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The metaphysics of financial performance in financial accounting

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Abstract
This paper argues that the metaphysics of financial performance in the conceptual framework employed by accounting standard-setters is incoherent: income and expenses cannot, as the framework holds, *both* be independent elements of financial statements, identified from underlying events, tested for recognition and measured by discrete acts, separately from the identification, testing and measurement of other elements *and* satisfy the analytical relationship between performance and position embraced by the framework. An alternative conceptualisation is proposed, under which income and expenses are part of a wider system of classifying all changes in assets and liabilities, measured indirectly. This approach improves the metaphysical coherence, and thus the intellectual strength, of the framework project; while it leaves the measurement of financial performance unchanged, by emphasising the importance of classification, it invites further attention to the presentation of financial performance, with the potential for improving the usefulness of disclosures.

Keywords Classification · Conceptual framework · Financial performance · Individuation · Pragmatism

In this paper I argue that there is a significant flaw in the ontological scheme of the conceptual framework widely adopted by accounting standard-setters around the world. For convenience, I focus on the most recent framework to undergo a completed revision, the 2018 version of the International Accounting Standards Board's *Conceptual framework for financial reporting* (henceforth, the Framework; all references are to this pronouncement unless otherwise stated), but similar arguments apply to other versions, including the foundational project of the US Financial Accounting Standards Board (Zeff 1999).

The flaw arises because the Framework holds that the identification, testing for recognition, and measurement of each financial statement element in its ontological scheme, a

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scheme covering financial position and performance, are acts distinct from the identification, testing for recognition, and measurement of all other elements; that income and expenses are identified, tested for recognition, and measured as outcomes of events generating them, and hence contingently (empirically); and that income less expenses necessarily (by definition) equals change in equity in the period. I show that this position is incoherent: it is possible to identify, test for recognition, and measure assets, liabilities and equity for the statement of financial position, and change in equity for the statement of financial performance,[1] and to *present* income and expenses in the statement of financial performance such that income less expenses necessarily equals change in equity, but not, at the same time, to hold that the income and expenses thus presented have been identified, tested for recognition, and measured as those terms are used in the Framework, that is, contingently, as the outcome of events generating them. Fortunately, the coherence of the Framework can easily be rescued by conceptualising income and expenses instead as categories in a classification system embracing changes in assets and liabilities in general. It is important to appreciate that the scheme must encompass all changes in assets and liabilities because the particular changes that constitute income and expenses cannot be identified without reference to the construction of the scheme itself – they emerge from the scheme rather than being identified independently and subsequently slotted into it. Although the necessary revisions may appear quite radical, it is inherent in the arguments of my paper that they actually bring the Framework into line with the methodology behind the fundamental structure of the contemporary statement of financial performance,[2] a position which the authors of the Framework may have believed it already occupies.

In fashioning my critique, and defending the proposed revision to the Framework, I follow the philosophically pragmatist stance towards the metaphysics of financial reporting adopted in Rutherford (2022), which addresses assets and liabilities. For philosophical pragmatists, 'what is important is what fits with all the experience that would be available, what the community of inquirers would converge upon' (Misak 2000: 95), having completed their investigations, and '[t]he characteristic idea of philosophical pragmatism is that efficacy in practical application … provides a standard for the determination of truth in the case of statements, rightness in the case of actions, and value in the case of appraisals' (Rescher 2005: 747). In determining what is to count as satisfying that standard in relation to statements, I subscribe to John Dewey's position that knowledge is the outcome of problem-solving activity and is to be evaluated by its pertinence and efficacy in addressing the problem-situation it is employed to resolve (Rutherford 2022). Pragmatists like Dewey take the objects and events of the accounting world to be socially constructed, but constructed in a process guided by evolutionary forces and hedged about by curbs and circumscriptions and, hence, not merely the outcome of individualistic free for all or unconstrained power struggles. Constructions must achieve efficacy in practical application within an interconnected network that functions coherently, not just within particular and local conditions, but in the large, over time, consistently, systematically, stably and across all relevant settings. Coherence refers here not just to the cogency of any particular logical formation but to

[1] For brevity, I assume an entity employing a single statement of financial performance to report comprehensive income.

[2] By the fundamental structure of the statement, I mean the essential character that makes the statement what it is, rather than any details of layout, ordering, sub-totalling, composition of individual line items, and so on. I am more specific about this in the concluding section.

wide-ranging and stable consistency with (all) other relevant claims to knowledge and to comportment with our beliefs about the world of experience (Walker 2001: 129–130). At the same time, pragmatism insists that all knowledge claims are ultimately tentative, with the always present prospect of refinement and amelioration. The broad scope of pragmatist philosophy's concern for efficacy in practical application means that it is capable of making powerful interventions in the direction of critique and reform: 'the hallmark of a pragmatic method is its continual re-evaluation of practices in the light of the norms that govern them and of the norms in the light of the practices they generate' (Wells 1992: 331).[3]

The following section sets out the aspects of the Framework's ontological scheme that I am concerned with. The bulk of the paper is devoted to demonstrating the incoherence of the scheme as it applies to the statement of financial performance. The final two sections summarise the argument and set out my proposal for a revised approach.

The framework's ontological scheme

The Framework's ontological scheme holds that financial position comprises assets less liabilities; that these financial statement elements are independent of, and discrete from, each other; that they arise from transactions and other events[4] (see, for example, paragraphs 4.51, 5.1 and 5.17); and that 'capturing' (paragraph 5.1) them for inclusion in the statement of financial position is the outcome of three separate and sequential stages: *identifying* an item as satisfying the relevant element definition (paragraph 5.6), *testing* it against recognition criteria, so that it is included essentially only if the information thus provided would be sufficiently useful to justify its cost (paragraphs 5.7-8), and *measuring* it (Chap.6).

