosure’, if the IASB were to confirm the preliminary view in its DP that ‘disclosure’ should be used as an overarching term, the AASB would consider it more important that the IPSASB’s and IASB’s terminology is consistent than for the IPSASB to use ‘display’ as an overarching term. Moreover, the AASB would prefer either of these terms to ‘presentation’ as an overarching term.

Distinction between ‘display’ and ‘disclosure’

5 The AASB considers that, in serving the objective of financial reporting:

(a) some information in a GPFR is more critical than other information for assessing an entity’s condition and prospects and the rendering of its accountability. Effective communication of financial information to users of financial reports requires more critical information to be displayed in a manner that assists users to identify its importance;

(b) how information is displayed can affect its interpretation by users. For example, academic research has found that disclosure in notes will not remedy non-recognition or poor recognition of elements of financial statements; and

(c) information shown on the face of a financial statement (either separately or within a total) is not necessarily more critical than information shown in a note. For example, whether information about an item is shown on the face of a financial statement will depend on matters such as:

(i) whether the item itself meets the definition and recognition criteria for an element of financial statements. For example, information about an event (e.g. the commencement of legal proceedings against the entity) might be disclosed only in the notes because the event does not give rise to an element of financial statements that qualifies for recognition (e.g. a liability), but might nonetheless be one of the most critical items of information in the entity’s GPFR; and

(ii) the nature of the information about that item, regardless of whether that item is recognised in the financial statements. For example:

(A) some critical information about an entity might be about the entity’s legal or economic environment, such as a change in laws affecting the entity’s future operations, rather than an element of financial statements;

(B) critical disclosures about measurement uncertainties and of a sensitivity analysis might need to be made in notes due to their volume and complexity; and

(C) some accounting policies adopted and judgements made in applying accounting policies might be critically important information for users of an entity's financial report.

6 In relation to paragraphs 5(a) and 5(b) above, how information is displayed (and, in particular, how more critical information is distinguished from other information) can affect its interpretation by users – but this is a more complex and nuanced issue than merely a dichotomy between 'display' and 'disclosure' (as those terms are used in the IPSASB ED). The IPSASB ED's heavy emphasis on the distinction between 'display' and 'disclosure' risks being interpreted as implying information shown on the face of a financial statement is more critical than information shown in a note (see also the comments in paragraphs 7 – 14 below).

7 The AASB considers that the IPSASB Conceptual Framework chapter on Presentation should clarify the aspects in paragraph 5 above more effectively than in the ED. In particular, in relation to the point in paragraph 5(c) above, the AASB:

(a) is pleased to note that the IPSASB has responded to the concern expressed by the AASB and others, regarding the IPSASB's CP on Presentation, that 'supporting' information should not be treated as less important than 'core' information; but

(b) considers that the IPSASB has responded to that concern in an ambiguous manner. This is explained in the comments in paragraphs 8 – 13 below; and

(c) notes that the point in paragraph 5(c)(i) above is acknowledged in paragraph BC4 of the Basis for Conclusions on the IPSASB ED, but considers that it should be expressed more prominently in the Presentation chapter of the IPSASB Conceptual Framework.

Ambiguity regarding the distinction between 'display' and 'disclosure'

8 The Basis for Conclusions on the ED says:

> "The need to distinguish the display and disclosure of information is a further important aspect of the IPSASB's overall approach to presentation." (paragraph BC14, first sentence)

9 However, the Basis for Conclusions does not explain why this distinction is important, and the ED does not seem to provide clear criteria for making that distinction. The AASB is concerned that the ED might be read as implying that all key information is displayed on the face of the appropriate financial statement, and other information (disclosed in the notes) merely makes that key information more useful. Such an interpretation would be similar to how some respondents (including the AASB) interpreted the IPSASB's CP on Presentation as indicating that 'supporting' information is less important than 'core' information.

10 The AASB notes that, regarding the IPSASB's reassessment of its preliminary view in its CP regarding 'core' and 'supporting' information, paragraph BC9 of the IPSASB's Basis for Conclusions on its ED says:

> "…There was no intention to imply that supporting information is less important than core information. … the terms core information and supporting information have not been retained and the descriptions of display and disclosure have been revised to explain what types of information would be displayed and what disclosed, without the implication that one type of information is more important than the other."

11 The AASB supports the removal of the distinction between 'core' and 'supporting' information and the statement in paragraph BC9 that displayed information is not more important than disclosed information. However, the AASB is concerned that these messages are clouded by the following comments in the IPSASB ED:

> "Information selected for display communicates *the* key messages in a GPFR." (paragraph 1.3, first sentence, emphasis added); and
>
> "Disclosed information makes displayed information more useful, by providing detail that will help users to understand the displayed information …" (paragraph 1.4, first sentence).

12 The AASB notes that the statement in paragraph 1.3 of the ED that information selected for display communicates *the* key messages in a GPFR might be interpreted—inconsistently with paragraph BC9—as indicating that <u>all</u> key information is presented on the face of a financial statement.

13 In addition, the comment in paragraph 1.5 (second sentence) of the ED that "Disclosure is not a substitute for display" merits clarification. Possibly, the statement is intended to rephrase the principle in paragraph 7.2 of the IPSASB ED on 'Elements and Recognition' (November 2012) that disclosure is not a substitute for recognition (which the AASB supports – see paragraph 5(b) above). However, it could also be read as implying displayed information is more important than disclosed information, particularly if the reader does not read the much later comment in paragraph BC9 (quoted in paragraph 10 above).

14 The AASB considers it is important that the IPSASB clarifies the matters discussed in paragraphs 5 – 13 above, and that, in this regard, it would be useful to include the clarifying comments in paragraph BC9 in paragraph 1.6 of the ED, to put paragraphs 1.3 – 1.5 of the ED in context.

Specific Matter for Comment 2

Do you agree with the identification of three presentation decisions (selection, location and organisation) in Section 1? If not, how would you modify the identification of presentation decisions?

15 The AASB supports the identification of the three presentation decisions (selection, location and organisation) in paragraphs 1.8 – 1.10 of Section 1. However, as noted in paragraphs 2 – 4 above, the AASB considers that these decisions would more appropriately be collectively described as 'display decisions' (where 'display' has a

broader meaning than that attributed to it in the IPSASB ED), subject to whether the IASB confirms the preliminary view in its Conceptual Framework DP that ‘disclosure’ should be used as an overarching term.

