Financial Accounting Standards Board

ORIGINAL PRONOUNCEMENTS

AS AMENDED

Statement of Financial Accounting Concepts No. 5

Recognition and Measurement in Financial Statements of Business Enterprises

Statement of Financial Accounting Concepts No. 5 Recognition and Measurement in Financial Statements of Business Enterprises

STATUS

Issued: December 1984

Affects: No other pronouncements

Affected by: No other pronouncements

HIGHLIGHTS

[Best understood in context of full Statement]

- This Statement sets forth recognition criteria and guidance on what information should be incorporated into financial statements and when. The Statement provides a basis for consideration of criteria and guidance by first addressing financial statements that should be presented and their contribution to financial reporting. It gives particular attention to statements of earnings and comprehensive income. The Statement also addresses certain measurement issues that are closely related to recognition.

- Financial statements are a central feature of financial reporting—a principal means of communicating financial information to those outside an entity. Some useful information is better provided by financial statements and some is better provided, or can only be provided, by notes to financial statements, supplementary information, or other means of financial reporting. For items that meet criteria for recognition, disclosure by other means is not a substitute for recognition in financial statements.

- Recognition is the process of formally incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, or the like. A recognized item is depicted in both words and numbers, with the amount included in the statement totals.

- A full set of financial statements for a period should show:
  - Financial position at the end of the period
  - Earnings for the period
  - Comprehensive income for the period
  - Cash flows during the period
  - Investments by and distributions to owners during the period.

- Financial statements individually and collectively contribute to meeting the objectives of financial reporting. No one financial statement is likely to provide all the financial statement information that is useful for a particular kind of decision.

- The parts of a financial statement also contribute to meeting the objectives of financial reporting and may be more useful to those who make investment, credit, and similar decisions than the whole.

- Financial statements result from simplifying, condensing, and aggregating masses of data. As a result, they convey information that would be obscured if great detail were provided. Although those simplifications, condensations, and aggregations are both necessary and useful, the Board believes that it is important to avoid focusing attention almost exclusively on "the bottom line," earnings per share, or other highly simplified condensations.

- A statement of financial position provides information about an entity's assets, liabilities, and equity and their relationships to each other at a moment in time. The statement delineates the entity's resource structure—major classes and amounts of assets—and its financing structure—major classes and amounts of liabilities and equity.
- A statement of financial position does not purport to show the value of a business enterprise but, together with other financial statements and other information, should provide information that is useful to those who desire to make their own estimates of the enterprise's value. Those estimates are part of financial analysis, not of financial reporting, but financial accounting aids financial analysis.
- Statements of earnings and of comprehensive income together reflect the extent to which and the ways in which the equity of an entity increased or decreased from all sources other than transactions with owners during a period.
- The concept of earnings set forth in this Statement is similar to net income for a period in present practice; however, it excludes certain accounting adjustments of earlier periods that are recognized in the current period—cumulative effect of a change in accounting principle is the principal example from present practice. The Board expects the concept of earnings to be subject to the process of gradual change or evolution that has characterized the development of net income.
- Earnings is a measure of entity performance during a period. It measures the extent to which asset inflows (revenues and gains) associated with cash-to-cash cycles substantially completed during the period exceed asset outflows (expenses and losses) associated, directly or indirectly, with the same cycles.
- Comprehensive income is a broad measure of the effects of transactions and other events on an entity, comprising all recognized changes in equity (net assets) of the entity during a period from transactions and other events and circumstances except those resulting from investments by owners and distributions to owners.
- A variety of terms are used for net income in present practice. The Board anticipates that a variety of terms will be used in future financial statements as names for earnings (for example, net income, profit, or net loss) and for comprehensive income (for example, total nonowner changes in equity or comprehensive loss).
- Earnings and comprehensive income are not the same because certain gains and losses are included in comprehensive income but are excluded from earnings. Those items fall into two classes that are illustrated by certain present practices:
  - Effects of certain accounting adjustments of earlier periods that are recognized in the current period (already described)
  - Certain other changes in net assets (principally certain holding gains and losses) that are recognized in the period but are excluded from earnings, such as some changes in market values of investments in marketable equity securities classified as noncurrent assets, some changes in market values of investments in industries having specialized accounting practices for marketable securities, and foreign currency translation adjustments.
- The full set of financial statements discussed in this Statement is based on the concept of financial capital maintenance.
- Future standards may change what is recognized as components of earnings. Future standards may also recognize certain changes in net assets as components of comprehensive income but not of earnings.
- A statement of cash flows directly or indirectly reflects an entity's cash receipts classified by major sources and its cash payments classified by major uses during a period, including cash flow information about its operating, financing, and investing activities.
- A statement of investments by and distributions to owners reflects an entity's capital transactions during a period—the extent to which and in what ways the equity of the entity increased or decreased from transactions with owners *as owners.*

- An item and information about it should meet four fundamental recognition criteria to be recognized and should be recognized when the criteria are met, subject to a cost-benefit constraint and a materiality threshold. Those criteria are:
  - *Definitions.* The item meets the definition of an element of financial statements.
  - *Measurability.* It has a relevant attribute measurable with sufficient reliability.
  - *Relevance.* The information about it is capable of making a difference in user decisions.
  - *Reliability.* The information is representationally faithful, verifiable, and neutral.
- Items currently reported in the financial statements are measured by different attributes (for example, historical cost, current [replacement] cost, current market value, net realizable value, and present value of future cash flows), depending on the nature of the item and the relevance and reliability of the attribute measured. The Board expects use of different attributes to continue.
- The monetary unit or measurement scale in current practice in financial statements is nominal units of money, that is, unadjusted for changes in purchasing power of money over time. The Board expects that nominal units of money will continue to be used to measure items recognized in financial statements.
- Further guidance in applying the criteria for recognizing components of earnings is necessary because of the widely acknowledged importance of earnings as a primary measure of entity performance. Guidance for recognizing components of earnings is concerned with identifying which cycles are substantially complete and with associating particular revenues, gains, expenses, and losses with those cycles.
- In assessing the prospect that as yet uncompleted transactions will be concluded successfully, a degree of skepticism is often warranted. As a reaction to uncertainty, more stringent requirements have historically been imposed for recognizing revenues and gains as components of earnings than for recognizing expenses and losses. Those conservative reactions influence the guidance for applying the recognition criteria to components of earnings.
- Guidance for recognizing revenues and gains is based on their being:
  - *Realized or realizable.* Revenues and gains are generally not recognized as components of earnings until realized or realizable and
  - *Earned.* Revenues are not recognized until earned. Revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. For gains, being earned is generally less significant than being realized or realizable.
- Guidance for expenses and losses is intended to recognize:
  - *Consumption of benefit.* Expenses are generally recognized when an entity's economic benefits are consumed in revenue-earning activities or otherwise or
  - *Loss or lack of benefit.* Expenses or losses are recognized if it becomes evident that previously recognized future economic benefits of assets have been reduced or eliminated, or that liabilities have been incurred or increased, without associated economic benefits.
- In a limited number of situations, the Board may determine that the most useful information results from recognizing the effects of certain events in comprehensive income but not in earnings, and set standards accordingly. Certain changes in net assets that meet the fundamental recognition criteria may qualify for recognition in comprehensive income even though they do not qualify for recognition as components of earnings.
- Information based on current prices should be recognized if it is sufficiently relevant and reliable to justify the costs involved and more relevant than alternative information.
- Most aspects of current practice are consistent with the recognition criteria and guidance in this Statement, but the criteria and guidance do not foreclose the possibility of future changes in practice. When evidence indicates that information that is more useful (relevant and reliable) than information currently reported is available at a justifiable cost, it should be included in financial statements.

Statement of Financial Accounting Concepts No. 5
Recognition and Measurement in Financial Statements of Business Enterprises

STATEMENTS OF FINANCIAL ACCOUNTING CONCEPTS

This Statement of Financial Accounting Concepts is one of a series of publications in the Board's conceptual framework for financial accounting and reporting. Statements in the series are intended to set forth objectives and fundamentals that will be the basis for development of financial accounting and reporting standards. The objectives identify the goals and purposes of financial reporting. The fundamentals are the underlying concepts of financial accounting—concepts that guide the selection of transactions, events, and circumstances to be accounted for; their recognition and measurement; and the means of summarizing and communicating them to interested parties. Concepts of that type are fundamental in the sense that other concepts flow from them and repeated reference to them will be necessary in establishing, interpreting, and applying accounting and reporting standards.

The conceptual framework is a coherent system of interrelated objectives and fundamentals that is expected to lead to consistent standards and that prescribes the nature, function, and limits of financial accounting and reporting. It is expected to serve the public interest by providing structure and direction to financial accounting and reporting to facilitate the provision of evenhanded financial and related information that helps promote the efficient allocation of scarce resources in the economy and society, including assisting capital and other markets to function efficiently.

Establishment of objectives and identification of fundamental concepts will not directly solve financial accounting and reporting problems. Rather, objectives give direction, and concepts are tools for solving problems.

The Board itself is likely to be the most direct beneficiary of the guidance provided by the Statements in this series. They will guide the Board in developing accounting and reporting standards by providing the Board with a common foundation and basic reasoning on which to consider merits of alternatives.

However, knowledge of the objectives and concepts the Board will use in developing standards also should enable those who are affected by or interested in financial accounting standards to understand better the purposes, content, and characteristics of information provided by financial accounting and reporting. That knowledge is expected to enhance the usefulness of, and confidence in, financial accounting and reporting. The concepts also may provide some guidance in analyzing new or emerging problems of financial accounting and reporting in the absence of applicable authoritative pronouncements.

Statements of Financial Accounting Concepts do not establish standards prescribing accounting procedures or disclosure practices for particular items or events, which are issued by the Board as Statements of Financial Accounting Standards. Rather, Statements in this series describe concepts and relations that will underlie future financial accounting standards and practices and in due course serve as a basis for evaluating existing standards and practices.*

The Board recognizes that in certain respects current generally accepted accounting principles may be inconsistent with those that may derive from the objectives and concepts set forth in Statements in this series. However, a Statement of Financial Accounting Concepts does not (a) require a change in existing generally accepted accounting principles; (b) amend, modify, or interpret Statements of Financial Accounting Standards, Interpretations of the FASB, Opinions of the Accounting Principles Board, or Bulletins of the Committee on Accounting Procedure that are in effect; or (c) justify either changing existing generally accepted accounting and reporting practices or interpreting the pronouncements listed in item (b) based on personal interpretations of the objectives and concepts in the Statements of Financial Accounting Concepts.