Although, as we will see, there is some ambivalence in the Framework's text, key passages hold that the elements of financial performance, income and expenses, have the same ontological status as assets and liabilities. The recognition of income and expenses falls within the scope of the statement of performance and is described separately from the recognition of assets and liabilities in the statement of position (paragraphs 3.3 and 5.6). Like assets and liabilities, income and expenses are held to constitute independent and discrete financial statement elements: each is defined separately from other elements in the scheme (paragraphs 4.68-69); all elements in the scheme are given equal prominence (paragraphs 4.1-2); and, like assets and liabilities, income and expenses arise from (see, for example, paragraphs 4.51 and 6.81), or are even generated by (paragraph 4.72), underlying events. The Framework says that 'recognition is the process of capturing … an item that meets the definition of one of the elements of financial statements – an asset, a liability, … income or expenses' (paragraph 5.1) and '[f]aithful representation of a recognised asset, liability, … income or expenses involves … recognition of *that item*' (paragraph 5.24, emphasis added), in both cases

[3] Perhaps it is time for accounting scholars to attempt a full-blown metaphysics of financial reporting as embodied in the Framework. If so, Deweyan pragmatics, with its ecological theory of experience, transactional realism, instrumental naturalism, genetic method, and rejection of the duality of an outside world and an observing and thinking mind, is well-suited to the purpose (Alexander 2002; Burke 1994; Shook 2000; Sleeper 2001).

[4] For brevity, I will henceforth refer simply to 'events'.

surely implying that the process is to be applied to items of each element separately. The Framework also envisages ‘the selection of different measurement bases for different assets, liabilities, income and expenses’ (paragraph 6.2), again implying that these actions are taken separately.

Further, as with assets and liabilities, the stages in capturing income and expenses are separate and sequential. Not all identified items are recognised (paragraph 5.6), so testing for recognition must be a second and subsequent stage to identification; neither the definition of recognition (paragraph 5.1) nor the principal recognition criteria (paragraph 5.7) mention measurement; recognition and measurement are dealt with in separate chapters (Chaps.5 and 6 respectively); the Framework uses phraseology such as ‘not only recognition of [an] item, *but also* its measurement (paragraph 5.24, emphasis added) and ‘considering how recognition criteria *and* measurement concepts will apply’ (paragraph 4.49, emphasis added); and, perhaps most significantly, the Framework suggests that, ‘it may be appropriate to select one unit of account for recognition and a different unit of account for measurement’ (paragraph 4.49), including for income and expenses.

From the very outset, the conceptual framework project has sought evolutionary, rather than revolutionary, change (European Financial Reporting Advisory Group 2013a: 9; Financial Accounting Standards Board 1984: paragraph 2; Storey 1981: 94; Tweedie 1996: 22 and 33) and the ambivalence in the Framework that I referred to earlier follows from its attempt, while awarding income and expenses the same ontological status as assets and liabilities, to respect the fundamental structure of the financial statements embodied in historical and contemporary practice. As a consequence of the latter, once captured, all items stand in a close relationship to each other: assets minus liabilities equals equity and equity at the beginning of a period plus income minus expenses for the period equals equity at the end of the period after allowing for contributions and distributions of equity.[5] This relationship is taken to hold analytically, that is, by definition: as well as being described in paragraph 5.3, it is set out in the form of a mathematical equation (diagram 5.1) and the Framework does not countenance the possibility of it applying statistically, for example by discussion of deviation, disturbance or residuals. Furthermore, the Framework (paragraph 5.4) observes accountancy’s famous ‘duality principle’ (Mattessich 1964: 26) under which ‘a transaction … has basically two dimensions: an aspect and a counter-aspect’ (p. 27).[6]

Because the relationship between the elements of financial position and those of financial performance is taken to hold analytically, once the definitions of elements in one set have been established, the definitions of elements in the other set must be derived from those in the first; in the conceptual framework project, famously (or, perhaps, notoriously), it is income and expenses that are derivative of assets and liabilities (Ernst & Young 1996; Storey and Storey 1998). This is acknowledged in the text of the Framework in its many references to recognition and measurement actions being taken for an asset or liability *and related income and expenses* (see, for example, paragraphs 4.49, 5.7, 5.12, 5.18 and 6.1); these references suggest a tension with, but do not lead to a coherent alternative interpreta-

[5] For brevity, I will henceforth generally ignore contributions and distributions of equity.

[6] Mattessich tells us that he employs these terms to avoid referring to input and output, which he regards as too concrete, and debit and credit, as too closely bound up with the technology of double entry (1964: 27). I will henceforth follow Mattessich on this point.

tion of, the key passages alluded to earlier in this section.[7] The tension carries through to the Framework's Basis for Conclusions, which concedes that 'transactions that result in income and expenses also cause changes in assets and liabilities' but goes on to explain that '[c]onsequently, identifying income and expenses necessarily leads to identifying which assets and liabilities have changed' (paragraph BC4.94(c)), implying not only that the income and expenses can be identified separately from changes in assets and liabilities but that the related changes in assets and liabilities are to be identified by working back from the identification of the income and expenses.

Importantly, the tension is apparent in the Framework's definitions of income and expenses, which, ignoring, as we are doing in this paper, contributions and distributions of equity, are as follows:

Income is increases in assets, or decreases in liabilities, that result in increases in equity (paragraph 4.68).

Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity (paragraph 4.69).