Specific Matter for Comment 3

Do you agree with the proposed approach to making presentation decisions in Section 1? If not, how would you modify it?

16 The AASB supports the strong emphasis in Section 1 on striving to meet the objective of financial reporting when making presentation decisions. As the Essay on a Disclosure and Presentation Framework published by the AASB (referred to earlier in this submission) argues, there is a gap in the conceptual framework between the objective level and the lower levels. Filling that gap is necessary to flesh out the objective and, among other things, serve as a basis for developing principles for the presentation level of a Conceptual Framework. Therefore, whilst the AASB agrees that the starting point for presentation decisions is the objective of financial reporting, it considers there is much work to be done to support meeting that objective. In this regard, the AASB notes the apparent lack of guidance in Section 1 (and elsewhere in the ED) on how the IPSASB would use the draft Presentation chapter to make presentation decisions in the development or review of IPSASs and RPGs.

17 It is unclear to the AASB how this Specific Matter for Comment fundamentally differs from Specific Matter for Comment 1 (which also addresses key aspects of Section 1 of the ED). As mentioned in its comments on Specific Matter for Comment 1, the AASB considers that the IPSASB Conceptual Framework chapter on Presentation should clarify more effectively than in the ED that, in serving the objective of financial reporting:

(a) some information in a GPFR is more critical than other information;

(b) how information is displayed can affect its interpretation by users; and

(c) information shown on the face of a financial statement is not necessarily more critical than information shown in a note.

Specific Matter for Comment 4

Do you agree with the description of information selection in Section 2:

(a) In the financial statements; and

(b) Within other GPFRs?

If not, how would you modify the description(s)?

18 The AASB’s primary concern regarding Section 2 on information selection is that it does not seem to meet the IPSASB’s stated objective of providing criteria that would be useful for the IPSASB in developing or reviewing requirements (or

guidance) on information selection in IPSASs or RPGs (see comments on page 3 of this submission).

19 Based on Section 2, it would appear that decisions about information selection are to be made largely (if not completely), in effect, by considering other finalised and proposed chapters of the IPSASB Conceptual Framework. For example, paragraph 2.10 of the ED seems essentially to repeat the qualitative characteristics (QCs) in the QCs chapter of the IPSASB Conceptual Framework (January 2013). The AASB considers that the finalised chapter on Presentation should indicate which parts of its content are simply consequences of other chapters of the IPSASB Conceptual Framework and which parts (if any) cover new or separate aspects.

20 In addition, the AASB considers paragraph 2.1(c) to be confusing and potentially circular. Did the IPSASB intend indicating that an entity should consider information reported by that entity in other, limited-purpose, GPFRs (e.g. detailed financial reports on long-term sustainability of an entity's finances)? The AASB recommends that the IPSASB clarifies its intended meaning in paragraph 2.1(c).

Specific Matter for Comment 5

Do you agree with the description of information location in Section 3:

(b) In the financial statements;

(b) In other GPFRs; and,

(c) Between different reports within GPFRs?

If not, how would you modify the description(s)?

21 The AASB's primary concern regarding Section 3 on information location is that it does not seem to meet the IPSASB's stated objective of providing criteria that would be useful for the IPSASB in developing or reviewing requirements (or guidance) on information location in IPSASs or RPGs (see comments on page 3 of this submission).

22 The AASB also notes that paragraph 3.3(c) says a factor affecting information location is any jurisdiction-specific factors such as legal provisions. The AASB is concerned that, without clarification, that comment could be interpreted as giving conceptual endorsement to jurisdiction-specific laws even if they are incompatible with the IPSASB's Presentation concepts. The AASB recommends clarifying in the IPSASB Framework that this would not be the case.

Specific Matter for Comment 6

Do you agree with the description of information organisation in Section 4:

(c) In the financial statements; and

(b) In other GPFRs?

If not, how would you modify the description(s)?

23 The AASB's primary concern regarding Section 4 on information organisation is that it does not seem to meet the IPSASB's stated objective of providing criteria that would be useful for the IPSASB in developing or reviewing requirements (or guidance) on information organisation in IPSASs or RPGs (see comments on page 3 of this submission).

Specific Matter for Comment 7

Do you consider that CF—ED4 contains sufficient detail on concepts applicable to presentation in GPFRs, including the financial statements, of governments and other public sector entities? If not, how would you extend the proposals?

24 Consistent with its comments above on Specific Matters for Comment 4, 5 and 6, the AASB considers that the IPSASB ED does not contain sufficient detail on concepts applicable to presentation in GPFRs, including the financial statements, of governments and other public sector entities to meet the IPSASB's stated objective of providing criteria that would be useful for the IPSASB in developing or reviewing requirements (or guidance) on information selection, location and organisation in IPSASs or RPGs. Because of the early stage of development of the international debate on presentation and disclosure, the AASB does not propose particular additional or different conceptual guidance. Instead, the AASB strongly encourages the IPSASB to announce that, in view of the emerging but largely undeveloped international debate about presentation, it will review and update its Presentation chapter on a timely basis in light of the outcomes of various international projects on presentation and/or disclosure currently in progress. In addition, the AASB strongly encourages the IPSASB to participate in that debate.

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AASB Essay 2013-1

Rethinking the Path from an Objective of Economic Decision Making to a Disclosure and Presentation Framework

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Rethinking the Path from an Objective of Economic Decision Making to a Disclosure and Presentation Framework

Synopsis

In this essay it is contended there is a gap in the conceptual framework that, if filled, would improve our ability to provide accounting responses to users' needs, including through the development of a better, purpose-driven disclosure and presentation framework. The thesis is that there are a limited number of generic types of information, termed stocks and flows, that characterise all types of entities to one degree or another.

The essay contends that the gap in the framework falls between the objective level and the lower levels. Both the objective and the stocks and flows identified are part of entities' environments. The selections of qualitative characteristics, elements, measurement bases and presentation/disclosures approaches should be seen as accounting responses aimed at satisfying users' needs for information for decision making (the "objective").

Specification of the relevant stocks and flows could also bring meaning to "financial position" and "performance", as well as potentially providing a way to define financial reporting, bounding it by the generic stocks and flows identified.