Since a Statement of Financial Accounting Concepts does not establish generally accepted accounting principles or standards for the disclosure of financial information outside of financial statements in published financial reports, it is not intended to invoke application of Rule 203 or 204 of the Rules of Conduct of the Code of Professional Ethics of the American Institute of Certified Public Accountants (or successor rules or arrangements of similar scope and intent).†

Like other pronouncements of the Board, a Statement of Financial Accounting Concepts may be amended, superseded, or withdrawn by appropriate action under the Board's *Rules of Procedure.*

---

*Pronouncements such as APB Statement No. 4, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises,* and the Accounting Terminology Bulletins will continue to serve their intended purpose—they describe objectives and concepts underlying standards and practices existing at the time of their issuance.

†Rule 203 prohibits a member of the American Institute of Certified Public Accountants from expressing an opinion that financial statements conform with generally accepted accounting principles if those statements contain a material departure from an accounting principle promulgated by the Financial Accounting Standards Board, unless the member can demonstrate that because of unusual circumstances the financial statements otherwise would have been misleading. Rule 204 requires members of the Institute to justify departures from standards promulgated by the Financial Accounting Standards Board for the disclosure of information outside of financial statements in published financial reports.

CONTENTS

INTRODUCTION, SCOPE, AND LIMITATIONS

1. This Statement sets forth fundamental recognition criteria and guidance on what information should be formally incorporated into financial statements and when. It builds on the foundation laid by earlier concepts Statements, bringing those concepts together to apply them to broad recognition issues. As a basis for considering recognition criteria, the Statement first addresses financial statements that should be presented and how those financial statements contribute to the objectives of financial reporting. Both that discussion and the later discussion of recognition give particular attention to statements of earnings and comprehensive income.

2. The recognition criteria and guidance in this Statement are generally consistent with current practice and do not imply radical change. Nor do they foreclose the possibility of future changes in practice. The Board intends future change to occur in the gradual, evolutionary way that has characterized past change.

3. This Statement also addresses certain measurement issues that are closely related to recognition. Measurement involves choice of an attribute by which to quantify a recognized item and choice of a scale of measurement (often called "unit of measure"). The Statement notes that different attributes are currently used to measure different items in financial statements and that the Board expects the use of different attributes to continue. The Statement further notes that the measurement scale in current practice is nominal units of money (that is, unadjusted for changes in purchasing power over time) and that the Board expects use of nominal units to continue.

4. This Statement is not intended to apply to organizations other than business enterprises. Recognition criteria and guidance on what information should be formally incorporated into financial statements of nonbusiness organizations can be considered only after completion of another Board project that concerns significant underlying concepts upon which recognition criteria and guidance are built. The Board issued its Exposure Draft, *Proposed Amendments to FASB Concepts Statements 2 and 3 to Apply Them to Nonbusiness Organizations,* on July 7, 1983 and held public hearings on that matter on November 14 and 15, 1983. Since that project is still in progress, all references in this Statement are to the original Statements, FASB Concepts Statements No. 2, *Qualitative Characteristics of Accounting Information,* and No. 3, *Elements of Financial Statements of Business Enterprises.*

FINANCIAL STATEMENTS

Financial Statements, Financial Reporting, and Recognition

5. Financial statements are a central feature of financial reporting—a principal means of communicating financial information to those outside an entity. In external general purpose financial reporting, a financial statement is a formal tabulation of names and amounts of money derived from accounting records that displays either financial position of an entity at a moment in time or one or more kinds of changes in financial position of the entity during a period of time. Items that are recognized in financial statements are financial representations of certain resources (assets) of an entity, claims to those resources (liabilities and owners' equity), and the effects of transactions and other events and circumstances that result in changes in those resources and claims. The financial statements of an entity are a fundamentally related set that articulate with each other and derive from the same underlying data.[1]

6. Recognition is the process of formally recording or incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, or the like. Recognition includes depiction of an item in both words and numbers, with the amount included in the totals of the financial statements. For an asset or liability, recognition involves recording not only acquisition or incurrence of the item but also later

---

[1]FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises,* pars. 6 and 18; Concepts Statement 3, pars. 6 and 14 and 15. *Financial position* and *changes in financial position* are used here in a broad sense and do not refer to specific financial statements. "Used broadly, financial position refers to state or status of assets or claims to assets at moments in time, and changes in financial position refers to flows or changes in assets or claims to assets over time" (Concepts Statement 3, par. 14, footnote 6). "Through the financial accounting process, the myriad and complex effects of the economic activities of an enterprise are accumulated, analyzed, quantified, classified, recorded, summarized, and reported as information of two basic types: (1) financial position, which relates to a point in time, and (2) changes in financial position, which relate to a period of time" (APB Statement No. 4, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises,* par. 10).

changes in it, including changes that result in removal from the financial statements.[2]

7. Although financial statements have essentially the same objectives as financial reporting, some useful information is better provided by financial statements and some is better provided, or can only be provided, by notes to financial statements or by supplementary information or other means of financial reporting:[3]

a. Information disclosed in notes or parenthetically on the face of financial statements, such as significant accounting policies or alternative measures for assets or liabilities, amplifies or explains information recognized in the financial statements.[4] That sort of information is essential to understanding the information recognized in financial statements and has long been viewed as an integral part of financial statements prepared in accordance with generally accepted accounting principles.
b. Supplementary information, such as disclosures of the effects of changing prices, and other means of financial reporting, such as management discussion and analysis, add information to that in the financial statements or notes, including information that may be relevant but that does not meet all recognition criteria.[5]

8. The scope of this concepts Statement is limited to recognition (and measurement) in financial statements. That limitation on scope does not alter the status of notes, supplementary information, or other means of financial reporting; those types of information remain important and useful for the reasons discussed in the preceding paragraph. To clarify the scope of this concepts Statement, the diagram on page CON5–8 illustrates the types of information used in investment, credit, and similar decisions.

9. Since recognition means depiction of an item in both words and numbers, with the amount included in the totals of the financial statements, disclosure by other means is *not* recognition. Disclosure of information about the items in financial statements and their measures that may be provided by notes or parenthetically on the face of financial statements, by supplementary information, or by other means of financial reporting is not a substitute for recognition in financial statements for items that meet recognition criteria. Generally, the most useful information about assets, liabilities, revenues, expenses, and other items of financial statements and their measures (that with the best combination of relevance and reliability) should be recognized in the financial statements.

Financial Statements and Objectives of Financial Reporting

10. FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises,* describes the broad purposes of financial reporting, including financial statements.[6] Financial reporting should provide:

> Information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions (paragraphs 34–36)
>
> Information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise because their prospects for receiving cash from investments in, loans to, or other participation in the enterprise depend significantly on its cash flow prospects (paragraphs 37–39)
>
> Information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects

---

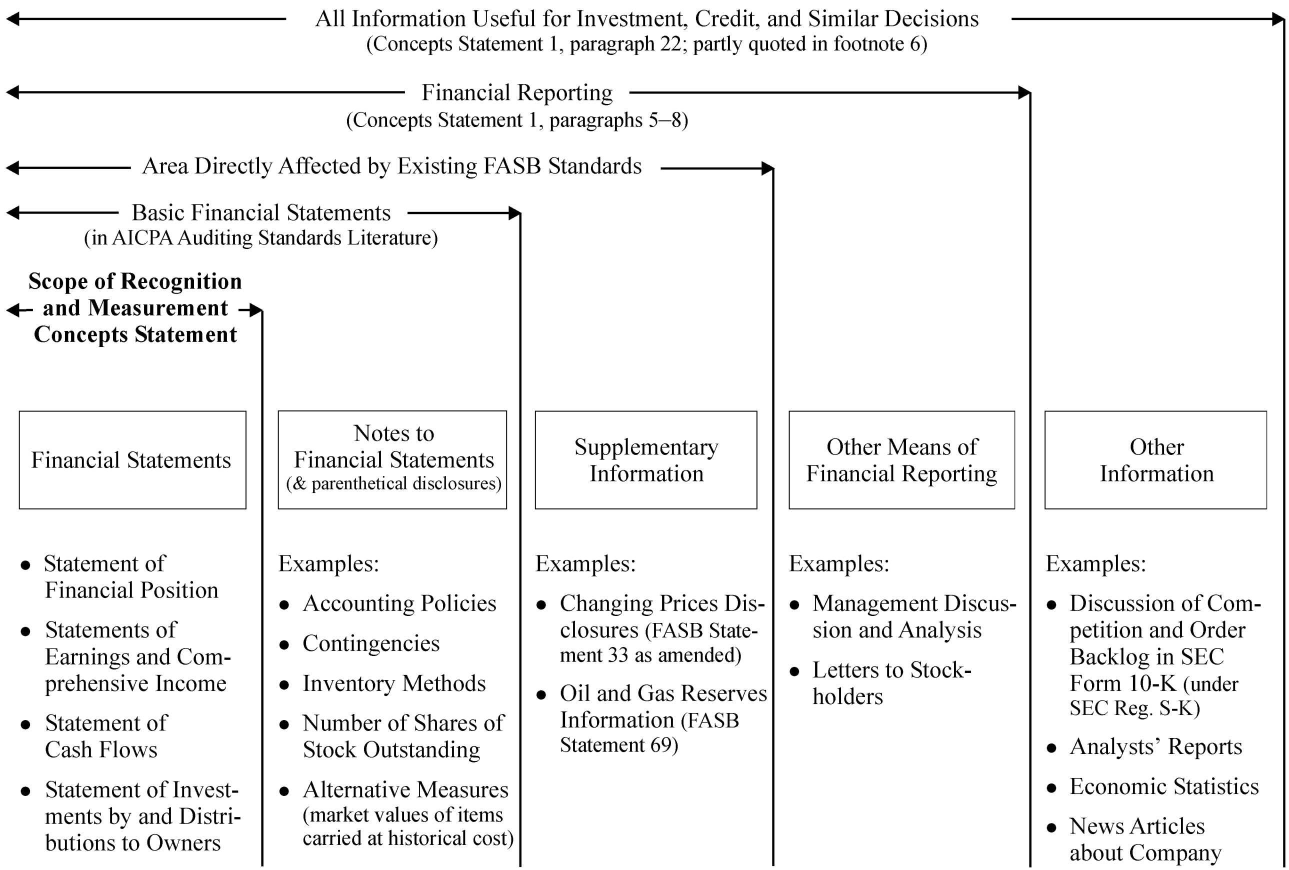
[2]Concepts Statement 3, pars. 83, 6, 25, 26, and 34 and 35.

