

# RE-THINKING ECONOMIC DECISION-MAKING, DISCLOSURE AND PRESENTATION

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## The Issue - A Gap in the Framework

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2. Therefore, CF lacks principles powerful enough to drive decisions lower in the Framework, especially about disclosure and presentation requirements
3. The phrase “Amount, timing and uncertainty of cash flows”, used to gain focus when determining disclosures, is not explicitly articulated with economic decision-making
4. **D&P should be “objectives driven” - answering the question “what are we really trying to tell users?”**

## A WARNING ABOUT CONTEXT

1. The work here is seen to be an elaboration of the current Conceptual Framework
2. It may raise some questions about the meaning (scope) of financial reporting; that is, the boundaries of the discipline of financial reporting
3. Some may be uncomfortable with the forward looking focus.

# REFINEMENTS IN THINKING SINCE WORK BEGAN

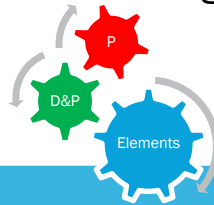
The stocks and flows fill a gap at the objectives level of the conceptual framework. They stem only from the question “what does a user need to know to make economic decisions about an entity?”

**The implication of this observation is that:**

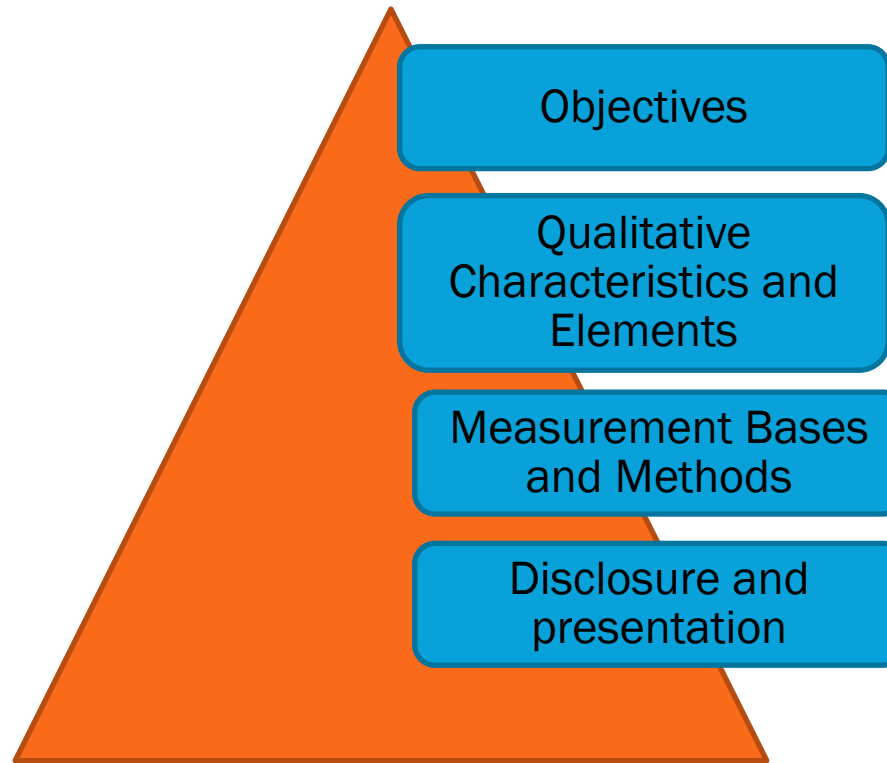
Though the ideas apply to presentation and disclosure (P&D), they also should drive the rest of the Framework; that is, below Objectives, and could indeed provide a basis for linkage between any accounting response (the construct) and economic decision making (part of the world with which we deal).

**A caution: the levels of the Framework are interactive**

Choices made between accounting responses will themselves impact P&D. For example an historical cost model might need disclosures about price changes, whereas current value models might need more information about estimation.