Introduction[1]

Financial reporting can be characterised as a relatively young information science that aims to provide the users of financial reports with information that faithfully depicts the economic condition[2] of an entity and enables users to assess that condition and changes in it. In doing so, the purpose is to help those users to make decisions about the allocation of scarce resources to an entity and within an entity; that is, whether to make, or cause to be made[3], new allocations, or to confirm those of the past.[4]

It is often contended that, for users to be able to make such decisions, they need information that helps them assess the amount, timing and uncertainty of future cash flows. Indeed, this is stated in paragraph OB3 of Chapter 1 of the IASB's revised Conceptual Framework[5]. It is further contended that the various types of users, in both the private and public sectors, have common information needs for such information, albeit for several types of decisions about the allocation of scarce resources.

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1 The author acknowledges the very useful input received from Robert Keys, Angus Thomson, Jim Paul and other staff of the AASB, as well as Warren McGregor, Mike Bradbury and members of the Accounting Standards Special Interest Group of the Accounting and Finance Association of Australia and New Zealand.

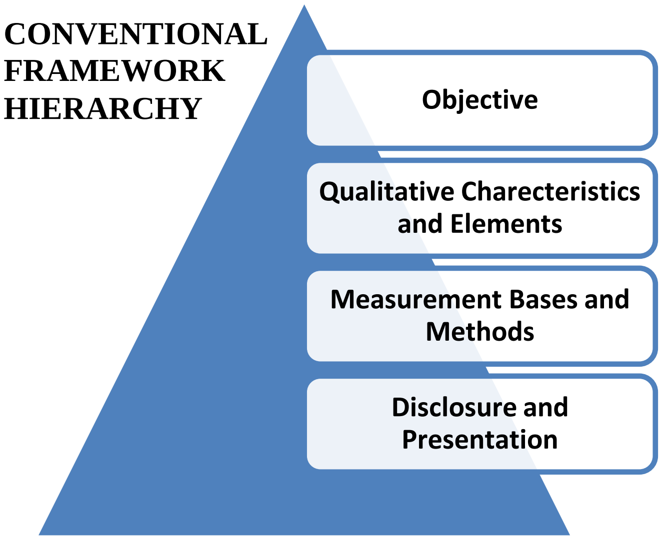
2 The phrase "economic condition" used here is purposefully broad; to be filled out by the essay as it goes. Readers please bear with me.

3 This is intentionally wide, covering both the prospect of changing a party's direct interest and influencing the decision making of those governing an entity.

4 This essay does not explore accountability as an objective of financial reporting. Rather it uses that term to mean the responsibility of preparers to provide information that is useful for economic decision making.

5 IASB *Conceptual Framework for Financial Reporting*, September 2010.

We have become accustomed to a view of the resulting conceptual framework as depicted below:



The IASB's Framework goes on to say, in paragraph OB4, that "to assess an entity's prospects for future net cash inflows, existing and potential investors, lenders and other creditors need information about the resources of the entity, claims against the resources of the entity, and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources." The connection made between users' needs and the characteristics of the entity is not explored in depth. Indeed, in this essay it is contended that there is a missing link in the Framework between the objective and the lower reaches of the Framework. This means that when the IASB or others try to provide accounting responses to satisfy users' needs they do not always have guidance from the Framework on which to depend. This doesn't bode well for determining a disclosure and presentation framework.

For much of the history of accounting standards, debates have been bound up primarily in recognition and measurement, often on a topical basis (for example, leases, revenue, financial instruments). Along the way we have accumulated a large body of required, but somewhat un-rationalised[6], disclosures mostly stemming from expounding on recognised items in balance sheets, income statements and cash flow statements. In more recent times, we have seen a trend towards adding risk disclosures, consistent with the idea of conveying information about uncertainty. We have also seen a rise in the importance attached to business models, which has tended to bring new disclosures, sometimes promising increased relevance and sometimes exhibiting nervousness about depending on a less than defined notion that could mean different things to different people or perhaps be manipulated.

Our current disclosure regime might be characterised as largely, though not exclusively (for the reasons mentioned above), topically driven. Within each topic, we have, to one degree or another, increasingly tried to draw out information about cash flow implications (for example, the requirements for maturity analyses for financial and non-financial liabilities). Our approach to presentation has not been explicitly linked to a logic that might also drive disclosure. Rather, it has been characterised by minimum required line items, somewhat stilted formatting and limited ordering principles (for example, use of liquidity order).

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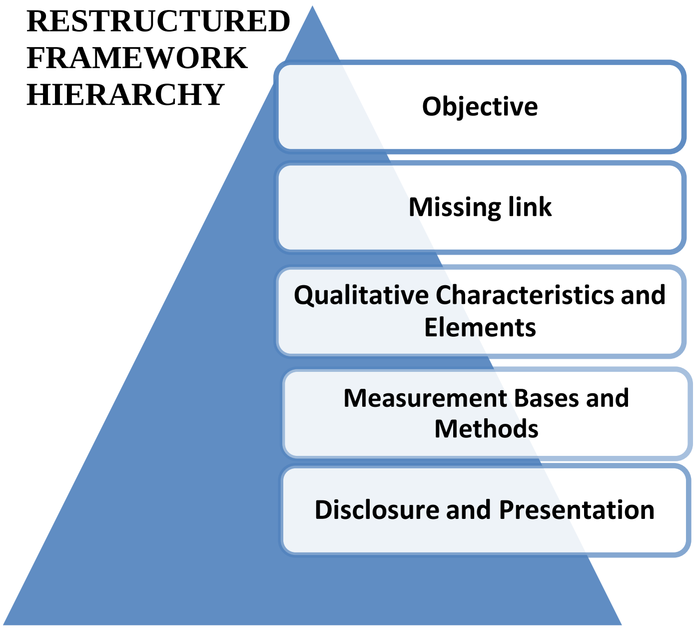
6 In the sense we have not seen a comprehensive review of disclosures based on explicitly rendered principles.

Early in its life as a workshop draft, this essay questioned whether accumulating information in that manner was appropriate and whether we would be better served to think about the possible purposes of different types of information and how those purposes might relate to the decision making of users. The essay was intended to discern the principles that might be included in the conceptual framework to cover disclosure and presentation. As time went on and various commentators raised questions, it became clear that the focal point of the essay should be the identification of the characteristics of entities with which users would need to be concerned in order to make decisions about allocating scarce resources.