[3]Concepts Statement 1, par. 5.

[4]For example, notes provide essential descriptive information for long-term obligations, including when amounts are due, what interest they bear, and whether important restrictions are imposed by related covenants. For inventory, the notes provide information on the measurement method used— FIFO cost, LIFO cost, current market value, etc. For an estimated litigation liability, an extended discussion of the circumstances, counsel's opinions, and the basis for management's judgment may all be provided in the notes. For sales, useful information about revenue recognition policies may appear only in the notes (FASB Statement No. 47, *Disclosure of Long-Term Obligations;* ARB No. 43, Chapter 4, "Inventory Pricing," statement 8; FASB Statement No. 5, *Accounting for Contingencies,* par. 10; and APB Statement 4, par. 199).

[5]Concepts Statement 1, pars. 6, 7, and 22. Supplementary financial statements, complete or partial, may be useful, especially to introduce and to gain experience with new kinds of information. Criteria for including information in supplementary statements may have much in common with recognition criteria for primary statements discussed here, but the criteria discussed in this Statement apply specifically to primary financial statements.

[6]Paragraphs 8–33 of Concepts Statement 1 give needed background. They describe factors affecting the objectives of general purpose external financial reporting, such as characteristics of the environment in the United States, characteristics and limitations of information provided, potential users and their interests, and the nature of the objectives. For example, "financial reporting is but one source of information needed by those who make economic decisions about business enterprises" (par. 22).


All Information Useful for Investment, Credit, and Similar Decisions
(Concepts Statement 1, paragraph 22; partly quoted in footnote 6)
Financial Reporting
(Concepts Statement 1, paragraphs 5–8)
Area Directly Affected by Existing FASB Standards
Basic Financial Statements
(in AICPA Auditing Standards Literature)
Scope of Recognition and Measurement Concepts Statement
Financial Statements
Notes to Financial Statements (& parenthetical disclosures)
Supplementary Information
Other Means of Financial Reporting
Other Information
• Statement of Financial Position
• Statements of Earnings and Comprehensive Income
• Statement of Cash Flows
• Statement of Investments by and Distributions to Owners
Examples:
• Accounting Policies
• Contingencies
• Inventory Methods
• Number of Shares of Stock Outstanding
• Alternative Measures (market values of items carried at historical cost)
Examples:
• Changing Prices Disclosures (FASB Statement 33 as amended)
• Oil and Gas Reserves Information (FASB Statement 69)
Examples:
• Management Discussion and Analysis
• Letters to Stockholders
Examples:
• Discussion of Competition and Order Backlog in SEC Form 10-K (under SEC Reg. S-K)
• Analysts' Reports
• Economic Statistics
• News Articles about Company

of transactions, events, and circumstances that change resources and claims to those resources (paragraph 40).

11. Concepts Statement 1 also gives guidance about the kinds of information that financial reporting, including financial statements, should provide:

Information about an enterprise's economic resources, obligations, and owners' equity (paragraph 41)

Information about an enterprise's performance provided by measures of earnings and comprehensive income[7] and their components measured by accrual accounting (paragraphs 42–48)

Information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital (equity) transactions, including cash dividends and other distributions of enterprise resources to owners, and about other factors that may affect an enterprise's liquidity or solvency (paragraph 49)

Information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it (paragraphs 50–53).

12. A full, articulated set of several financial statements that provide those various kinds of information about an entity's financial position and changes in its financial position is necessary to satisfy the broad purposes of financial reporting.

Full Set of Financial Statements

13. The amount and variety of information that financial reporting should provide about an entity require several financial statements. A full set of financial statements for a period should show:

Financial position at the end of the period

Earnings (net income)[8] for the period

Comprehensive income (total nonowner changes in equity)[8] for the period

Cash flows during the period

Investments by and distributions to owners during the period.

Information about earnings, comprehensive income, cash flows, and transactions with owners have in common that they are different kinds of information about the effects of transactions and other events and circumstances that change assets and liabilities during a period.

14. This Statement does not consider details of displaying those different kinds of information and does not preclude the possibility that some entities might choose to combine some of that information in a single statement. In present practice, for example, a reconciliation of beginning and ending balances of retained earnings is sometimes appended to an income statement.

Purposes and Limitations of Financial Statements

General Purpose Financial Statements and Individual Users

15. General purpose financial statements, to which the objectives of financial reporting apply, are directed toward the common interest of various potential users in the ability of a business enterprise to generate favorable cash flows.[9] General purpose financial statements are feasible only because groups of users of financial information have generally similar needs. But "general purpose" does not mean "all purpose," and financial statements do not necessarily satisfy all users equally well.

16. Each decision maker judges what accounting information is useful, and that judgment is influenced by factors such as the decisions to be made, the methods of decision making to be used, the information already possessed or obtainable from other sources, and the decision maker's capacity (alone or with professional help) to process the information. Even users

[7]Concepts Statement 3 used the term *comprehensive income* for the concept that was called *earnings* in Concepts Statement 1 and reserved the term *earnings* for possible use to designate a component part of comprehensive income (par. 1, footnote 1). Earnings, including its relationship to comprehensive income, is a major topic of this Statement.

[8]Pars. 33 and 40.

[9]Concepts Statement 1, par. 30.

of financial statement information who make generally similar kinds of decisions differ from each other in those matters.[10]

Usefulness of Financial Statements, Individually and Collectively

17. Financial statements of an entity individually and collectively contribute to meeting the objectives of financial reporting. Component parts of financial statements also contribute to meeting the objectives.

18. Each financial statement provides a different kind of information, and, with limited exceptions (paragraph 14), the various kinds of information cannot be combined into a smaller number of statements without unduly complicating the information. Moreover, the information each provides is used for various purposes, and particular users may be especially interested in the information in one of the statements. Paragraphs 26–57 of this Statement summarize how individual financial statements provide the information listed in paragraph 13.

19. The following two sections first describe how classification and aggregation, if done and used with care, enhance the decision usefulness of financial statements and how financial statements complement each other.

Classification and aggregation in financial statements

20. Classification in financial statements facilitates analysis by grouping items with essentially similar characteristics and separating items with essentially different characteristics. Analysis aimed at objectives such as predicting amounts, timing, and uncertainty of future cash flows requires financial information segregated into reasonably homogeneous groups. For example, components of financial statements that consist of items that have similar characteristics in one or more respects, such as continuity or recurrence, stability, risk, and reliability, are likely to have more predictive value than if their characteristics are dissimilar.

21. Financial statements result from processing vast masses of data and involve needs to simplify, to condense, and to aggregate.[11] Real things and events that affect a dynamic and complex business enterprise are represented in financial statements by words and numbers, which are necessarily highly simplified symbols of the real thing. Real transactions and other events are voluminous and are interpreted, combined, and condensed to be reflected in financial statements. Numerous items and components are aggregated into sums or totals. The resulting financial statements convey information that would be obscured from most users if great detail, such as descriptions of each transaction or event, were provided.

22. Although those simplifications, condensations, and aggregations are both necessary and useful, the Board believes it is important to avoid focusing attention almost exclusively on "the bottom line," earnings per share, or other highly simplified condensations. Summary data, such as the amounts of net assets, comprehensive income, earnings, or earnings per share, may be useful as general indicators of the amount of investment or overall past performance and are often used in efforts to compare an entity with many other entities. But, in a complex business enterprise, summary amounts include many heterogeneous things and events. Components of a financial statement often reflect more homogeneous classes of items than the whole statement. The individual items, subtotals, or other parts of a financial statement may often be more useful than the aggregate to those who make investment, credit, and similar decisions.

Complementary nature of financial statements

23. Financial statements interrelate (articulate) because they reflect different aspects of the same transactions or other events affecting an entity.[12] Although each presents information different from the others, none is likely to serve only a single purpose or provide all the financial statement information that is useful for a particular kind of assessment or decision. Significant tools of financial analysis, such

[10]Concepts Statement 2, pars. 23–26 and 32–41. For example, information cannot be useful to decision makers who cannot understand it, even though it may otherwise be relevant to a decision and be reliable. Understandability of information is related to the characteristics of the decision maker as well as to the characteristics of the information itself.

[11]". . . It is a very fundamental principle indeed that knowledge is always gained by the *orderly* loss of information, that is, by condensing and abstracting and indexing the great buzzing confusion of information that comes from the world around us into a form which we can appreciate and comprehend" (Kenneth E. Boulding, *Economics as a Science* [New York: McGraw-Hill Book Company, 1970], p. 2, emphasis added).

[12]Concepts Statement 3, pars. 14 and 15.

as rates of return and turnover ratios, depend on interrelationships between financial statements and their components.

24. Financial statements complement each other. For example:

a. Statements of financial position include information that is often used in assessing an entity's liquidity and financial flexibility,[13] but a statement of financial position provides only an incomplete picture of either liquidity or financial flexibility unless it is used in conjunction with at least a cash flow statement.
b. Statements of earnings and comprehensive income generally reflect a great deal about the profitability of an entity during a period, but that information can be interpreted most meaningfully or compared with that of the entity for other periods or that of other entities only if it is used in conjunction with a statement of financial position, for example, by computing rates of return on assets or equity.
c. Statements of cash flows commonly show a great deal about an entity's current cash receipts and payments, but a cash flow statement provides an incomplete basis for assessing prospects for future cash flows because it cannot show interperiod relationships. Many current cash receipts, especially from operations, stem from activities of earlier periods, and many current cash payments are intended or expected to result in future, not current, cash receipts. Statements of earnings and comprehensive income, especially if used in conjunction with statements of financial position, usually provide a better basis for assessing future cash flow prospects of an entity than do cash flow statements alone.[14]
d. Statements of investments by and distributions to owners provide information about significant sources of increases and decreases in assets, liabilities, and equity, but that information is of little practical value unless used in conjunction with other financial statements, for example, by comparing distributions to owners with earnings and comprehensive income or by comparing investments by and distributions to owners with borrowings and repayments of debt.