It is, perhaps, mildly curious that income is defined in the singular, possibly implying a mass object, while 'expense' is eschewed in favour of the plural, although it may be that those drafting the Framework took 'expenses' to be one of those English words that is plural but uncountable (like 'trousers'). Grammar is not definitive on conceptualisation but it can provide a clue (Bunt 1965): if my new diet requires me to eat fewer potatoes and less butter, this suggests that potatoes are separate objects but butter requires further specification (a pat, a churn, and so on). However, in this case, the difference seems more likely to be a consequence of English usage than a deliberate differentiation in conceptualisation, with neither element a mass object. If income (or expenses) over a period covering more than one event is conceived of as a mass it would have to be derived from the net change in assets or liabilities over the same period, so that the statement of financial performance would contain only either income or expenses and as a single lump sum. The Framework clearly sees income and expenses as generated by particular events, so that they can differ in character according to the nature of those events and be classified, one at a time, on the basis of that character (paragraphs 4.72 and 7.14), implying that it takes income and expenses to arise in the form of individual *income items* and *expense items* respectively.

Seen as part of its ontological scheme, the Framework's definitions of income and expenses are less clear-cut than they may appear to a reader steeped in accounting practice. In the interests of simplicity, I will focus here on an income item in the shape of an increase in assets, so that the Framework's definition of income reduces to increases in assets that result in increases in equity.

Under the duality principle (and following Mattessich's terminology), any event generating an increase in assets in one aspect will typically generate adecrease in assets or increase in liabilities in its counter-aspect. In order to respect the fundamental structure of the contemporary statement of financial performance, the item constituting income must be

[7] In some cases, the two viewpoints occur in close proximity to each other; for example, paragraph 5.6 says that, '[o]nly items that meet the definition of an asset [or] a liability … are recognised in the statement of financial position. Similarly, only items that meet the definition of income or expenses are recognised in the statement … of financial performance', surely implying discrete processes, while the following paragraph says that '[a]n asset or liability is recognised only if recognition of that asset or liability and of any resulting income [and] expenses … provides users of financial statements with information that is useful', revealing a linkage between the two.

the increase in assets arising from the first of those twin aspects, considered in isolation – *disarticulated*, as it were – from its counter-aspect; put more conventionally, the increase must be 'gross' of any separate decrease in assets or increase in liabilities in the journal entry. Otherwise, income for a period would equal total profit on profitable transactions and expenses would equal total losses on loss-making transactions.

But viewed from the perspective of the disarticulated aspect, *all* increases in assets result in increases in equity: for example, a credit transaction acquiring goods for sale increases inventory and this increase in assets increases equity if we disregard the counter-aspectual increase in trade payables. In order to respect the fundamental structure of the contemporary statement of financial performance, such a disarticulated increase in assets cannot count as income. Hence, the second clause in the definition (an increase in equity) must be intended to discriminate among all disarticulated increases in assets by some means other than merely scrutinising the character of the disarticulated aspect alone. In the main, the discrimination necessary can be achieved by including in income only disarticulated increases in assets that, in articulation with their counter-aspect, result in *changes* in equity – not necessarily increases, of course, because sales may be loss-making. This is not, however, quite sufficient because break-even sales result in no change in equity from the articulated aspect and counter-aspect. What is actually at the heart of the discrimination is the adoption of a position on the point at which profit and loss is manifested, a matter not actually referred to in the definitions. The second clause in the definition is insufficient, read by itself, to discriminate between all increases in assets in the way required and must be read, instead, in the context of the wider system.

As we will see in what follows, the tension between the Framework's award of the same ontological status to income and expenses as to assets and liabilities and its respect for the fundamental structure of contemporary financial performance – between discreteness and interrelatedness in the conceptualisation of elements and between independence and connections in the sequence of identification, testing for recognition, and measurement – results in serious incoherence, and is ultimately unsustainable.

Individuation and financial performance

The social construction of objects and events involves, among other things, *individuation*, that is the 'process whereby a universal, e.g. *cat*, becomes instantiated in an individual – also called a particular – e.g. Minina' (Gracia 2015: 507). For pragmatists, our partitionings of the world are determined in part by our cognitive interests: 'regularities are where you find them, and you can find them anywhere' (Goodman 1965: 82). But 'the claim is not that we make up regularities with no constraints coming from "the world". We find what we're looking for, in part at least, only after deciding what it is we're looking for. *It is both the world and our cognitive interests* that shape what regularities … there are' (Boersema 2009: 172, emphasis supplied, note omitted).

Granting, for the purposes of the discussion, that I can individuate Minina herself as an object, there are some properties of Minina, changes in which appear straightforward to individuate: consider, for example, her leggedness; were she to be involved in a road accident and become a three-legged creature, it would be easy to individuate the change. There are other properties, changes in which it does not seem possible even to contemplate

individuating; for example, her hunger, her temper, and the volume of her purring. Between these two extremes are properties, changes in which, depending on the circumstances, I may or may not be able to individuate in a way that makes for coherence with experience and potential for efficacious problem-solving. For example, I can individuate changes in her weight where these manifest themselves in objects that are or have been part of Minina, including the decrease in weight following her hypothetical accident: the weight loss would be the now separate leg. But suppose, as we must all hope, that a change in weight results from my generous feeding. Can I individuate this change in her weight - that is, can I identify *the actual pounds* Minina has this month that she did not have last month? It does not seem sensible to attempt to find a way of doing so that will cohere with experience or aid problem-solving. I may be able to individuate the extra food that appears to yield the weight gain before the event but ordinary digestive processes mean that even an immediate autopsy will not be able individuate the particular food once it is part of Minina. Of course, if I exchange Minina for my neighbour's lighter cat, Minino, I can individuate the two gross changes in cat weightiness (Minina gone, Minino arrived) and *measure* the net change, but still I cannot *individuate* the net change in cat weightiness about the house – the particular pounds of Minina that aren't there now that Minino is substituting for the remainder.