This focus is about the "economics of the entity" that need to be considered before coming to any accounting constructs or responses. And it is a focus that should drive all such constructs and responses, not just disclosure and presentation. Accordingly, the essay is more about the generic characteristics of entities that should be identified before we think about qualitative characteristics, elements or measurement concepts.

In essence, the essay says we have been glib about economic decision making and too ready to accept somewhat unexplored phrases such as "the amount, timing and uncertainty of cash flows". The essay does not decry information about the amount, timing and uncertainty of such flows. Rather, it calls for identification of the generic characteristics of entities that will enable users to understand the significance of that information at understandable levels of aggregation and classification.

The informational abstractions we do mention in relation to existing financial statements include "financial position" and "results for a period". Sometimes we might mention amounts that are connected with financial analysis, such as "performance", "free cash flow", "underlying earnings" and, as indicated above, in quite recent times, exposures to various forms of risk. However, we are vague in the use of most of these terms and readers might well ask "what are you really trying to tell us?" Critically, there has been little explicit connection between the accounting constructs and responses and what might be expected to be deduced from them. Accordingly, in addition to there being a possible missing link between the objective and the rest of the Framework, the topic of disclosure and presentation needs to be handled at a much higher level in the Framework. We need to know what we are trying to convey before deciding on when and how. Therefore, the conventional framework might be re-depicted as:



Sometimes, we standard-setters have contended that financial analysis is not our business, but rather that of users. Whilst possibly correct at one level, standard-setters and preparers choose what, when and how to measure, and we use presentation, classification, and ordering, to turn data into information. To make choices, implicitly at the very least, we must have ideas about the purposes of users when they analyse.

In the case of disclosure, the existing topically driven approach has evolved into unstated or undeveloped principles as we have attempted to be more consistent in our choices. This parallels the way in which implicit conceptual frameworks for financial reporting evolve in the absence of formal frameworks. The choice, as with conceptual frameworks generally, is not about whether, for example, to have a disclosure and presentation framework, but rather between one or more implicit and ill-developed frameworks and something that is explicit, open to debate and development, and potentially much more purposeful.

The absence of a formal disclosure and presentation framework has seen unproductive arguments between competing and incompatible ideas. It has also opened us up to the risk of excessive and inconsistent disclosure requirements, building up as more and more topics are dealt with over time. It seems now to be generally recognised that this risk has been well and truly realised.

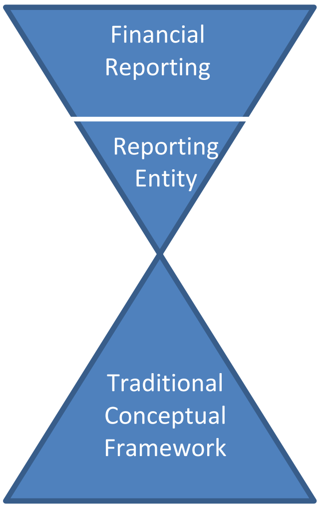
But before we get to disclosure and presentation, or indeed any other accounting responses, it is also worth stating that the definition of financial reporting – another under-developed aspect of attempts at a conceptual framework – could well benefit from the identification of the types of information about an entity that could be both useful and within the bounds of our discipline. Until now we have either depended on geographical positioning of financial reports (for example, by specifying pages in a periodic report), laws or the scoping of individual or groups of standards to determine the borders of financial reporting. And we have, wisely we hope, acknowledged that the scope of financial reporting could be expected to change as users' expectations, and even as our abilities as accountants, change. Perhaps knowing the generic characteristics of entities relevant to economic decision making can point more definitively to the borders we need.

This essay will return to the issue of defining financial reporting and other implications when the types of information that generically explain the "economics of entities" have been explored.

The Australian version of the Framework[7] showed an inverted pyramid (see below) on top of the conventional one shown above. The importance of that placement was only partially understood then. It is becoming evident that our hunches were correct and that we should have developed the notions involved further.

[7] As embodied in the Statements of Accounting Concepts issued by the Australian Accounting Research Foundation, which were issued and revised from August 1990 to March 1995 – these Statements were developed before the AASB adopted the IASB's *Framework for the Preparation and Presentation of Financial Statements*.

VARIATION ON CONVENTIONAL HIERARCHY



Objective-Based Development of the Conceptual Framework

When the Financial Statements Presentation project of the IASB was commenced in 2001/2002, the topic was originally titled "Performance Reporting". There was no great distinction between disclosure and presentation and the emphasis was on connecting financial statement information with how information is used, including with reference to equity valuation approaches.

The promise of that original project could be said to have been around classifying and ordering income statements in a purposeful manner, oriented to users' assessments. It was to be objective-driven. Further, the early papers for the project identified principles on which a performance statement might be based. An example of such principles was that, when producing income statements: expected growth rates should be the primary differentiator between performance statement components[8]. By differentiating between components that grow at different rates, it was argued that the user would have a better basis for predicting future events and estimating their effects.

Somewhere along the line, the IASB project became derailed as debates about such matters as recycling and matrix formats led to decisions to fragment and confine the project. The redirection of the project has seen us lose the perspective of an objective-driven approach to information, the performance reporting accent and the value of the principles discerned. And we have become somewhat preoccupied with rules-based presentation issues (for example, should an item be shown in other comprehensive income?). Arguably, presentation should just be a subset of the broader question of how to convey information, and logically should be driven by the same principles that should govern disclosure.

Clearing the Decks of Intellectual Baggage

This essay uses the terms "stocks" and "flows" somewhat in the manner used by economists and others[9], instead of the terms with which accountants are more familiar, such as financial position and results. This is an appeal to accountants to free themselves from their own jargon

8 Drawn from various IASB staff papers presented to the IASB in 2002.
9 I say "somewhat in the manner" because of the following comments on capacity. I am not using "stocks" in the sense used in government financial statistics in relation to measured amounts.