Individual Financial Statements

25. This discussion summarizes how individual financial statements provide the information listed in paragraph 13. It also introduces recognition considerations, which are the subject of the sections following.

Statement of Financial Position

26. A statement of financial position provides information about an entity's assets, liabilities, and equity and their relationships to each other at a moment in time. The statement delineates the entity's resource structure—major classes and amounts of assets—and its financing structure—major classes and amounts of liabilities and equity.

27. A statement of financial position does not purport to show the value of a business enterprise[15] but, together with other financial statements and other information, should provide information that is useful to those who desire to make their own estimates of the enterprise's value. As a result of limitations stemming from uncertainty and cost-benefit considerations, not all assets and not all liabilities are included in a statement of financial position, and some assets and liabilities that are included are affected by events, such as price changes or accretion, that are not recognized. Statements of financial position also commonly use different attributes to measure different assets and liabilities.[16]

28. Uncertainty and related limitations of financial accounting put the burden of estimating values of business enterprises and of investments in them on investors, creditors, and others. Information about components of earnings and comprehensive income often plays a significant part in that analysis. For example, investors may use that information to help estimate "earning power," or other amounts that they perceive as representative of long-term earning ability of an enterprise, as a significant step in comparing the market price of an equity security with its "intrinsic value." Those estimates and analyses are part of

[13]Liquidity reflects an asset's or liability's nearness to cash. Financial flexibility is the ability of an entity to take effective actions to alter amounts and timing of cash flows so it can respond to unexpected needs and opportunities.

[14]Concepts Statement 1, pars. 42–46.

[15]Ibid., par. 41.

[16]The different attributes are defined and their current use illustrated in paragraphs 66–70 of this Statement.

financial analysis, not financial reporting,[17] but financial accounting facilitates financial analysis by, among other things, classifying financial statement information in homogeneous groups.[18]

29. Important uses of information about an entity's financial position include helping users to assess factors such as the entity's liquidity, financial flexibility, profitability, and risk. Comparisons among entities and computations of rates of return are enhanced to the extent that significant asset and liability groupings are homogeneous in general characteristics and measurement.

Statements of Earnings and Comprehensive Income

30. Statements of earnings and comprehensive income together reflect the extent to which and the ways in which the equity of an entity increased or decreased from all sources other than transactions with owners during a period. Investors, creditors, managers, and others need information about the causes of changes in an entity's assets and liabilities—including results of its ongoing major or central operations, results of its incidental or peripheral transactions, and effects of other events and circumstances stemming from the environment that are often partly or wholly beyond the control of the entity and its management.

31. Effects of an entity's various activities, transactions, and events differ in stability, risk, and predictability, indicating a need for information about various components of earnings and comprehensive income. That need underlies the distinctions between revenues and gains, between expenses and losses, between various kinds of gains and losses, and between measures found in present practice such as income from continuing operations and net income.[19]

32. Since the parts of a financial statement may be more useful to decision makers than the whole (paragraphs 20–22), this Statement emphasizes usefulness of components, interrelationships, and different perspectives as well as usefulness, collectively and individually, of financial statements.

Earnings

33. The concept of earnings described in this Statement is similar to net income in present practice. It includes almost all of what is in present net income for a period, and a statement of earnings based on it will be much like a present income statement. Present practice accepts a variety of terms for net income, and the Board anticipates that net income, profit, net loss, and other equivalent terms will continue to be used in financial statements as names for earnings. However, earnings is not exactly the same as present net income, and this Statement uses the term *earnings* in part to distinguish the concept described here from present net income.

34. Earnings does not include the cumulative effect of certain accounting adjustments of earlier periods that are recognized in the current period.[20] The principal example that is included in present net income but excluded from earnings is the cumulative effect of a change in accounting principle, but others may be identified in the future. Earnings is a measure of performance for a period and to the extent feasible excludes items that are extraneous to that period—items that belong primarily to other periods.[21] The following condensed statements show the similarities and major existing difference between earnings and present net income.

---

[17]". . . [A]ccrual accounting provides measures of earnings rather than evaluations of management's performance, estimates of 'earning power,' predictions of earnings, assessments of risk, or confirmations or rejections of predictions or assessments. Investors, creditors, and other users of the information do their own evaluating, estimating, predicting, assessing, confirming, or rejecting. For example, procedures such as averaging or normalizing reported earnings for several periods and ignoring or averaging out the financial effects of 'nonrepresentative' transactions and events are commonly used in estimating 'earning power.' However, both the concept of 'earning power' and the techniques for estimating it are part of financial analysis and are beyond the scope of financial reporting" (Concepts Statement 1, par. 48).

[18]Pars. 20–22 of this Statement.

[19]Concepts Statement 3, pars. 61 and 151.

[20]That is, the cumulative effect on equity at the beginning of the period for which an earnings statement is provided, sometimes called a "catch-up adjustment."

[21]Prior period adjustments as defined in FASB Statement No. 16, *Prior Period Adjustments,* are not included in net income in present practice and are not, therefore, differences between earnings in this Statement and present net income. Statement 16 narrowed considerably the definition of prior period adjustments in APB Opinions No. 9, *Reporting the Results of Operations,* and No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions.* Some items that were prior period adjustments under those Opinions are included in net income in present practice, and some argue that the existing definition is too narrow because as a result net income includes items that belong to other periods.

	Present Net Income		Earnings	
Revenues		100		100
Expenses		80		80
Gain from unusual source		(3)		(3)
Income from continuing operations		23		23
Loss on discontinued operations				
Income from operating discontinued segment	10		10	
Loss on disposal of discontinued segment	12	2	12	2
Income before extraordinary items				21
and effect of a change in accounting principle		21		
Extraordinary loss	6			6
Cumulative effect on prior years of a change in accounting principle	2	8		
Earnings				15
Net Income		13		

35. The Board expects the concept of earnings to be subject to the process of gradual change or evolution that has characterized the development of net income. Present practice has developed over a long time, and that evolution has resulted in significant changes in what net income reflects, such as a shift toward what is commonly called an "all-inclusive" income statement. Those changes have resulted primarily from standard-setting bodies' responses to several factors, such as changes in the business and economic environment and perceptions about the nature and limitations of financial statements, about the needs of users of financial statements, and about the need to prevent or cure perceived abuse(s) in financial reporting. Those factors sometimes may conflict or appear to conflict. For example, an all-inclusive income statement is intended, among other things, to avoid discretionary omissions of losses (or gains) from an income statement, thereby avoiding presentation of a more (or less) favorable report of performance or stewardship than is justified. However, because income statements also are used as a basis for estimating future performance and assessing future cash flow prospects, arguments have been advanced urging exclusion of unusual or nonrecurring gains and losses that might reduce the usefulness of an income statement for any one year for predictive purposes.

36. Earnings is a measure of performance during a period that is concerned primarily with the extent to which asset inflows associated with cash-to-cash cycles[22] substantially completed (or completed) during the period exceed (or are less than) asset outflows associated, directly or indirectly, with the same cycles. Both an entity's ongoing major or central activities and its incidental or peripheral transactions involve a number of overlapping cash-to-cash cycles of different lengths. At any time, a significant proportion of those cycles is normally incomplete, and prospects for their successful completion and amounts of related revenues, expenses, gains, and losses vary in degree of uncertainty. Estimating those uncertain results of incomplete cycles is costly and involves risks, but the benefits of timely financial reporting based on sales or other more relevant events, rather than on cash receipts or other less relevant events, outweigh those costs and risks.

37. Final results of incomplete cycles usually can be reliably measured at some point of substantial completion (for example, at the time of sale, usually

[22]The patterns of cash-to-cash cycles vary by industry. "Descriptions of operations of business enterprises commonly describe a cycle that begins with cash outlays and ends with cash receipts. That description . . . generally fits manufacturing, merchandising, financial, and service enterprises whose operations comprise primarily activities such as acquiring goods and services, increasing their value by adding time, place, or form utility, selling them, and collecting the selling price. Cash receipts may precede cash payments, however, and commonly do in the operations of some service and financial enterprises" (Concepts Statement 1, par. 39, footnote 8).

meaning delivery) or sometimes earlier in the cycle (for example, as work proceeds on certain long-term, construction-type contracts), so it is usually not necessary to delay recognition until the point of full completion (for example, until after receivables have been collected and warranty obligations have been satisfied). Guidance for applying recognition criteria to components of earnings (paragraphs 78–87) helps define earnings by aiding in making those determinations.

38. Earnings focuses on what the entity has received or reasonably expects to receive for its output (revenues) and what it sacrifices to produce and distribute that output (expenses). Earnings also includes results of the entity's incidental or peripheral transactions and some effects of other events and circumstances stemming from the environment (gains and losses).[23]

Comprehensive income

39. Comprehensive income is a broad measure of the effects of transactions and other events on an entity, comprising all recognized changes in equity (net assets) of the entity during a period from transactions and other events and circumstances except those resulting from investments by owners and distributions to owners.[24]

40. Just as a variety of terms are used for net income in present practice, the Board anticipates that total nonowner changes in equity, comprehensive loss, and other equivalent terms will be used in future financial statements as names for comprehensive income.

41. Components of comprehensive income other than those that are included in earnings present no recognition problems in addition to those involved in recognizing assets and liabilities, for which fundamental criteria are described later (paragraphs 58–77).

Relationships between earnings and comprehensive income

42. Earnings and comprehensive income have the same broad components—revenues, expenses, gains, and losses—but are not the same because certain classes of gains and losses are included in comprehensive income but are excluded from earnings.[25] Those items fall into two classes that are illustrated by certain present practices:

a. Effects of certain accounting adjustments of earlier periods that are recognized in the period, such as the principal example in present practice—cumulative effects of changes in accounting principles—which are included in present net income but are excluded from earnings as set forth in this Statement (paragraphs 33 and 34)
b. Certain other changes in net assets (principally certain holding gains and losses) that are recognized in the period, such as some changes in market values of investments in marketable equity securities classified as noncurrent assets, some changes in market values of investments in industries having specialized accounting practices for marketable securities, and foreign currency translation adjustments.[26]

Both classes and the items they comprise are subject to evolutionary change (paragraph 35).