Philosophers of mensuration draw a distinction between *direct* measurement by observation and *indirect* measurement, that is, 'any measurement of a given quantity which involves the measurement of one or more other quantities' (Kyburg 2009: 16; see also Ellis 1968). An example of indirect measurement is density, measured as the ratio of mass and volume. I can measure the weight of Minina, and of Minino, directly because I can individuate them. I cannot expect always to be able to individuate changes in Minina's weight and so I can only rely on measuring them indirectly,[8] in this case by weighing the entire Minina at two points in time, and I can only ever measure the change in cat weightiness from Minina to Minino indirectly.

Returning now to income and expenses, recall that, on the Framework's definitions, these purported objects are disarticulated changes in assets and liabilities. Granted that, with appropriate handling (Rutherford 2022), assets and liabilities can be individuated and thus measured directly, disarticulated changes in assets and liabilities will sometimes also be individuatable straightforwardly and thus measurable directly; examples include additional physical inventory purchased, or sales of inventory assigned cost by specific identification. But in many cases it is difficult to imagine an individuation that is functional for problem-solving or coherent with experience; for example, changes in the state of physical assets, such as depreciation, sales of inventory assigned cost by formula, and disposals of partial interests in non-monetary investments. To follow through a single example from this list, we would have to somehow identify the object that embodied the amount of each category of overhead added to the cumulative cost of inventory. Monetary items offer very considerable problems in relation to individuation. It is difficult to think of a functional and coherent individuation even for relatively straightforward items like payments from a bank account; even in the days of physical cheques, the cheque surely symbolised rather than individuated actual cash passing from one account to another. It seems more coherent with experience to think of a cheque (or its contemporary equivalents) as paralleling, say, an instruction from

[8] Indirect measurement generally draws on units which differ from that of the target property, as in the example of density, but this is not essential to the definition.

the vet that an overweight Minina should lose a given number of pounds: actions eventuate, the outcome of which can be *measured* but not individuated.

Another problem is that some events will yield multiple disarticulated changes satisfying the definition of income or of expenses. Take, for example, a sale, the proceeds of which are to be received partly in cash and partly by settlement of a debt owed to the purchaser, leaving a balance to be paid at a future time – two increases in (different) assets and one decrease in a liability. Do we here have: (a) three income items, because each change in asset or liability is to be treated separately; (b) two items, because assets are to be considered in aggregate and liabilities are to be considered in aggregate but the conjunction 'or' in the definition means that aggregate assets and aggregate liabilities are to be considered separately; or (c) one item because the conjunction is to be read as opening up possibilities not excluding alternatives (the 'tea with milk or sugar' conundrum)?

The consequence of the incidence of unindividuatability is that we can only rely on measuring changes in assets and liabilities indirectly. Further, articulated (event-level) changes can never be individuated and must always be measured indirectly.

The relationship between recognition and measurement

As we have seen, the Framework implies that testing for recognition and measurement are separate and sequential stages in the process of capturing an item for the financial statements. However, the discussion of recognition points out that it 'involves depicting the item … in words and by a monetary amount, and including that amount in one or more totals in [a] statement' (paragraph 5.1), so that it is surely impossible to recognise an item unless it can be measured. Since the recognition criteria require that recognition provides useful information (paragraph 5.7), measuring an item must involve finding a measurement basis that provides useful information: an item must be, not merely measurable, but usefully measurable. Once it has been determined that a category of items can be recognised, a search for additional, perhaps even more useful, measurement bases, and the choice between them, can take place as a subsequent stage. However, the recognition stage of the process of depicting a category of items in the financial statements necessarily entails measurement to the extent of establishing that at least one basis for usefully measuring that category is available and, to that extent, measurement is intertwined with the recognition decision.

Because income and expense items cannot be reliably individuated, with the consequent need for indirect measurement, the measurement basis for an income or expense item is the measurement basis determined for the relevant asset or liability and not a matter to be resolved afresh for the item itself; it is derivative in the same way that the definitions of income and expenses are derivative of those for assets and liabilities. Many categories of assets and liabilities can result in income and expense items varying widely in nature: quintessentially, a decrease in cash or increase in trade payables can be associated with expense items as wide-ranging as materials, energy, rent, payroll, administration costs, and so on. Because decisions about recognition (including measurability), and about available measurement bases, are made generically for categories of assets and liabilities, and categorical recognition and measurement decisions determine concrete acts of measurement, it is difficult to see how it is even sensible to think of taking recognition and measurement

decisions about income and expense items at the categorical level: decisions simply follow from categorical decisions about assets and liabilities.

The discussion of the Framework's ontological scheme in an earlier section shows that the tightness and direction of the relationship between recognition and measurement of income and expenses and assets and liabilities is not always apparent in the text of the Framework, adding to the tension we have already encountered.[9]

The role of the earnings cycle

The earnings cycle, the sequence of an entity's transactions from cash sacrifices for inputs to cash benefits from outputs, plays a central part in the fundamental structure of the contemporary statement of financial performance (American Institute of Certified Public Accountants 1973: Chap.5). It would seem perfectly possible to envisage a world which took profit to manifest itself when entrepreneurs acquired the goods destined to be sold for more than their purchase price; a world in which it is the astuteness, initiative and boldness of entrepreneurs' opening commitments that earn the reward and the subsequent operations and exchanges carried out by humdrum production and marketing functionaries constitute no more than routine closure. On such a view, the increase in inventories on a purchase would be recognised and measured by selling price and the increment above the increase in trade payables recognised and measured by purchase price would increase equity; the disarticulated changes in assets and liabilities occurring at the beginning of the earnings cycle would satisfy definitions of income and expenses and be included in the statement of financial performance and the sale would constitute an exchange event resulting in no change in equity, its aspects remaining articulated and omitted from the statement.[10]

Alternatively, it would be possible to regard profit as manifesting itself steadily over the earnings cycle; indeed, the Trueblood Report (the immediate precursor to the USA's conceptual framework) in effect contemplated both possibilities by suggesting that '[t]he determination of periodic earnings may develop in stages toward a methodology based on changes in discounted cash flows' (American Institute of Certified Public Accountants 1973: 32). In a world of steady accumulation of profit, events at any point in the earnings cycle could add to that accumulation and the role of the statement of financial performance would need to be radically re-thought.