# CONVENTIONAL CF HIERARCHY



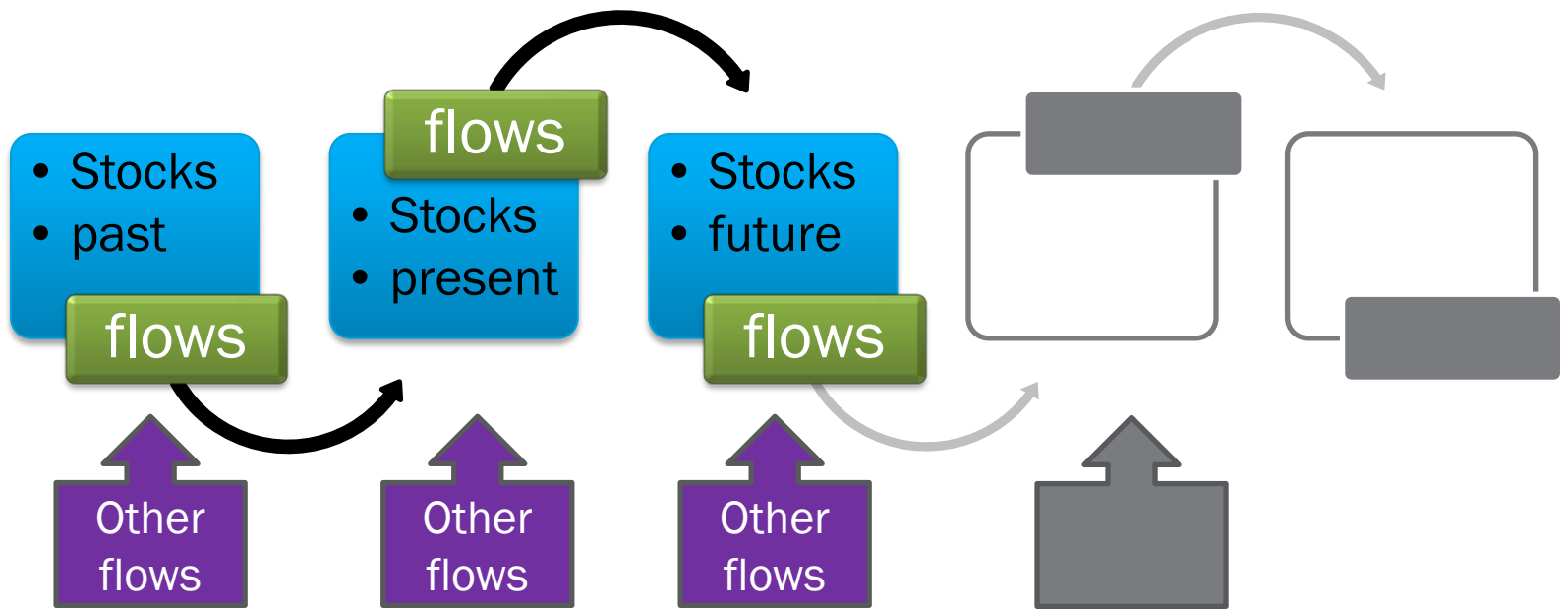
# VARIATIONS ON CONVENTIONAL CF HIERARCHY