43. Differences between earnings and comprehensive income require some distinguishing terms. The items in both classes described in paragraph 42 are gains and losses under the definitions in Concepts Statement 3 (paragraphs 67–73), but to refer to *some* gains and losses that are included in earnings and *other* gains and losses that are included in comprehensive income but are excluded from earnings is not

---

[23]Concepts Statement 3, paragraphs 50 and 63–73, defines revenues, expenses, gains, and losses.

[24]Ibid., pars. 50, 56–62, and 147–152.

[25]That possibility was noted in Concepts Statement 3: ". . . the reason for using *comprehensive income* rather than *earnings* in this Statement is that the Board has decided to reserve *earnings* for possible use to designate a different concept that is a component part of—that is, is narrower than or less than—comprehensive income. . . ." (par. 58, footnote reference omitted).

[26]FASB Statements No. 12, *Accounting for Certain Marketable Securities;* No. 60, *Accounting and Reporting by Insurance Enterprises;* and No. 52, *Foreign Currency Translation.* Changes in market values of marketable securities are included in earnings by some other entities having specialized accounting practices for marketable securities (for example, securities brokers and dealers and investment companies) and for some classes of marketable securities (for example, securities held in trading accounts of banks and futures contracts that are considered speculative [FASB Statement No. 80, *Accounting for Futures Contracts*]).

only clumsy but also likely to be confusing. This Statement therefore uses *gains* and *losses* for those included in earnings and uses *cumulative accounting adjustments* and *other nonowner changes in equity* for those excluded from earnings but included in comprehensive income.

44. The relationships between earnings and comprehensive income described in the foregoing paragraphs mean that statements of earnings and comprehensive income complement each other something like this:[27]

+	Revenues	100	+	Earnings	15
–	Expenses	80	–	Cumulative accounting adjustments	2
+	Gains	3			
–	Losses	8	+	Other nonowner changes in equity	1
=	Earnings	15	=	Comprehensive income	14

Financial capital maintenance

45. The full set of articulated financial statements discussed in this Statement is based on the concept of financial capital maintenance.

46. An enterprise receives a return only after its capital has been maintained or recovered. The concept of capital maintenance, therefore, is critical in distinguishing an enterprise's return *on* investment from return *of* its investment. Both investors and the enterprises in which they acquire an interest invest financial resources with the expectation that the investment will generate more financial resources than they invested.

47. A return on financial capital results only if the financial (money) amount of an enterprise's net assets at the end of a period exceeds the financial amount of net assets at the beginning of the period after excluding the effects of transactions with owners. The financial capital concept is the traditional view and is the capital maintenance concept in present financial statements.[28] In contrast, a return on physical capital results only if the physical productive capacity of the enterprise at the end of the period (or the resources needed to achieve that capacity) exceeds the physical productive capacity at the beginning of the period, also after excluding the effects of transactions with owners. The physical capital maintenance concept can be implemented only if inventories and property, plant, and equipment (and perhaps other assets) are measured by their current costs, while the financial capital maintenance concept does not require measurement by a particular attribute.

48. The principal difference between the two capital maintenance concepts involves the effects of price changes during a period on assets while held and liabilities while owed. Under the financial capital concept, if the effects of those price changes are recognized, they are conceptually holding gains and losses (though they are commonly reported under other names)[29] and are included in the return on capital. Under the physical capital concept, those changes would be recognized but conceptually would be capital maintenance adjustments that would be included directly in equity and not included in return on capital. Both earnings and comprehensive income as set forth in this Statement, like present net income, include holding gains and losses that would be excluded from income under a physical capital maintenance concept.

Recognition implications of earnings

49. Although recognition involves considerations of relevance and comparability, recognition criteria, conventions, and rules are primarily intended to increase reliability—they are means of coping with the uncertainty that surrounds business and economic activities. Uncertainty in business and economic affairs

[27]Earnings and its components are the same as in the example in paragraph 34. Both *cumulative accounting adjustments* and *other nonowner changes in equity* may be either additions to or deductions from earnings. The signs used in the example are for illustration only.

[28]Concepts Statement 3, par. 58. "Comprehensive income as defined in paragraph 56 is a return *on* financial capital" (Ibid.).

[29]For example, under the FIFO method in present practice, gains from price increases on inventory while held reduce cost of goods sold.

is a continuum, ranging from mere lack of absolute sureness to a degree of vagueness that precludes anything other than guesswork. Since uncertainty surrounds an entity's incomplete cash-to-cash cycles in varying degrees, measuring progress reliably involves determining whether uncertainty about future cash flows has been reduced to an acceptable level.

50. In response to uncertainty, there has been a general tendency to emphasize purchase and sale transactions and to apply conservative procedures in accounting recognition. Perceptions about characteristics such as realizability and volatility may also help to explain why some events are recognized in present practice while others are not. For example, revenues are sometimes recognized before sale if readily realizable (if sale is a more-or-less effortless or perfunctory activity, and uncertainty about amounts involved is reduced to an acceptable level by quoted prices for interchangeable units in active markets or other reliable measures).[30] Those characteristics may also help to explain certain special recognition rules. For example, so-called translation adjustments from translating foreign currency financial statements are excluded from net income but are reported separately in comprehensive income (paragraphs 39 and 42) because they are considered not only unrealized but also unrealizable short of sale or liquidation of the investment in the entity. Effects of exchange rate changes on the net investment are considered too uncertain and remote to be included in operating results.[31] Similarly, a reason commonly given for the same treatment for certain changes in market values of investments in marketable equity securities is that they may be temporary, and temporary fluctuations in market values of long-term investments should not be included in net income.[32]

51. Since earnings in this Statement is similar to net income for a period in present practice, criteria and guidance given in the Statement for recognizing components of earnings (paragraphs 58–87) are generally similar to revenue and expense recognition criteria or rules in present practice. Future standards may change what is recognized as components of earnings (paragraph 35). Moreover, because of the differences between earnings and comprehensive income, future standards also may recognize certain changes in net assets as components of comprehensive income but not as components of earnings.[33]

Statement of Cash Flows

52. A statement of cash flows directly or indirectly reflects an entity's cash receipts classified by major sources and its cash payments classified by major uses during a period. It provides useful information about an entity's activities in generating cash through operations to repay debt, distribute dividends, or reinvest to maintain or expand operating capacity; about its financing activities, both debt and equity; and about its investing or spending of cash. Important uses of information about an entity's current cash receipts and payments include helping to assess factors such as the entity's liquidity, financial flexibility, profitability, and risk.

53. Since neither earnings nor comprehensive income measured by accrual accounting is the same as cash flow from operations, cash flow statements provide significant information about amounts, causes, and intervals of time between earnings and comprehensive income and cash receipts and outlays. Users commonly consider that information in assessing the relationship between earnings or comprehensive income and associated cash flows.

54. Statements of cash flows present few recognition problems because all cash receipts and payments are recognized when they occur. Reporting cash flows involves no estimates or allocations and few judgments except regarding classification in cash flow statements.[34]

Statement of Investments by and Distributions to Owners

55. A statement of investments by and distributions to owners reflects the extent to which and in what ways the equity of an entity increased or decreased

---

[30] ARB No. 43, Chapter 4, par. 16; FASB Statement 12, pars. 14–16, 27, and 28.

[31] Statement 52, pars. 111–113.

[32] Statement 12, pars. 21, 29, and 30.

[33] A possibility that has been suggested is the "inventory profits" that would result if cost of goods sold were reported on LIFO while inventories were reported on FIFO.

[34] Determinations about the particular items to be reported within cash flow statements and the form of those statements are matters that may be developed further in Statements of Financial Accounting Standards or in practice.

from transactions with owners as owners[35] during a period. That is, it reflects the capital transactions[36] of the entity, in contrast to its income transactions—those with nonowners—which are reflected in statements of earnings and comprehensive income. Statements of comprehensive income and statements of transactions with owners together include all changes in equity (net assets) recognized during a period.

56. Investments by owners establish or increase ownership interests in the entity and may be received in the form of cash, goods or services, or satisfaction or conversion of the entity's liabilities. Distributions decrease ownership interests and include not only cash dividends when declared (or other cash withdrawals by owners of noncorporate entities) but also transactions such as reacquisitions of the entity's equity securities and distributions "in kind" of noncash assets. Information about those events is useful, in conjunction with other financial statement information, to investors, creditors, and other users as an aid in assessing factors such as the entity's financial flexibility, profitability, and risk.

57. Transactions with owners are now normally recognized when they occur. Recognition problems concerning them can be difficult; for example, problems sometimes arise in distinguishing transactions with owners from transactions with certain creditors, and investments and dividends in kind may present measurement problems.[37] However, the recognition implications of earnings that lead to special guidance do not apply to transactions with owners, and that sort of special guidance is not needed for them.

RECOGNITION CRITERIA

58. As noted in paragraphs 6–9, recognition is the process of formally recording or incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, or the like. A recognized item is depicted in both words and numbers, with the amount included in the statement totals. Recognition comprehends both initial recognition of an item and recognition of subsequent changes in or removal of a previously recognized item.

Purposes of Criteria

59. Criteria are set forth in this Statement to provide direction for resolving issues that involve accounting recognition. An entity's assets and liabilities and the effects of events on them and on its equity are candidates for recognition in its financial statements.

60. Some events that affect assets, liabilities, or equity are not recognized in financial statements at the time they occur. Some events that result in future benefits, for example, creation of product awareness by advertising and promotion, may perhaps never be recognized as separate assets. Other events, for example, a disaster loss of unknown dimension, are recognized only when sufficient information about the effects of the event has become available at a justifiable cost to reduce uncertainty to an acceptable level. Recognition criteria aid in making those determinations.

Structure of Recognition Criteria

61. The recognition criteria in this Statement are derived from the qualitative characteristics of financial information in Concepts Statement 2 and are helpful in making the definitions of elements of financial statements in Concepts Statement 3 operational in resolving financial reporting issues.