It follows that the conceptualisation of the earnings cycle plays a central and crucial role in shaping the fundamental structure of the statement of financial performance. Any event may be *neutral*[11] in its impact on equity, that is, its two aspects may involve equivalent

[9] Standards and practice may appear to suggest the measurement decision about some income and expense items is taken prior to the determination of a change in assets and liabilities, for example in the case of apportioning finance costs through time for leased plant and equipment, with the change in liability ensuing from this as an adjustment to accruals. However, since income and expenses are defined as changes in assets and liabilities, and not the other way round, conceptually, the calculation must surely be thought of as determining the adjustment to accruals, with the income or expense item following from this.

[10] Any difference between expected and actual sales price would represent an estimation error akin to adjustments of bad debt provisions in respect of past sales under contemporary accounting.

[11] Since accountancy already employs several ideas involving equivalence and, as a consequence, has used up some of the more obvious terminology, including balancing, offsetting and matching, I have had to use other, in some cases more obscure, terms to describe the slightly different ideas of equivalence involved in this paper.

changes in assets and liabilities, or it may be *charged*, changing equity as well as assets and liabilities. Wherever in the earnings cycle profit or loss crystallises,[12] events have the potential to be charged, though they need not be (break-even); elsewhere neutrality is presumed. Further, a single crystallisation point permits the isolation of disarticulated changes in assets and liabilities at that point as income and expenses.

The adoption of a conceptualisation of the earnings cycle in which profit and loss crystallise at a single point, always crystallise at the same point for all types of operation, and crystallise at the particular point selected, is, on the one hand, essential to yield income and expense items in comportment with the fundamental structure of the contemporary statement of financial performance, as, I have argued, the Framework can be presumed to be seeking to do, but, on the other, actually quite difficult to accommodate within the Framework's key metaphysical claims about income and expenses. Yet the Framework says very little about these matters.[13]

The selection of a particular conception of the earnings cycle, for example to recognise inventory at cost, looks a lot like a decision related to measurement basis, a decision which is supposed to come at the end of the process of capturing income and expenses, not at the beginning. It might be argued that the crystallisation point has been determined by the application of the Framework's recognition criteria as a point, presumably the earliest chronological point, at which relevant, representationally faithful information can be provided (paragraph 5.7). There are two problems with this defence. The first is that the application must have been carried out on a vastly generic scale, crossing all potential categories of changes in assets and liabilities, and in advance of any actual scrutiny of these. The second is that it is difficult to square with the notion that, as required under the Framework, the criteria have been applied as a second stage in a process that begins with income and expense items having been identified as items satisfying the definitions of these elements, items which will have been potentially identifiable (and thus testable against recognition criteria) since the beginning of the cycle.

Events off the crystallisation point

An earnings cycle with a crystallisation point creates a presumption of neutrality for events occurring in the pre-crystallisation, or latent, and the post-crystallisation, or manifest, phases of the cycle, and for those taking place outside the cycle, such as capital transactions. Typically, for events in the latent phase, such as, and classically, inventory purchase transactions, disarticulated changes in assets and liabilities are taken to be *necessarily* equivalent, leaving no possibility of an articulated (net) change in assets and liabilities and, hence, of equity.

[12] Some of the terminology used in discussing the earnings cycle here is drawn from chemical science (see, for example, Coles and Threlfall 2014).

[13] At various points the Framework asserts that there are significant differences between changes in assets and liabilities resulting from financial performance and those from other events (for example, paragraph 1.15) but the discussion essentially takes it for granted, as, I argue, do the definitions of income and expenses, that we already know *how* to distinguish them. Equally, the Framework discusses accruals accounting and the place of financial performance within it (paragraphs 1.17-19) but implicitly assumes a single, self-evident, crystallisation point without explaining the rationale behind this. The Framework rejects *matching* of income and expenses as an objective (paragraph 5.5) so this cannot be the rationale for the assumption.

We might call this strong form of equivalence, equivalence which must hold analytically (by definition) and not merely contingently, *equipendency.*[14]

A purchase transaction is equipendent because the fundamental structure of contemporary financial performance (essentially, realised revenue and matched costs) holds that the relevant increase in assets (inventory) is set at cost, that is, equal to the decrease in assets or increase in liabilities in its counter-aspect, or, to put it another way, that the change in equity is set equal to nil, so that there is no possibility of profit or loss. Other events in the latent phase, such as increases in work in progress, have the same character. This means that the change in assets and liabilities occurring as one aspect of an equipendent event is, arguably, not measured at all but set equal to its counter-aspect. It might appear that this does not matter because events in this phase cannot give rise to income and expenses and hence cannot need to be measured as part of determining financial performance. But this puts the cart before the horse: their exclusion from financial performance involves an analytical relationship between two disarticulated changes in assets and liabilities, established a priori, whereas the Framework's ontological scheme holds that each disarticulated change is to be examined to see if it qualifies as an income or expense item.