Financial  
Reporting

Reporting  
Entity

# CHARACTERISTICS OF AN ENTITY RELEVANT TO ECONOMIC DECISION MAKING?

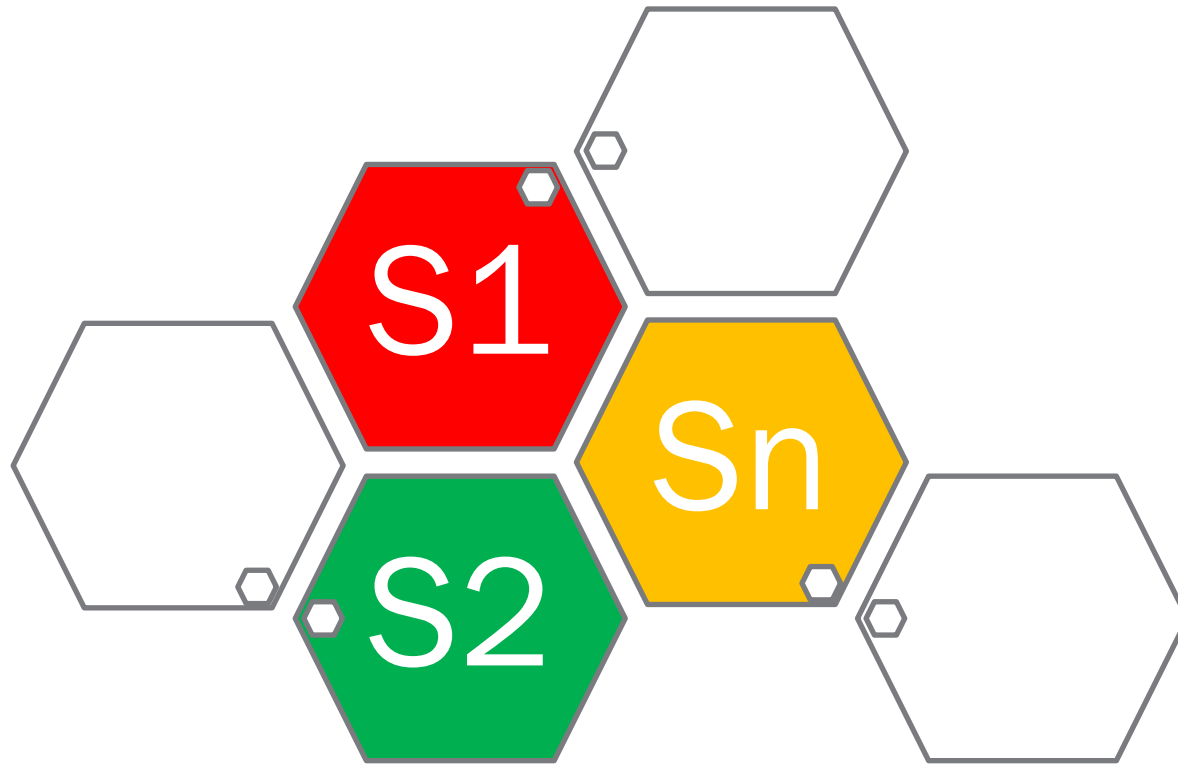


# STOCKS

Possible definition:

“The accumulated positions, attributes or standings of an entity, at any one time, that could impact the resource allocations made by users at that time”

# HOW MANY STOCKS?



# STOCKS

**Contention: Only a limited number of “stocks” are pertinent to user decisions**

**Warning: Some stocks likely always to be unrecognised or mismeasured**

# FLOWS

Flows are the changes in stocks

(“Other Flows” are conceptually unneeded but are included in the diagram shown just as a reminder that some stocks may be unrecorded or mismeasured)

## IF IT HELPS

The combination of the “stocks” = financial position

The effects of (all) the flows = performance

But merit is seen in avoiding accounting phrases when trying to resolve the conceptual issues. Too much intellectual baggage.