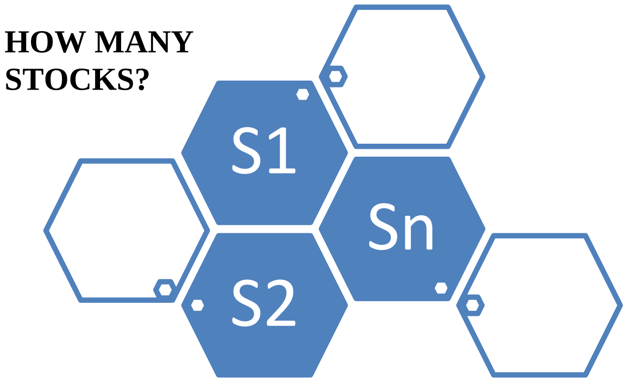
and trappings, so that they may think more creatively about how to develop the Framework and, among other things, consequently to devise a disclosure and presentation framework. The use of stocks and flows is not a new idea; it comes from both the economics and accounting literature over a long period.[10]

Stocks can be described as the accumulated positions, attributes or standings of an entity at any one time. Flows are the changes in those stocks during any given period.

An example of a stock would be the capacity of the entity to meet its commitments as and when they fall due. Another example would be the capacity of an entity to make new investments. Flows for these two stocks would be the change for a period in those capacities.

But entities may have thousands of stocks. What is the principle for how to discern the stocks that could, generically, be relevant to users in assessing the "economics of entities"? In the context of financial reporting, the stocks in question are all those positions, attributes or standings that are relevant to users when making decisions about allocating scarce resources. Accordingly, the objective of financial reporting must be the driver for the topic of this essay and be the broadest filter of the stocks to be considered.

I use the phrase "generically relevant stocks" – but what makes them generic and relevant?



"Generic", in this sense, means that all entities could have these stocks and they could be material to the decision making of all types of existing and potential users identified in the Framework. But individual entities may not have all of them, and they may vary in importance between entities.

The term "capacity"[11] is used so that thinking is not restricted by accounting conventions governing recognition and measurement. Disclosure is not just about explaining balances of recognised elements. For example, the capacity to meet commitments as and when they fall due may be influenced by the future market for the entity's products, the availability of normal credit offerings in the market or committed plans for capital expenditure.

Building Blocks for Developing the Objective of Economic Decision Making

Leaving aside balance sheets, income statements, accounting methods and conventions, what are the possible stocks and flows that could, generically, be used to characterise the

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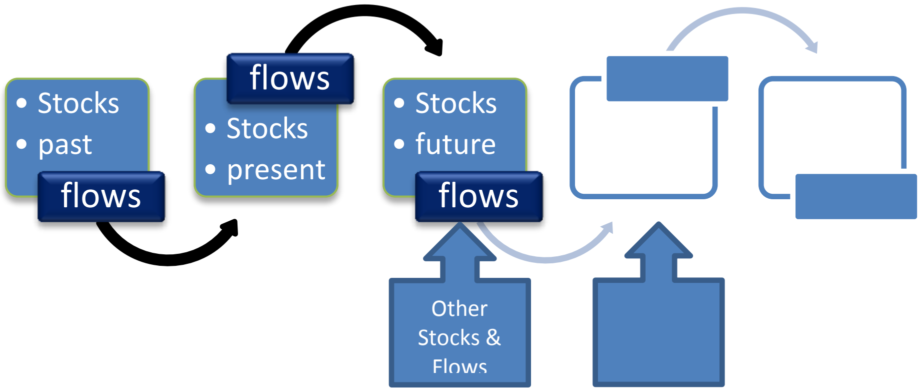
[10] For example, in the early 1950s economists were debating stocks and flows in the context of monetary interest theory (for example, Lawrence H Klein *Stock and Flow Analysis in Economics*, Econometrica, Vol. 18, No.3, July 1950). More recently, Bob Herz, the former Chair of the Financial Accounting Standards Board, indicated his preference for this form of analysis in *Accounting Changes: Chronicles of Convergence, Crisis and Complexity in Financial Reporting*, AICPA, June 2013.

[11] "Capacity" is introduced three paragraphs earlier and used below to describe each stock tentatively identified in this essay.

"economics of an entity"?[12] This essay contends that there is an identifiable list of such stocks and flows and that we are actually quite familiar with the items on that list. But in the past we have not used them explicitly to directly condition the conceptual framework's accounting constructs and responses when portraying entities and serving users' needs.[13]

In terms of flows, in addition to their volumes, it will also be important to know about their timing, direction, pace of change, variability and predictability. Users will be concerned with both the past and the future flows of entities' stocks.

CHARACTERISTICS OF AN ENTITY RELEVANT TO ECONOMIC DECISION MAKING AND ACCOUNTABILITY?



Stocks

The stocks set out below are expressed in terms of what users would want to be able to assess, at least in part, using financial statements. They would also often want information from other sources to complement what can be deduced from those statements. The stocks identified are highly inter-related. As for the Conceptual Framework generally, the cross-cutting aspects are more difficult to document than the building blocks that comprise it. This essay does not attempt to go into the cross-cutting issues in any length. That can come after refinement and acceptance of the stocks identified.

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[12] "Economics", as intimated early in the essay, is used here in the broadest sense and is not intended to signify a "for-profit" oriented entity.

[13] Many participants in many debates (for example, some of those arguing for one measurement basis over another) implicitly weight different stocks and flows differently and wonder why agreement seems elusive.

Tentatively Identified Stocks[14]

Six stocks are identified in this essay.

1. *The current capacity of the entity to provide goods or services*

STOCKS

This stock relates to the very essence of why the entity exists in its current state. For example, for a mining company, it might be the ability to continue to extract quantities of high grade ore, an ability that comes from a combination of controlled rights to explore, physical access to reserves, having available appropriate property, plant and equipment, employing a suitably skilled workforce and having access to viable markets that reward the scale of operations. For a not-for-profit entity, it might relate to having access to supplies of low cost materials, well-placed and adequate collection facilities or equipment, a blend of professional and volunteer staff and appropriate distribution facilities, vehicles or equipment. Essentially the question is about how well placed is the entity to actually operate as intended?

The flows in this stock come from operations (in which resources are consumed, directly or indirectly, in return for revenue[15]), changes in capital (injections and withdrawals) and from impairments and windfall gains.

Apart from quantification of an entity's ability to provide goods or services as intended, we also need to know its relative context or significance. For example, the size of the stock, given the entity's stage of development, might be important. Does a for-profit entity have enough stock to be successful in each of its market segments? Can a not-for-profit entity hope to meets its community responsibility given its current level of scarce resources?

And of course, we need to know about diversity in the operational capacity, with segment reporting being one manifestation of how that information need has been served to date.