Typically, events in the manifest phase of the earnings cycle, such as, and classically, settlement of a sales transaction, and many events outside the earnings cycle, are expected to be, and are, neutral, but the equivalence of their disarticulated changes in assets and liabilities is a contingent, empirical, outcome of circumstances rather than holding analytically. We might call this form of equivalence, *equiponderance*.[15] Many events off the crystallisation point which are expected to be, and do turn out to be, equiponderant pose no difficulties beyond those arising from the role of the earnings cycle and already discussed. One challenging issue concerns events that include, but are not limited to, receipts and payments on behalf of third parties, occurring on the crystallisation point, for example collection of sales taxes. Contemporary practice treats such receipts and payments as outside the scope of the statement of financial performance and there is no indication that the Framework intends to change this. It seems likely that the authors of the Framework would argue that the relevant amounts (say, for example, a sum paid in cash in addition to the amount treated as income and a liability to pay the tax authorities the same sum) represent a separate, and equiponderant, event, to be excluded from income and expenses like any other equiponderant event. But in an ontological scheme that derives income and expenses from the observation of actual disarticulated changes in assets and liabilities, and faced with what is actually a single event, what is the justification for overlooking these particular disarticulated changes in assets and liabilities, which are undoubtedly disarticulated changes in the assets and liabilities of the entity? Disregarding them as relating to a third party is, once again, looking outside the definition to decide whether equity changes.

Problems arise where an event does not meet the expectation of equiponderance. Take the case of settlement of a sales transaction which, for some reason, falls below the amount included in income as sales revenue less any allowance already made for bad debts associated with the revenue in question: the shortfall must, of course, be included in financial performance. In a contemporary statement of financial performance this would be done by including the shortfall as an expense item, possibly in a period after the initial recognition

[14] The condition of hanging in equipoise, that is, having been caused, or made, to stay in balance.

[15] The condition of being evenly balanced.

of income and expenses, and inevitably so if, conceptually, we are looking at events one at a time. But, given the Framework's approach of identifying income and expense items as a prior stage to their recognition, and doing so by examining the events giving rise to them, surely we should look to the disarticulated changes in assets and liabilities in the event's two aspects, as we do at the crystallisation point? On this basis, the event could be thought of as something like a sale of a financial instrument at a loss, with income of the settlement amount and expenses of the amount no longer included in receivables. This plainly would not accord with the fundamental structure of contemporary financial performance but if we defend that structure by arguing that we should look to the articulated change to identify the income or expense item, why do we identify disarticulated changes at the crystallisation point and articulated changes elsewhere? It is as if we are treating the event as a re-measurement of the net change (but not the gross changes[16]) from the previous event. We might try to justify contemporary practice by arguing that we should revalue the carrying amount of the receivable as a separate event prior to the receipt of the cash, a revaluation which would yield a disarticulated decrease in assets and make the settlement a neutral event, although hardly a contingently equivalent one, so that we have effectively extended the scope of the equipendent category. But why, on this argument, do we not revalue inventory to selling price immediately prior to sale, making the sale, too, equipendent and leading to all financial performance being recognised net and the effective abolition of the statement of financial performance? More and more seems to turn on the relation of events to the crystallisation point and less and less on the sequence of identification, testing for recognition, and measurement of discrete items in accordance with the Framework's ontological scheme.

Other examples of failed equiponderance include amounts designated in a foreign currency, settlement of which requires more or less of the functional currency than expected when the event was recorded; a late payment penalty unexpectedly incurred, or a prompt payment discount unexpectedly taken; and redeeming debentures at a discount. In some cases, events outside the earnings cycle are equipendent; examples include acquisitions of property, plant and equipment and capital transactions where one side of the exchange is non-monetary, such as a share issue. In some cases, contemporary practice involves a kind of exocyclic crystallisation point, a crystallisation of profit or loss occurring outside the earnings cycle, as in the sale of property, plant and equipment, where profit or loss is included in the statement of financial performance net. This is held by IAS1: *Presentation of financial statements* to be the offsetting of income and expense items, themselves identified in the usual way, justified on the grounds that the transaction is 'incidental to the main revenue-generating activities' (International Accounting Standards Board 2014a: paragraph 34). The Framework does not mention the possibility of offsetting income and expense items, leaving open that it envisages the treatment as recognition of the articulated change in net assets and liabilities as the sole income or expense item involved, as (presumably) in the case of the unanticipated bad debt. On the latter interpretation, the issues are as rehearsed in the previous paragraph; on the former interpretation, the issues are those, already rehearsed, arising from the role of the earnings cycle, together with the need to distinguish incidental from main activities, a question not actually referred to in the Framework.[17]

[16] If the actual sales receipts had been known at the time of sale, presumably this amount would have been treated as the income item.

[17] The US framework does make this distinction, more clearly in the original version than in the recently revised text. This approach is discussed in a later section of this paper.