## **CAUTION**

**Assessments of stocks and flows are dynamic, involving past, present attributes and expectations about the future.**

**Implication for CF: this observation is the “hook” for comparatives, trend analysis and the like.**



# FLOWS: WHAT ARE EXPECTATIONS ABOUT THE AMOUNTS, TIMINGS AND UNCERTAINTIES OF STOCKS AND FLOWS?



# AMOUNTS, TIMINGS AND UNCERTAINTIES (ATU)

**Contention:**

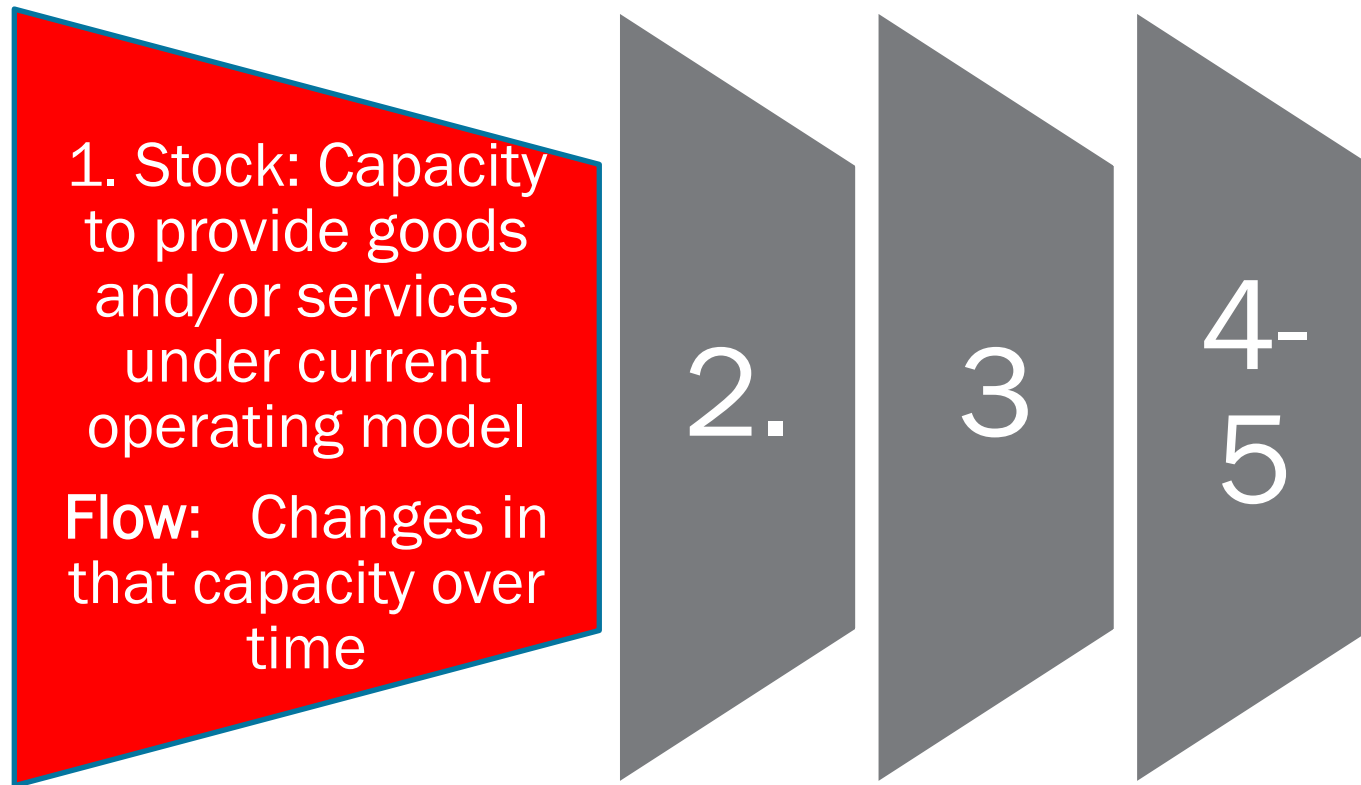
**ATU of stocks and flows – More so than of cash flows**

**This is not to deny cash flows, but rather to add specificity to the framework**

## THE QUESTION

**So what are the stocks users need to know about , for which flows explain performance?**

# STOCKS AND FLOWS



# STOCKS AND FLOWS

1.

2. **Stock:**  
Sustainability of  
operating model  
**Flow:** Changes in  
that sustainability

3-5

# STOCKS AND FLOWS

1.