For businesses that are more mature, the current ability to provide goods or services might be a strong indicator of its ability to meet its objectives in the future. For a start-up business, the current ability might be confined to a licence just acquired and say less about the future.

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[14] This section draws broadly from the work of Robert L Newman, *Financial Position: Nature and Reporting*, Accounting Theory Monograph 6, Australian Accounting Research Foundation (AARF), 1988; and before that, the work of Alan D Barton, *Objectives and Basic Concepts of Accounting*, Accounting Theory Monograph 2, AARF, 1982.

[15] Including from appropriations, grants or donations to not-for-profit entities.

Across all stocks, users will also want to know about the current plans for changes, which will limit the relevance of historical data.

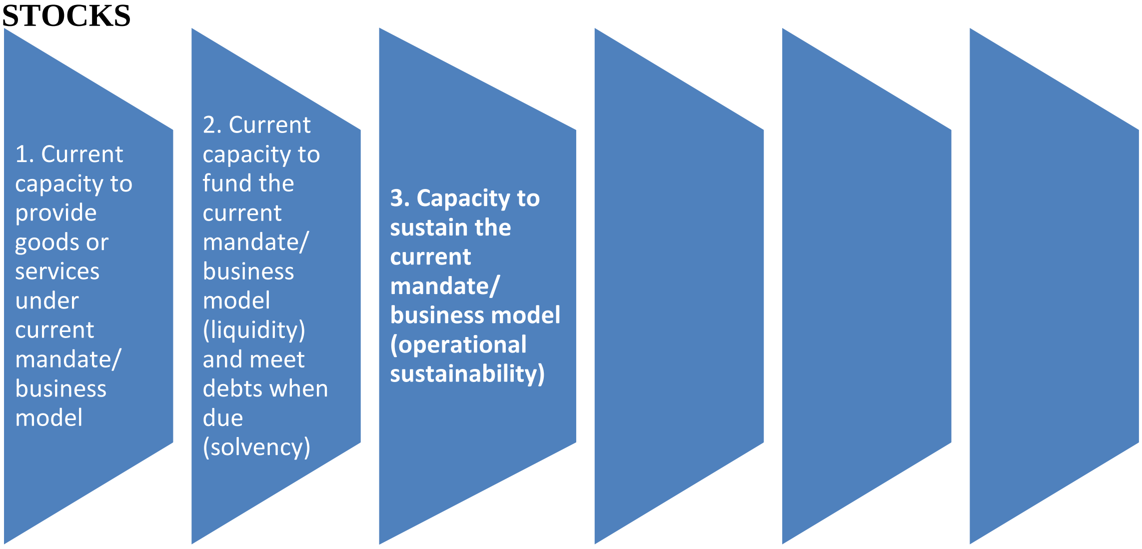
2. The capacity of the entity, with its current financial structure, to efficiently and effectively fund its current operations and meet its commitments as and when they fall due

STOCKS

Users need information to assess an entity's capacity to meet its commitments as and when they fall due, whether the entity is fundamentally solvent and whether meeting those commitments would harm its current operations. Apart from their capacity to meet commitments, entities need also be able to take advantage of opportunities that arise in the context of normal operations. Considerations here would include the matching, in terms of amounts and timing, of operational cash inflows and outflows, the ability to refinance or roll-over debt when it falls due, the ability to adequately service debt and equity and the ability to acquire inputs efficiently and effectively. For a not-for-profit entity, it may be a question of the sources, types and amounts of donations, pledges, bequests received and promised, and recurring or long-term grants compared with one-off grants. For all sectors, it may also depend on traditional sources of funding remaining available.

3 The capacity of the entity to sustain current operations

STOCKS



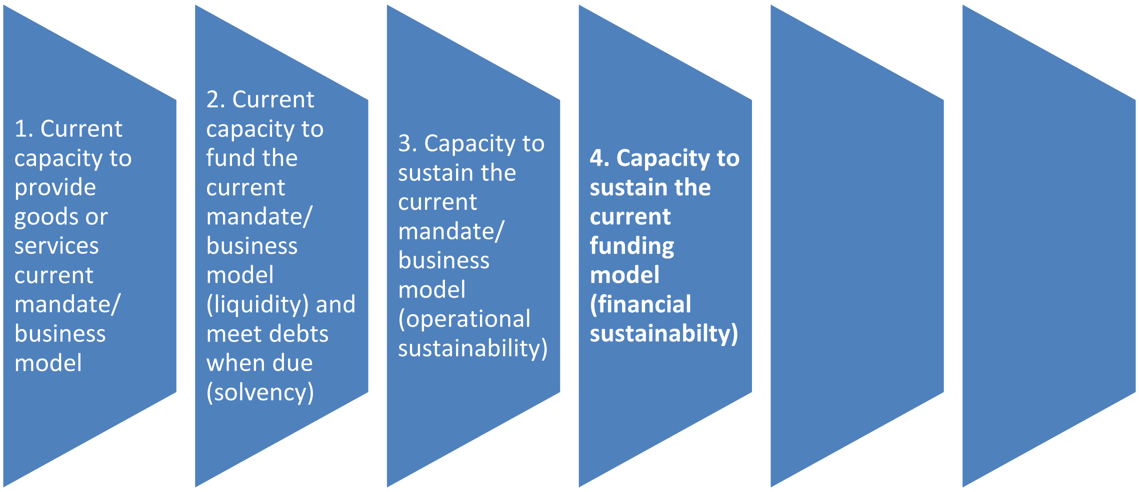
Users need to know that the entity's modes of operation are capable of being sustained. Entities can sometimes appear to be quite promising early in their existence, but fall away over time. They might depend on short-term economic circumstances or opportunistic behaviour, the benefits of which are eroded as competition enters the market, as leverage levels become unbearable, as prices return to normal or as volunteers lose enthusiasm.

The public sector recognises the notion of fiscal sustainability of governments, but the idea translates well to all reporting entities. Typically, in the public sector the topic is approached by asking what would be the consequences if it is assumed that a government maintains its current policies. This is extrapolation rather than forecasting, aimed at highlighting whether policies are sustainable. This way of approaching fiscal sustainability is not all there is to reporting on sustainability more generally, but one can see that the objective it is intended to serve need not be confined to the public sector.

Looked at more generally, are the current policies of an entity, which may appear to have been successful in the current period or in the past, really capable of being sustained over time? Some would say this is the question that the management of some financial institutions needed to seriously consider in the period leading up to the global financial crisis, when lending practices were particularly aggressive.