Transgressing the boundaries

We now come to what may be the most startling consequence of comparing contemporary practice against a strict application of the Framework's system of definitions. Consider the case of an entity making a credit sale on which a prompt payment discount is available but not expected to be taken. Accounting in accordance with IFRS15: *Revenue from contracts with customers* (International Accounting Standards Board 2014b), the entity would recognise the disarticulated increase in receivables as an income item at full list price. Should the customer actually pay promptly and take the discount, contemporary practice requires that the shortfall in assets as receivables are exchanged for cash is recognised as a single (net) amount. This is achieved by the articulation of aspect and counter-aspect, yielding a decrease in assets that results in a decrease in equity, thus, at least overlooking the presumption for dealing with disarticulated aspects, satisfying the Framework's definition of *expenses*. But best practice (see, for example, Association of Chartered Certified Accountants 2022) requires the recognition of the item in *income*, albeit at a negative amount. A defender of this practice would no doubt argue that the amount constitutes an adjustment to income previously recognised but this justification is conceptually problematic. Conceptually, every event is separate and therefore occurs in its own time period (and the two events in this case may occur in different reporting periods), with the second event being the settlement and unexpected taking of the discount, the income on the sales event having been correctly depicted (certainly as IFRS15 would have it) in its own time period. Other examples of boundary transgression include reversal of a write-down recognised as a reduction in expenses under IAS2: *Inventories* (International Accounting Standards Board 2006: paragraph 35) and deferred tax adjustments from a reduction in tax rate included in tax expense under IAS12: *Income taxes* (International Accounting Standards Board 2016a: paragraph 79 and illustrative example 2). Transgressive treatments are generally defended on the basis of perceived connections with other (earlier) events, which may well be supportable causally or empirically, but which do not change the outcome of actually applying element definitions to the actually identified changes in assets and liabilities involved in each event.

A perhaps even more surprising case is that of the 'complex supplier arrangements' (Financial Reporting Council 2014) covering volume rebates, promotion discounts, contributions to marketing expenses, and the like in certain sectors. Events of this kind arise as increases in assets or reductions in liabilities and thus the Framework's definitions would identify them as income items; in general, and even in some instances in the sectors covered by complex supplier arrangements, they are nonetheless treated as expense items at a negative amount. However, when they are included by an entity within the scope of a complex supplier arrangement, they are frequently treated as income items; this approach generated some controversy when it first attracted the attention of users and the media (Financial Reporting Council 2017) but, ironically, actually complies with the Framework definitions.

The us conceptual framework

At first sight, the US framework appears to avoid some of the incoherence anatomised in this paper. Income (referred to as revenues – note the plural) and expenses are defined in terms of changes in assets and liabilities from 'delivering or producing goods, rendering services,

or carrying out other activities' (Financial Accounting Standards Board 2021: paragraphs E80 and E81), without mentioning equity. But this approach only overcomes the problem of inventory purchase events apparently satisfying the definition of income if one understands the activities referred to as limited exclusively to sales events: why does producing goods not include acquiring the necessary raw materials, for example?[18] Although the definitions do seem to overcome the break-even sales problem, it is not clear that this is intentional; in the original version of the US framework there is a discussion (Financial Accounting Standards Board 1985: paragraphs 64–65 and see especially the diagram in paragraph 64) that indicates clearly that income and expenses arise only from changes in assets and liabilities accompanied by changes in equity.[19] The US framework includes two elements not present in the International Accounting Standards Board (IASB) Framework, gains and losses, defined in terms of changes in equity from events that do not yield income, expenses, contributions or distributions, and thus as the articulated changes in assets and liabilities. Defining additional elements in this way obviously justifies articulation in those cases but it does not seem likely that the Framework intends that all non-equiponderant events off the crystallisation point (for example settlement discounts taken unexpectedly) should be excluded from income and expenses simply to permit this articulation (and thus netting). The distinction between income and gains and between expenses and losses depends on one's understanding of the meaning of the activities referred to in the definitions of income and expenses and is thus vulnerable to the argument I make earlier in this section.

Ultimately, as with the IASB Framework, making the particular sense of the definitions that the Board plainly wants depends on bringing to the text a prior understanding of the earnings cycle, and especially the crystallisation point, that is not explicitly referenced in the definitions and is not greatly discussed in the Framework.

The fallacy of recognising income and expenses

The main argument of the paper can now be summarised.

Key passages in the Framework hold that income and expenses are independent and discrete financial statements elements, standing apart from each other and from the remaining elements, to be identified, tested for recognition, and measured, in separate and sequential stages, in the same way as other elements. This is a fallacy, sustainable only by the extended, elaborate and inter-woven chain of assertions employed to make the claim.

Income and expenses are defined as changes in assets and liabilities with a particular characteristic, but changes in assets and liabilities cannot be reliably individuated. One con-

[18] The original version of the US framework referred to 'activities that constitute the entity's ongoing major or central operations' (Financial Accounting Standards Board 1985: paragraphs 78 and 80), which invites the question why purchasing is not part of an entity's ongoing major or central operations. In the revised version, other activities are glossed as 'those activities that permit others to use the entity's resources, which, for example, result in interest, rent, royalties, and fees. Other activities also include charitable contributions received and made' (Financial Accounting Standards Board 2021: paragraph E84). If the first sentence constitutes a definition of other activities, the second sentence is plainly incorrect in relation to contributions received and convoluted, at best, in relation to contributions made. If, in order to rescue the correctness of the second sentence, the first is read as not exclusive, it is arguable that inventory purchase events are other activities even if not counted under the category of producing goods.

[19] This must refer to articulated changes in equity because there are categories of change not accompanied by changes in equity and this would not be possible if the reference was to disarticulated changes.

sequence of this is that they cannot be identified as discrete objects for the purpose of determining whether they satisfy an element definition. Another is that they cannot be measured directly and, thus, cannot be determined to be measurable, or actually measured, separately from related assets and liabilities. Recognition involves identifying an item as satisfying the relevant definition, determining that it is measurable, and, ultimately, measuring it, and these processes cannot be undertaken for changes in assets and liabilities as independent items which, consequently, cannot be recognised as that term is understood in the Framework. Rather, income and expenses emerge from acts of recognition of other elements in the Framework's ontological scheme.

All disarticulated changes in assets and liabilities can be measured indirectly so that the measured amounts are available for examination. However, income and expense items corresponding to the fundamental structure of the contemporary statement of financial performance, as the Framework clearly intends them to do, cannot be identified from the inherent characteristics of disarticulated changes; rather their identification requires that discriminations are made among the pool of all disarticulated changes in assets and liabilities, discriminations that are not themselves inherent in the element definitions and which pose a number of problems.