62. The fundamental criteria apply to all recognition decisions. Further guidance is provided in paragraphs 78–87 for applying the fundamental criteria to components of earnings.

Fundamental Recognition Criteria

63. An item and information about it should meet four fundamental recognition criteria to be recognized and should be recognized when the criteria are

---

[35]Rather than as its employees, suppliers, customers, lenders, or the like (Concepts Statement 3, par. 44); that Statement defines investments by and distributions to owners in paragraphs 52–55.

[36]Capital transactions are transactions with owners that affect ownership interests (equity) in an entity:

> Although *capital* is not a precise term in referring to ownership interests because it is also applied to assets and liabilities in various ways, it is used in this discussion because *capital* is part of so many terms commonly used to describe aspects of ownership interests; for example, investments by owners are commonly called capital contributions, distributions to owners are commonly called capital distributions, and discussions of comprehensive income and its components often refer to capital maintenance. [Concepts Statement 3, par. 144]

[37]Concepts Statement 3, par. 49, and APB Opinion No. 29, *Accounting for Nonmonetary Transactions.*

met, subject to a cost-benefit constraint and a materiality threshold. Those criteria are:

> *Definitions*—The item meets the definition of an element of financial statements.
>
> *Measurability*—It has a relevant attribute measurable with sufficient reliability.
>
> *Relevance*—The information about it is capable of making a difference in user decisions.
>
> *Reliability*—The information is representationally faithful, verifiable, and neutral.

All four criteria are subject to a pervasive cost-benefit constraint: the expected benefits from recognizing a particular item should justify perceived costs of providing and using the information.[38] Recognition is also subject to a materiality threshold: an item and information about it need not be recognized in a set of financial statements if the item is not large enough to be material and the aggregate of individually immaterial items is not large enough to be material to those financial statements.[39]

Definitions

64. The definitions are those in FASB Concepts Statement No. 3, *Elements of Financial Statements of Business Enterprises.*[40] To be recognized in financial statements, a resource must meet the definition of an asset, and an obligation must meet the definition of a liability. A change in equity must meet the definition of a revenue, expense, gain, or loss to be recognized as a component of comprehensive income.[41]

Measurability

65. The asset, liability, or change in equity must have a relevant attribute[42] that can be quantified in monetary units with sufficient reliability. Measurability must be considered together with both relevance and reliability.

Measurement attributes

66. Items currently reported in financial statements are measured by different attributes, depending on the nature of the item and the relevance and reliability of the attribute measured. The Board expects the use of different attributes to continue.

67. Five different attributes of assets (and liabilities) are used in present practice:

a. *Historical cost (historical proceeds).* Property, plant, and equipment and most inventories are reported at their historical cost, which is the amount of cash, or its equivalent, paid to acquire an asset, commonly adjusted after acquisition for amortization or other allocations. Liabilities that involve obligations to provide goods or services to customers are generally reported at historical proceeds, which is the amount of cash, or its equivalent, received when the obligation was incurred and may be adjusted after acquisition for amortization or other allocations.
b. *Current cost.* Some inventories are reported at their current (replacement) cost, which is the amount of cash, or its equivalent, that would have to be paid if the same or an equivalent asset were acquired currently.

---

[38] Concepts Statement 2, pars. 32 and 33 and 133–144.

[39] "Individual judgments are required to assess materiality. . . . The essence of the materiality concept is clear. The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item" (Concepts Statement 2, par. 132).

[40] Concepts Statement 3 does not define elements of cash flow statements but notes classes of items that may be called elements of financial statements, for example, cash provided by operations, cash provided by borrowing, cash provided by issuing equity securities, and so forth (par. 4). However, all items in cash flow statements involve cash receipts or payments, which for recognition purposes are covered by the definitions in that Statement.

[41] As already noted (pars. 42 and 43), the items called *cumulative accounting adjustments* and *other nonowner changes in equity* are gains and losses under the definitions in Concepts Statement 3.

[42] *Attribute* "refers to the traits or aspects of an element to be quantified or measured, such as historical cost/historical proceeds, current cost/current proceeds, etc. Attribute is a narrower concept than measurement, which includes not only identifying the attribute to be measured but also selecting a scale of measurement (for example, units of money or units of constant purchasing power)" (Concepts Statement 1, par. 2, footnote 2).

c. *Current market value.* Some investments in marketable securities are reported at their current market value, which is the amount of cash, or its equivalent, that could be obtained by selling an asset in orderly liquidation. Current market value is also generally used for assets expected to be sold at prices lower than previous carrying amounts. Some liabilities that involve marketable commodities and securities, for example, the obligations of writers of options or sellers of common shares who do not own the underlying commodities or securities, are reported at current market value.
d. *Net realizable (settlement) value.* Short-term receivables and some inventories are reported at their net realizable value, which is the nondiscounted amount of cash, or its equivalent, into which an asset is expected to be converted in due course of business less direct costs, if any, necessary to make that conversion. Liabilities that involve known or estimated amounts of money payable at unknown future dates, for example, trade payables or warranty obligations, generally are reported at their net settlement value, which is the nondiscounted amounts of cash, or its equivalent, expected to be paid to liquidate an obligation in the due course of business, including direct costs, if any, necessary to make that payment.
e. *Present (or discounted) value of future cash flows.* Long-term receivables are reported at their present value (discounted at the implicit or historical rate), which is the present or discounted value of future cash inflows into which an asset is expected to be converted in due course of business less present values of cash outflows necessary to obtain those inflows. Long-term payables are similarly reported at their present value (discounted at the implicit or historical rate), which is the present or discounted value of future cash outflows expected to be required to satisfy the liability in due course of business.

68. The different attributes often have the same amounts, particularly at initial recognition. As a result, there may be agreement about the appropriate amount for an item but disagreement about the attribute being used. Present financial statements frequently are characterized as being based on the historical cost (historical proceeds) attribute. That no doubt reflects the fact that, for most enterprises, a great many of the individual events recognized in financial statements are acquisitions of goods or services for cash or equivalent that are recorded at historical cost. Although the "historical cost system" description may be convenient and describes well present practice for some major classes of assets (most inventories, property, plant, and equipment, and intangibles), it describes less well present practice for a number of other classes of assets and liabilities—for example, trade receivables, notes payable, and warranty obligations.

69. "Historical exchange price" is more descriptive of the quantity most generally reflected in financial statements in present practice (and "transaction-based system" would be a better description of the present accounting model than "historical cost system"). Amounts initially recorded for trade receivables and long-term notes payable, for example, generally fit the historical exchange price description. But some assets are acquired, and some liabilities are incurred, without exchanges—for example, assets found or received as contributions and income tax or litigation liabilities. There is no historical exchange price in those situations, and some other attribute must be used. Moreover, carrying amounts of assets (liabilities) are frequently reduced (increased) from historical exchange price to a lower (higher) current cost, current market value, or net realizable value, even though no subsequent exchange of the assets held or liabilities owed has occurred. And some assets are carried at current market value, independent of historical exchange price.

70. Rather than attempt to characterize present practice as being based on a single attribute with numerous major exceptions for diverse reasons, this concepts Statement characterizes present practice as based on different attributes. Rather than attempt to select a single attribute and force changes in practice so that all classes of assets and liabilities use that attribute, this concepts Statement suggests that use of different attributes will continue, and discusses how the Board may select the appropriate attribute in particular cases.[43]

Monetary unit or measurement scale

71. The monetary unit or measurement scale in financial statements in current practice is nominal units

[43]This discussion of measurement attributes is based in part on the FASB Discussion Memorandum, *Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement* (December 2, 1976), paragraphs 388–574, which further describes and illustrates each of the attributes and remains a useful reference.

of money, that is, unadjusted for changes in purchasing power of money over time. An ideal measurement scale would be one that is stable over time. At low rates of change in general purchasing power (inflation or deflation), nominal units of money are relatively stable. Also, preparation and use of financial statements is simpler with nominal units than with other units of measure, such as units of constant general purchasing power (used, for example, in supplementary disclosures of the effects of changing prices),[44] artificial monetary units (for example, the European Currency Unit or ECU), or units of a commodity (for example, ounces of gold). However, as rates of change in general purchasing power increase, financial statements expressed in nominal units of money become progressively less useful and less comparable.

72. The Board expects that nominal units of money will continue to be used to measure items recognized in financial statements. However, a change from present circumstances (for example, an increase in inflation to a level at which distortions became intolerable) might lead the Board to select another, more stable measurement scale.

Relevance

73. Relevance is a primary qualitative characteristic. To be relevant, information about an item must have feedback value or predictive value (or both) for users and must be timely.[45] Information is relevant if it has the capacity to make a difference in investors', creditors', or other users' decisions. To be recognized, the information conveyed by including an asset, liability, or change therein in the financial statements must be relevant.

74. The relevance of particular information about an item being considered for recognition cannot be determined in isolation. Relevance should be evaluated in the context of the principal objective of financial reporting: providing information that is useful in making rational investment, credit, and similar decisions.[46] Relevance should also be evaluated in the context of the full set of financial statements—with consideration of how recognition of a particular item contributes to the aggregate decision usefulness.

Reliability

75. Reliability is the other primary qualitative characteristic. To be reliable, information about an item must be representationally faithful, verifiable, and neutral.[47] To be reliable, information must be sufficiently faithful in its representation of the underlying resource, obligation, or effect of events and sufficiently free of error and bias to be useful to investors, creditors, and others in making decisions. To be recognized, information about the existence and amount of an asset, liability, or change therein must be reliable.

76. Reliability may affect the timing of recognition. The first available information about an event that may have resulted in an asset, liability, or change therein is sometimes too uncertain to be recognized: it may not yet be clear whether the effects of the event meet one or more of the definitions or whether they are measurable, and the cost of resolving those uncertainties may be excessive. Information about some items that meet a definition may never become sufficiently reliable at a justifiable cost to recognize the item. For other items, those uncertainties are reduced as time passes, and reliability is increased as additional information becomes available.

77. Unavailability or unreliability of information may delay recognition of an item, but waiting for virtually complete reliability or minimum cost may make the information so untimely that it loses its relevance. At some intermediate point, uncertainty may be reduced at a justifiable cost to a level tolerable in view of the perceived relevance of the information. If other criteria are also met, that is the appropriate point for recognition. Thus, recognition may sometimes involve a trade-off between relevance and reliability.