4. The capacity to sustain the entity's current funding model

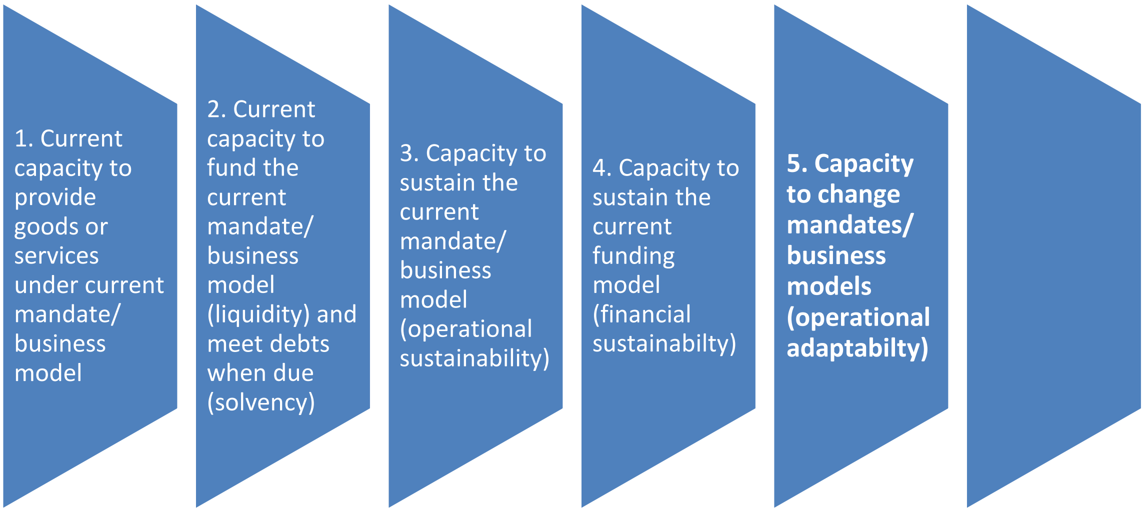
STOCKS



Though an entity's operations may seem justified on the demand side of operations, it may be employing a funding model that will work only in the current environment. An entity may be borrowing against the value of its asset holdings when market forces may be such that lending with that type of collateral dries up. A not-for-profit entity may well have growing demand for its services but may be funded in a way that can only be sustained in buoyant times or depends on a temporary arrangement between co-contributors, or may have limits placed on its capacity to raise levies or charge users for services it provides.

5. *The capacity of the entity to change operationally*

STOCKS

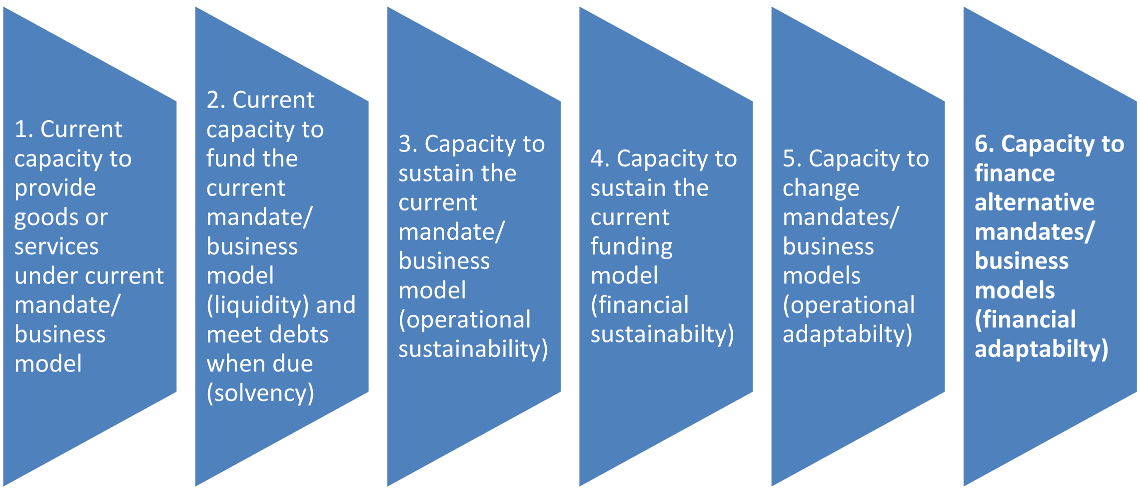


An entity might be financially solvent and financially flexible, but not necessarily be capable of adapting operationally to changes in its environment. This could be due to the nature of its specialised operations, the size of the investments required to enter the field and alternative fields, and availability of intellectual property or other inputs. The nature of an entity's investments may be such that once critical mass is reached, it is difficult to change direction quickly without severely stretching the skill sets of the entity or jeopardizing its well-being. Even with financial flexibility, the entity may not be very adaptable operationally.

The brief of an entity may limit its adaptability too. A public sector entity established for a purpose is often not free to reduce its service levels even when economic variables move against it.

6. *The capacity to finance material changes in operations*

STOCKS



If it is necessary or propitious to change the scale of the entity, to change its operations around or to cope with unexpected events, users want to know that the financial structure can also be adapted. As with operational adaptability, information is needed about its relevance to the entity's circumstances. And it is not merely a case that the more capacity the better, as there can be a trade-off between financial flexibility and returns.

The types of information that might be relevant to financial sustainability and adaptability include lines of potentially accessible credit, the equity raising capacity, the availability of assets that might be liquidated, the scope to renegotiate debt and the status of covenant restrictions. There will be some overlap here with the types of information set out for Stock 2.

Listing of Stocks Comprehensive?

It may well be that the stocks identified could be better expressed and/or added to. However, those listed are pervasive and it is unlikely that the common information needs of the users of general purpose financial reports, in relation to the "economics of an entity", will be better explained by a much longer list of characteristics with the same degree of elevation. If this contention is right, seemingly a relatively short list of stocks could be the basis of a substantial rationalisation of the seemingly infinite list of disclosures we have built.

But life is not so simple. We need also to deal with the flows and, as indicated, the interrelationships of stocks and flows.