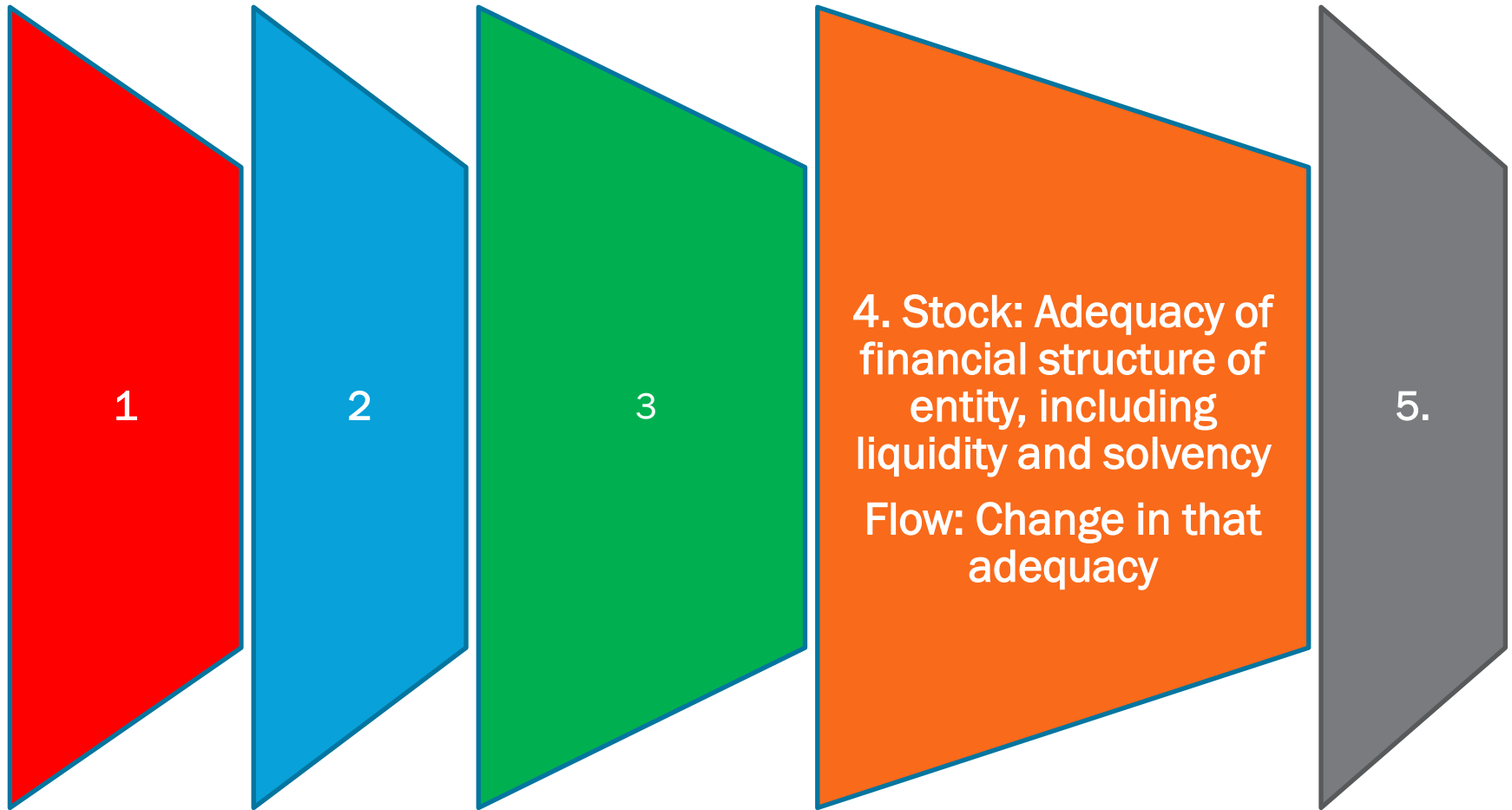
2.