GUIDANCE IN APPLYING CRITERIA TO COMPONENTS OF EARNINGS

78. This section discusses the need for and provides further guidance in applying the fundamental criteria in recognizing components of earnings. Changes in net assets are recognized as components of earnings

[44]FASB Statement No. 33, *Financial Reporting and Changing Prices,* as amended.

[45]Concepts Statement 2, pars. 46–57.

[46]Concepts Statement 1, pars. 34–40.

[47]Concepts Statement 2, pars. 58–110.

if they qualify under the guidance in paragraphs 83–87. Certain changes in net assets (discussed in paragraphs 42–44 and 49–51) that meet the four fundamental recognition criteria just described may qualify for recognition in comprehensive income even though they do not qualify for recognition as components of earnings based on that guidance.

79. Further guidance in applying the recognition criteria to components of earnings is necessary because of the widely acknowledged importance of information about earnings and its components as a primary measure of performance for a period. The performance measured is that of the entity, not necessarily that of its management, and includes the recognized effects upon the entity of events and circumstances both within and beyond the control of the entity and its management.[48] The widely acknowledged importance of earnings information leads to guidance intended in part to provide more stringent requirements for recognizing components of earnings than for recognizing other changes in assets or liabilities.

80. As noted in paragraph 36, earnings measures the extent to which asset inflows (revenues and gains) associated with substantially completed cash-to-cash cycles exceed asset outflows (expenses and losses) associated, directly or indirectly, with the same cycles. Guidance for recognizing components of earnings is concerned with identifying which cycles are substantially complete and with associating particular revenues, gains, expenses, and losses with those cycles.

81. In assessing the prospect that as yet uncompleted transactions will be concluded successfully, a degree of skepticism is often warranted.[49] Moreover, as a reaction to uncertainty, more stringent requirements historically have been imposed for recognizing revenues and gains than for recognizing expenses and losses, and those conservative reactions influence the guidance for applying the recognition criteria to components of earnings.

82. The guidance stated here is intended to summarize key considerations in a form useful for guidance for future standard setting—guidance which also is consistent with the vast bulk of current practice. The following paragraphs provide guidance separately for recognition of revenues and gains and for expenses and losses as components of earnings.

Revenues and Gains

83. Further guidance for recognition of revenues and gains is intended to provide an acceptable level of assurance of the existence and amounts of revenues and gains before they are recognized. Revenues and gains of an enterprise during a period are generally measured by the exchange values of the assets (goods or services) or liabilities involved, and recognition involves consideration of two factors, (a) being realized or realizable and (b) being earned, with sometimes one and sometimes the other being the more important consideration.

a. *Realized or realizable.* Revenues and gains generally are not recognized until realized or realizable.[50] Revenues and gains are realized when products (goods or services), merchandise, or other assets are exchanged for cash or claims to cash. Revenues and gains are realizable when related assets received or held are readily convertible to known amounts of cash or claims to cash. Readily convertible assets have (i) interchangeable (fungible) units and (ii) quoted prices available in an active market that can rapidly absorb the quantity held by the entity without significantly affecting the price.
b. *Earned.* Revenues are not recognized until earned. An entity's revenue-earning activities involve delivering or producing goods, rendering services, or other activities that constitute its on-

[48]"What happens to a business enterprise is usually so much a joint result of a complex interaction of many factors that neither accounting nor other statistical analysis can discern with reasonable accuracy the degree to which management, or any other factor, affected the joint result" (Concepts Statement 1, par. 53).

[49]Concepts Statement 2, par. 97.

[50]The terms *realized* and *realizable* are used in the Board's conceptual framework in precise senses, focusing on conversion or convertibility of noncash assets into cash or claims to cash (Concepts Statement 3, par. 83). *Realized* has sometimes been used in a different, broader sense: for example, some have used that term to include *realizable* or to include certain conversions of noncash assets into other assets that are also not cash or claims to cash. APB Statement 4, paragraphs 148–153, used the term *realization* even more broadly as a synonym for *recognition.*

going major or central operations,[51] and revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. Gains commonly result from transactions and other events that involve no "earning process," and for recognizing gains, being earned is generally less significant than being realized or realizable.

84. In recognizing revenues and gains:

a. The two conditions (being realized or realizable and being earned) are usually met by the time product or merchandise is delivered or services are rendered to customers, and revenues from manufacturing and selling activities and gains and losses from sales of other assets are commonly recognized at time of sale (usually meaning delivery).[52]
b. If sale or cash receipt (or both) precedes production and delivery (for example, magazine subscriptions), revenues may be recognized as earned by production and delivery.
c. If product is contracted for before production, revenues may be recognized by a percentage-of-completion method as earned—as production takes place—provided reasonable estimates of results at completion and reliable measures of progress are available.[53]
d. If services are rendered or rights to use assets extend continuously over time (for example, interest or rent), reliable measures based on contractual prices established in advance are commonly available, and revenues may be recognized as earned as time passes.
e. If products or other assets are readily realizable because they are salable at reliably determinable prices without significant effort (for example, certain agricultural products, precious metals, and marketable securities), revenues and some gains or losses may be recognized at completion of production or when prices of the assets change. Paragraph 83(a) describes readily realizable (convertible) assets.
f. If product, services, or other assets are exchanged for nonmonetary assets that are not readily convertible into cash, revenues or gains or losses may be recognized on the basis that they have been earned and the transaction is completed. Gains or losses may also be recognized if nonmonetary assets are received or distributed in nonreciprocal transactions. Recognition in both kinds of transactions depends on the provision that the fair values involved can be determined within reasonable limits.[54]
g. If collectibility of assets received for product, services, or other assets is doubtful, revenues and gains may be recognized on the basis of cash received.

Expenses and Losses

85. Further guidance for recognition of expenses and losses is intended to recognize consumption (using up) of economic benefits or occurrence or discovery of loss of future economic benefits during a period. Expenses and losses are generally recognized when an entity's economic benefits are used up in delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations or when previously recognized assets are expected to provide reduced or no further benefits.

Consumption of Benefits

86. Consumption of economic benefits during a period may be recognized either directly or by relating it to revenues recognized during the period:[55]

a. Some expenses, such as cost of goods sold, are matched with revenues—they are recognized upon recognition of revenues that result directly

---

[51]"Most types of revenue are the joint result of many profit-directed activities of an enterprise and revenue is often described as being 'earned' gradually and continuously by the whole of enterprise activities. *Earning* in this sense is a technical term that refers to the activities that give rise to the revenue—purchasing, manufacturing, selling, rendering service, delivering goods, allowing other entities to use enterprise assets, the occurrence of an event specified in a contract, and so forth. All of the profit-directed activities of an enterprise that comprise the process by which revenue is earned may be called the *earning process*" (APB Statement 4, par. 149). Concepts Statement 3, paragraph 64, footnote 31, contains the same concept.

[52]The requirement that revenue be earned before it is recorded "usually causes no problems because the earning process is usually complete or nearly complete by the time of [sale]" (APB Statement 4, par. 153).

[53]If production is long in relation to reporting periods, such as for long-term, construction-type contracts, recognizing revenues as earned has often been deemed to result in information that is significantly more relevant and representationally faithful than information based on waiting for delivery, although at the sacrifice of some verifiability. (Concepts Statement 2, paragraphs 42–45, describes trade-offs of that kind.)

[54]APB Opinion 29.

[55]Concepts Statement 3, pars. 84–89.

and jointly from the same transactions or other events as the expenses.

b. Many expenses, such as selling and administrative salaries, are recognized during the period in which cash is spent or liabilities are incurred for goods and services that are used up either simultaneously with acquisition or soon after.
c. Some expenses, such as depreciation and insurance, are allocated by systematic and rational procedures to the periods during which the related assets are expected to provide benefits.

Loss or Lack of Future Benefit

87. An expense or loss is recognized if it becomes evident that previously recognized future economic benefits of an asset have been reduced or eliminated, or that a liability has been incurred or increased, without associated economic benefits.

RECOGNITION OF CHANGES IN ASSETS AND LIABILITIES

88. Initial recognition of assets acquired and liabilities incurred generally involves measurement based on current exchange prices at the date of recognition. Once an asset or a liability is recognized, it continues to be measured at the amount initially recognized until an event that changes the asset or liability or its amount occurs and meets the recognition criteria.

89. Events that change assets and liabilities are of two types: (a) inflows (acquisitions of assets or incurrences of liabilities) and outflows (sale or other disposal or loss of assets and settlement or cancellation of liabilities) and (b) changes of amounts of assets while held or of liabilities while owed by the entity. The latter also are of two types: (i) changes in utility or substance and (ii) changes in price. Examples of changes in utility or substance that are recognized in current practice include use of assets in production, depreciation of assets used in administrative activities, and fire damage to assets.

90. Information based on current prices should be recognized if it is sufficiently relevant and reliable to justify the costs involved and more relevant than alternative information. The merits of recognizing changes in prices may be clear in certain cases, and, as already noted, some price changes are recognized in present practice. In other cases, the relative merits of information based on current prices and alternative information may be unclear or may be a matter of dispute. In considering the application of the fundamental recognition criteria, those relative merits must be evaluated in the light of the circumstances of each case.

SUMMARY

91. Most aspects of current practice are consistent with the recognition criteria and guidance in this Statement, but the criteria and guidance do not foreclose the possibility of future changes in practice. This Statement is intended to provide guidance for orderly change in accounting standards when needed. When evidence indicates that information about an item that is more useful (relevant and reliable) than information currently reported is available at a justifiable cost, it should be included in financial statements.

This Statement was adopted by the affirmative vote of six members of the Financial Accounting Standards Board. Mr. March dissented.

Mr. March dissents from this Statement because (a) it does not adopt measurement concepts oriented toward what he believes is the most useful single attribute for recognition purposes, the cash equivalent of recognized transactions reduced by subsequent impairments or loss of service value—instead it suggests selecting from several different attributes without providing sufficient guidance for the selection process; (b) it identifies all nonowner changes in assets and liabilities as comprehensive income and return on equity, thereby including in income, incorrectly in his view, capital inputs from nonowners, unrealized gains from price changes, amounts that should be deducted to maintain capital in real terms, and foreign currency translation adjustments; (c) it uses a concept of income that is fundamentally based on measurements of assets, liabilities, and changes in them, rather than adopting the Statement's concept of earnings as the definition of income; and (d) it fails to provide sufficient guidance for initial recognition and derecognition of assets and liabilities.