Flows

It follows from whichever way the stocks of an entity are analysed that users would be interested in both those identified stocks and material changes (flows) in the attributes of those stocks that have occurred or have some probability of occurring. This interest in changes will, as indicated previously, include an interest in volume, direction, pace of change, variability and predictability of change. Users will want to see over time how their expectations have been met, so they can refine their estimations and make decisions.

In accounting terms, we have seen the various attempts to define profit, operating profit, comprehensive income and many variants thereof. In broad terms, and ignoring opportunistic behaviour, those attempts, and the attempt of businesses to reveal "underlying profitability", are symptoms of the implicit need to find a better way to explain flows.

Criticisms of an undue focus on profits implicitly recognise some or all of the other attributes of stocks listed above. For example, measures of underlying earnings are produced, at least in some cases, because of concerns by preparers that the "bottom line" does not reveal the true changes in the operations of the business. The short-term "statutory profit" does not reflect their view of what will happen to profits in the future because of the inclusion of non-recurring items, because of the obscuring of an emerging trend in operational results or because they perceive limitations in extant accounting requirements.

Expressed much more positively, material changes (flows) in all of the attributes of key stocks need to be evident to the users of financial statements, rather than just profit, a compressed version of the change in one part of one fundamental stock. This is highlighted by the fact that improvements can be made in solvency, financial flexibility, adaptability, sustainability and even future profit prospects, without the income statement for a period being immediately affected.

Performance

Just as financial position may be used to cover the aggregate of the stocks of an entity, performance can be used to describe the aggregate effect of all of the flows of an entity. It is beyond the scope of this essay to explore the issue of performance in more detail, but suffice to say here that performance measured in relation to the stocks identified in this essay would not equal a broad notion of performance – but rather performance in relation to those stocks relevant to economic decision making.

Inter-relationship of Stocks

The above focus on stocks and flows therein is based on the perceived information needs of users. It does not follow that an entity increasing each of its capacities, if that were possible, will have necessarily performed well. For example, shareholders in a listed company may punish a management that builds up an entity lazily without paying dividends or returning capital. They may also punish an entity that improves its solvency and financial flexibility too conservatively; that is, at the price of lost operational opportunity. Not-for-profit entities making large surpluses may simply not be meeting their objectives. Users will want to assess the entity on various levels.

But it should be helpful to users to say that providing information about the stocks and flows above is what we are trying to achieve when conveying information – not thousands of seemingly unconnected pieces of data.

Relationship to Amount, Timing and Uncertainty of Cash Flows

The stocks and flows identified are not inconsistent with the objective to which standard-setters generally subscribe, that is, of wanting to assist users in their assessments of the amounts, timing and uncertainty of future cash flows. Rather, they provide facets or perspectives for such cash flows, enabling differing views of them to be brought into focus.

To be told that an entity has particular probability-weighted expected cash flows (X1 to Xn) across specified periods (P1 to Pn), without distinguishing capital expenditure, operational revenues and expenses and the rest of the information provided in financial reports, would be of very limited use.

An entity's additional investment in its capacity to provide goods or services, prompted by new regulations (for example, environmental regulations), might not give rise to an increase in expected future cash inflows – instead, that investment is necessary to protect its pre-existing ability to generate future cash inflows. Nonetheless, information about that additional investment is relevant to users in assessing the total amount invested in that capacity and likely future rates of return on that investment.

Nor do the stocks and flows identified suffer from the implicit view, seen in some literature on disclosure, that seems to accept the methods for valuing equities must be valid proxies for users' needs. Those with experience in public sector and other not-for-profit reporting find little connection with that notion. They could, however, appreciate each of the stocks and flows listed above.

More fundamentally for standard-setters, the stocks and flows provide the basis for expanding the Framework to make it more operational over time.

Financial Position / Performance vis-à-vis Financial Reporting

One of the possible consequences from identifying the generally relevant stocks and flows is that the terms "financial position" and "performance" can take on meaning. In turn, it could then be possible to define financial reporting as the discipline concerned with measuring financial position and performance as defined. This would provide guidance to standard-setters and regulators as they consider whether topics such as "integrated reporting" are within scope. This is a topic for another essay.

The other similar observation that can now be made is that when we use broad terms like the "economics of an entity" we can be more specific about what we mean. Those "economics" can be equated with the stocks of the various capacities – the scarce resources – and the flows being the changes in those resources.

Operationalising the Concepts of Financial Position and Performance (as defined)

This essay contends that once the stocks and flows generically relevant to economic decision making are identified, there will be ramifications for all of the parts of the Framework below the objective level, including for disclosure and presentation.

In relation to disclosure and presentation, instead of thinking of new requirements on a topical basis (leases, revenue, etc.), standard- setters would need to think about whether disclosures adequately describe the stocks, flows in the stocks and the inter-relationships between those stocks and flows.

For example, there are many requirements in IFRS that relate to the capacity of an entity to provide goods or services, but they are not comprehensive, co-ordinated or directly attuned to whether it is sustainable and whether the entity can adapt if it is not.

Rather, much of what is required in IFRS is driven by the classification of assets (property, plant and equipment, intangibles, leased assets, etc.) and the circumstances that provoked the development of the IFRS. The opportunity for rationalisation and improved relevance is great.

Concluding comments

In this essay, the proposition put is that there is a possible missing link in the Framework between the objective level and the levels of the Framework that are accounting response related. That gap reflects the failure to identify the generic types of information about an entity that should be relevant to users in order for them to make decisions about the allocation of scarce resources. The essay identifies the stocks and flows that are potentially relevant to all entities and might fill that gap. The essay contends that, among other consequences, purpose-driven disclosure and presentational approaches could flow from attempts to faithfully represent those stocks and flows. This would result in a substantial rationalisation of existing disclosures and provide a way of cutting through the unending debates about presentation that stem from multiple implicit conflicting goals.

The author is of the view that the implications of this essay could be illustrated by taking existing disclosures and presentation requirements and trying to classify them by reference to stocks and flows set out in this essay. This will prove not to be a simple task as the principles underlying those requirements are often unclearly stated or not stated at all.

The essay could also be extended to explore its ramifications for the vexed issue of measurement. For example, the current capacity of an entity to produce goods and services is a different stock from the capacity to adapt current operations. It might be argue that a different measurement attribute would be needed for each.

The straightforward contention is that once it is known what is to be faithfully represented, that is, the stocks and flows, it becomes much easier to rationalise decisions and achieve explicit purposes designed to assist the decision making of users.