3. Stock : Ability to change to alternative operating models (entity sustainability)

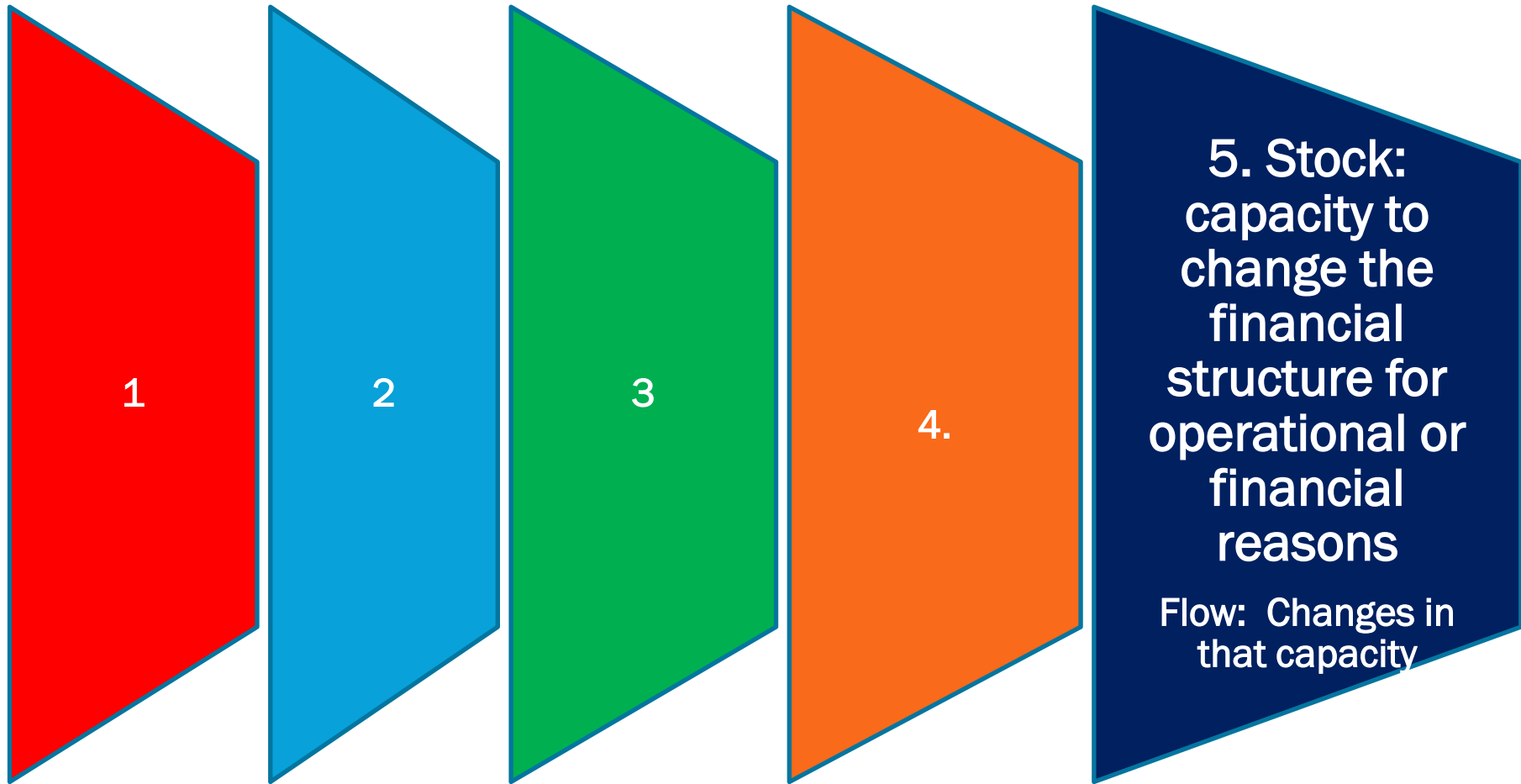
Flow: Changes in that ability /sustainability

4-5

# STOCKS AND FLOWS



# STOCKS AND FLOWS



# STOCKS AND FLOWS

1. Capacity to provide goods and/or services under current business model

2. Sustainability of business model

3. Ability to change to alternative business models (entity sustainability)

4. Adequacy of financial structure of entity, including liquidity and solvency

5. Capacity to change the financial structure.

# COMPLETENESS? ADEQUACY?

- Other stocks of same degree of elevation?
  - Some hints in research about models for factors affecting bond rate ratings?
- Better specification of the stocks?
- Other ways of thinking about user needs?
- Research evidence?
  - Preparers and analysts seem to find resonance
  - Valuers too
  - Academics suggest revisiting value relevance research

# APPLICATION PRINCIPLES AND IDENTIFICATION OF “HOOKS”

We need to tease out the relevance of the classification of stocks and flows for the lower reaches of the Conceptual Framework, especially, but not exclusively, for disclosure and presentation.

Application principles and guidance will be needed



# APPLICATION PRINCIPLES ALSO NEEDED?

Testing some of early IASB performance reporting project presentation disclosure tenets.