Mr. March would not, in general, recognize increases in prices of assets and decreases in prices of liabilities before they are realized. He believes present measurement practice can be characterized as largely using a single attribute, the cash equivalent of recognized transactions reduced by subsequent impairments or loss of service value, and that present practices that recognize revenues or gains from changes in prices before realization, such as the uses of current market values and net realizable values cited in paragraphs 67(c) and (d) and 69, are exceptions to the general use of that single attribute. Mr. March is concerned that the guidance in paragraph 90 would permit, and perhaps point toward, more recognition of changes in current prices before realization. He believes that income, recognition, and measurement concepts based largely on the single attribute that he proposes are most relevant to reporting capital committed, performance, and the investment and realization of resources.

Mr. March objects to comprehensive income, defined in Concepts Statement 3 and confirmed in this Statement, as a concept of income because it includes all recognized changes (including price changes) in assets and liabilities other than investments by owners and distributions to owners. He would exclude from income, and include in the amount of capital to be maintained (in addition to transactions with owners), what he would consider to be direct capital inputs to the enterprise from nonowner sources. Those include governmental and other capital contributions or grants and capital arising in reorganizations, recapitalizations, and extinguishments or restatements of debt capital.

Mr. March would also require that income must first deduct a provision for maintenance of capital in real terms (adjusted for changes in purchasing power of money over time, paragraphs 71–72). He believes that is necessary to avoid reporting a return of capital as income. Complex implementation should not be necessary to provide for the erosion of capital caused by the effects of inflation on the unit of measure. A "rubber yardstick" is a poor measuring tool. Mr. March would also exclude from income foreign currency translation adjustments (excluded from earnings but included in comprehensive income by paragraph 42(b)), which he believes are analogous to provisions for maintenance of capital in real terms.

The description of earnings (paragraphs 33–38) and the guidance for applying recognition criteria to components of earnings (paragraphs 78–87) is consistent with Mr. March's view that income should measure performance and that performance flows primarily from an entity's fulfillment of the terms of its transactions with outside entities that result in revenues, other proceeds on resource dispositions (gains), costs (expenses) associated with those revenues and proceeds, and losses sustained. However, Mr. March believes that those concepts are fundamental and should be embodied in definitions of the elements of financial statements and in basic income recognition criteria rather than basing income on measurements of assets, liabilities, and changes in them.

Disregarding the foregoing objections, Mr. March believes this Statement offers insufficient guidance for the near-term future work of the Board. To be useful, it needs to be supplemented with more specific guidance for selecting measurement attributes for specific assets, liabilities, and transactions and for deciding when the criteria require recognition or derecognition of an asset or a liability.

Members of the Financial Accounting Standards Board:

Donald J. Kirk,
Chairman
Frank E. Block
Victor H. Brown
Raymond C. Lauver
John. W. March
David Mosso
Robert T. Sprouse

Appendix

BACKGROUND INFORMATION

92. The Board's study of recognition and measurement concepts has spanned several years. The need to develop those concepts was identified early in the conceptual framework project, and the first FASB Concepts Statement, *Objectives of Financial Reporting by Business Enterprises,* listed them among several separate matters to be covered:

> . . . Later Statements are expected to cover the elements of financial statements and their recognition, measurement, and display . . . , criteria for distinguishing information to be included in financial statements from that which should be provided by other means of financial reporting, and criteria for evaluating and selecting accounting information (qualitative characteristics). [paragraph 2]

93. During that period, three FASB Research Reports,[56] a Discussion Memorandum,[57] a concepts Statement,[58] and an Exposure Draft[59] have dealt in whole or in part with recognition and measurement matters, and the Board has discussed those matters extensively.

94. The once-separate projects on recognition and on measurement were combined, principally because in the Board's view certain recognition questions, which are among the most important to be dealt with, are so closely related to measurement issues that it is not productive to discuss them separately. For example, the question of whether the appropriate attribute to measure a particular item is a past exchange price or a current exchange price is not easily separable from the question of whether events such as price changes should be recognized.

95. The Board issued an Exposure Draft, *Recognition and Measurement in Financial Statements of Business Enterprises,* on December 30, 1983 and received 104 letters of comment on it.

96. The changes made to the Exposure Draft were largely in response to suggestions in those comment letters and are intended to improve the clarity and organization of the ideas presented in the Exposure Draft. The Board believes that the substance of this Statement is not significantly changed from the Exposure Draft. Noteworthy changes made and changes suggested but not made are discussed below.

97. The discussion of financial statements, financial reporting, and recognition in paragraphs 5–12 has been expanded and reorganized in response to comments that the status of notes, supplementary information, and other means of financial reporting outside of financial statements (all of which are outside the scope of this concepts Statement) was unclear.

98. The term *full set* of financial statements has been used in paragraph 13 and elsewhere in response to comments that *complete set,* the term used in the Exposure Draft, implied that no further information beyond the listed financial statements was needed and to comments that *complete set* had been used in some standards in a different way.

99. A number of respondents inferred from the discussion of cash flow statements in the Exposure Draft that the Board had decided one or more specific issues about cash flow reporting. Those issues include the direct and indirect methods of presentation; whether or not "cash" should include equivalents to cash and, if so, what instruments qualify; whether or not the nonmonetary transactions currently reported in statements of changes in financial position should appear in cash flow statements; and the definitions of cash provided by (or used for) operations, financing activities, and investing activities. Those and other specific cash flow statement issues mentioned by respondents are beyond the scope of this concepts Statement. The discussion of the statement of cash flows was revised to emphasize that.

100. Many respondents criticized the term *comprehensive income* and some criticized the term *earnings* as unwarranted innovations likely to cause confusion and legal difficulties. Those terms are not new. They were first used in their present senses in Concepts Statement 3, in which the Board defined comprehensive income as an element of financial statements and reserved the term *earnings* for possible later use to designate a component part of comprehensive income. This Statement carries forward the concept of comprehensive income and describes a concept for earnings. The Board retained the idea of two separate measures both to reflect present practice for the items discussed in paragraph 42(b) and to allow for the possibility that future standards may recognize some items, for example, the cumulative accounting adjustments discussed in paragraph 42(a), in comprehensive income but not in earnings.

101. The Board explored the alternative terms for *comprehensive income* and *earnings* suggested by respondents, as well as other possibilities suggested by

---

[56]*Recognition of Contractual Rights and Obligations: An Exploratory Study of Conceptual Issues,* by Yuji Ijiri, December 1980; *Survey of Present Practices in Recognizing Revenues, Expenses, Gains, and Losses,* by Henry R. Jaenicke, January 1981; and *Recognition in Financial Statements: Underlying Concepts and Practical Conventions,* by L. Todd Johnson and Reed K. Storey, July 1982.

[57]FASB Discussion Memorandum, *Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement,* December 2, 1976, Part III.

[58]FASB Concepts Statement No. 3, *Elements of Financial Statements of Business Enterprises,* pars. 16 and 17, 37–43, and 74–89.

[59]FASB Exposure Draft, *Reporting Income, Cash Flows, and Financial Position of Business Enterprises,* November 1981, pars. 13–16 and elsewhere. This Statement supersedes that Exposure Draft.

its staff, but concluded that the other terms had disadvantages greater than those attaching to the terms originally selected. The Statement was revised to indicate that the Board anticipates that, as with net income in present practice, a variety of terms will be used in future financial statements as names for earnings (for example, net income, profit, or net loss) and for comprehensive income (for example, total nonowner changes in equity or comprehensive loss).

102. Some respondents urged the Board to clarify the concept of earnings. The discussion in paragraphs 36–38, the table in paragraph 44, and footnote 26 have been rewritten to explain more fully what the Board intended.

103. The materiality threshold for recognition, implicit in the conceptual framework, has been made explicit in paragraph 63 at the suggestion of several respondents. Some respondents suggested that materiality and cost–benefit considerations should be fundamental recognition criteria. No change was made because the Board believes that, while those considerations affect the application of the criteria, they are different in character from the four fundamental recognition criteria.

104. Several respondents urged the Board to include the question of the monetary unit or measurement scale within the scope of the Statement. The Exposure Draft described present practice as using nominal units of money but left the unit of measure outside its scope. The Board clarified the matter by indicating in paragraph 72 that it expects that nominal units of money will continue to be used to measure items recognized in financial statements.

105. The discussion of measurement has been expanded, in response to the suggestions of several respondents, to explain and illustrate the different attributes more fully and to discuss why different attributes are needed to describe present practice and are expected to continue to be used to measure items in financial statements.

106. Some respondents expressed concern that the guidance in paragraph 84(e) (concerning circumstances under which revenue or gain may be recognized at completion of production or when prices of assets change) and the guidance in paragraph 87 (concerning recognition of losses when it becomes evident that assets have been reduced or eliminated or liabilities incurred or increased without associated benefits) meant significant change from present practice. Those paragraphs describe concepts that the Board believes underlie many current practices and standards, just as do the other parts of the guidance for recognition of components of earnings. They have been retained and clarified.

107. Several respondents urged the Board to address in this Statement certain specific recognition and measurement issues including definitive guidance for recognition of contracts that are fully executory (that is, contracts as to which neither party has as yet carried out any part of its obligations, which are generally not recognized in present practice) and selection of measurement attributes for particular assets and liabilities. Those issues have long been, and remain, unresolved on a general basis. As noted in the introductory statement to this and earlier concepts Statements (page CON5–4), establishment of objectives and identification of fundamental concepts will not directly solve specific financial accounting and reporting problems. Rather, objectives give direction, and concepts are tools for solving problems.

108. The Board and others who use this Statement will be guided and aided by the concepts it sets forth, but judgments, based on the particular circumstances of each case, will continue to play a major role in solving problems of recognition and measurement in financial statements. The Board believes that further development of recognition, measurement, and display matters will occur as the concepts are applied at the standards level.

Summary Index of Concepts Defined or Discussed

Paragraph Numbers