## Stock 1: Capacity to provide goods or services

*“ expected growth rates should be the primary differentiator between ..... components.”*

## Stock 1 and Stock 2 (Sustainability of business model):

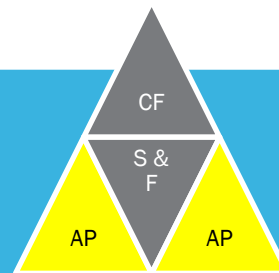
*“To the extent practically possible for net assets held at market values, a useful distinction can be made between expected income, unexpected income for a period, and unexpected capital gains and losses.”*

## Stock 2

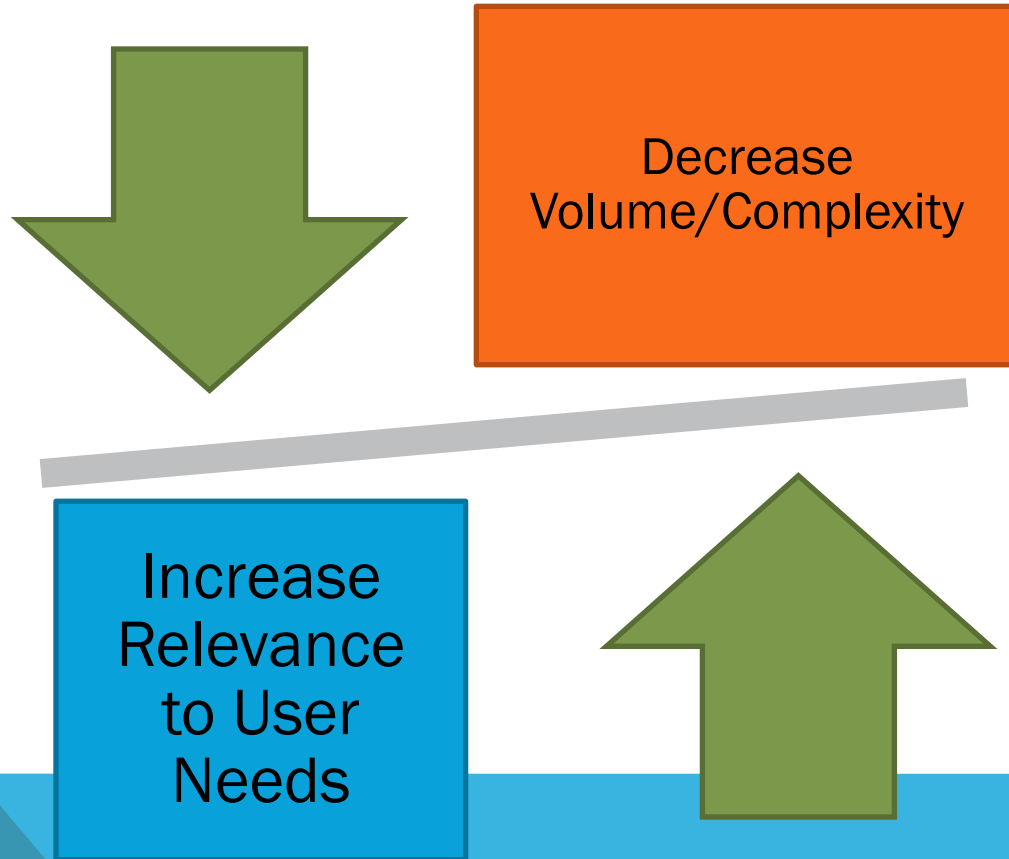
*“A performance statement should be able to distinguish the return on total capital employed from the return on equity. “*

## Stock 2

*“how efficient an entity was/is or plans to be with its inputs and activities in producing outputs and its effectiveness in producing outcomes that accomplish its objectives and goals”.*



# THE CHALLENGE



# THE CHALLENGE CONT'D

For disclosure and presentation

Instead of challenging users by cutting out disclosures, all of which mean something, how do we rationalise what is asked for into a more meaningful, purpose driven approach which replaces volume, complexity and implicit logic, with a coherent set of disclosures with explicit purposes?

# THE NATIONAL STANDARD-SETTER CHALLENGE

*How to think and be heard?*



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