First, neutral (equipendent and equiponderant) events off the crystallisation point are excluded from the pool but the distinction between events on and off the crystallisation point follows from the adoption of an earnings cycle with a crystallisation point and the selection of a particular such point, generic acts relating to recognition and measurement which precede the identification of items satisfying element definitions rather than, as required by the Framework, the other way round.

Secondly, exclusion of neutral events off the crystallisation point is achieved by addressing changes in assets and liabilities in articulation, and not disarticulated changes, as would be required to be consistent with the application of the element definitions on the crystallisation point, a move which follows from the event's location within the earning cycle and not from anything in the element definitions.

Thirdly, exclusion of equipendent events from the pool follows not from measuring disarticulated changes in assets and liabilities in aspect and counter-aspect independently and finding them to be equivalent but rather from a generic determination of equivalence in measurement made in advance of any actual act of identification, rather than, as required by the Framework, the other way round.

Fourthly, charged events off the crystallisation point remain in the pool but are generally addressed in articulation and not as disarticulated changes in assets and liabilities, as would be required to be consistent with the application of the element definitions on the crystallisation point, a move which, again, follows from the event's location within the earning cycle and not from anything in the element definitions, so that, again, generic acts relating to recognition and measurement precede identification.

Fifthly, where charged events outside the earnings cycle are addressed as disarticulated changes, the distinction between such events and other charged events outside the earnings cycle derives from the adoption of additional extra-cyclical crystallisation points rather than anything in the element definitions.

Sixthly, transgressive identifications are made on the basis of perceived connections with other events which cannot be derived from element definitions.

That certain *disarticulated* changes in assets and liabilities change equity, while others do not, is a consequence of their role in the wider system and not of a characteristic inherent in the disarticulated change itself, so that the only way to distinguish which disarticulated changes in assets and liabilities qualify as income and expense items is to look beyond the second clause in the definitions to that wider system. Put another way, it is not because changes in assets and liabilities are income or expense items that they are placed in the bag labelled 'statement of financial performance'; it is placing them in the bag labelled 'statement of financial performance' that makes them income and expense items. It is rather as if cats were defined as small furry creatures incarnating the deity Bastet, as, indeed, in ancient Egypt, they might well have been (Malek 2016). Provided that we are aware of the workings of the wider cultural system of the country, this might enable us to distinguish, say, a cape hare from a cat, on the basis of behaviour exhibited towards the animal, but it would not help us if we were unaware of that system or, indeed, not in ancient Egypt.

Income and expenses are not, then, like assets and liabilities, identified, tested for recognition and measured in a sequential chain that begins with underlying events; rather, they are included in the statement of financial performance under a model designed by accountants, with recognition and measurement a unified process integrated with the identification, testing for recognition and measurement of assets and liabilities. To put it at its starkest, income and expenses, as reflected in the remainder of the Framework, as included in all accounting standards issued by the IASB, and as embodied in the fundamental structure of the statement of financial performance in historical and contemporary practice, do not comply with their element definitions in the Framework, are not elements in the same sense as assets and liabilities are elements, and are probably not usefully considered as elements at all.

An alternative conceptualisation of the statement of financial performance

Have I blown the Framework's metaphysics of financial performance out of the water, leaving only conceptualised financial position and quotidian bookkeeping? I suggest that, viewed from a pragmatist philosophical perspective, we need not reach this gloomy conclusion.

The Framework's ontological scheme for financial position is coherent and consistent with the remainder of the Framework's content because, with appropriate handling (Rutherford 2022), assets and liabilities can be individuated, so that singleton assets and liabilities can be identified, tested for recognition, and measured directly. Equity can be measured indirectly[20] as relevant assets minus relevant liabilities, thus securely anchoring it in the ontology of financial position. Ignoring contributions and distributions of equity and assuming a single statement of financial performance, as we have done throughout, the Framework tells us (paragraph 5.3) that recognised change in equity during a period comprises income minus expenses recognised in the statement of financial performance. Put the other way round, income minus expenses (comprehensive income) for a period constitutes recognised change in equity during the period. Change in equity can be measured indirectly as relevant assets minus relevant liabilities at the end of the period minus relevant assets minus relevant liabilities at the beginning of the period, so that the very bottom line on the

[20] The Framework itself states that '[t]he total carrying amount of equity (total equity) is not measured directly' (paragraph 6.87).

statement of financial performance is likewise securely anchored within the Framework's ontological scheme by its relationship to financial position.

The lines above comprehensive income in the statement of financial performance, on the argument of this paper, can be no more than aggregations of various disarticulated changes in assets and liabilities occurring during the period. But the aggregations in the statement (and those excluded by articulation with their counter-aspect) represent categories of changes in assets and liabilities, classified under a particular system according to their traits and characteristics. It is as if, for example, I gave an account of the change in cat weightiness of my household over a period as consisting of Minina's loss of weight of 5 pounds and the gain from exchanging Minina for Minino of 15 pounds, a net gain of 10 pounds – none of these items can be individuated or measured directly but all can be measured indirectly.

Changes in singleton assets and liabilities can be measured indirectly by deduction of one quantity (the measure of the asset or liability after the event generating the change) from another (the measure of the asset or liability before the event generating the change) and thus the changes are securely anchored in the Framework's ontology of financial position; a classification system for financial performance thus has the potential for coherence with the remainder of the Framework, including its objective for financial reporting. Where the Framework is in error, however, is not only in its (intermittent) claims that the lines above comprehensive income are accumulations of discrete items arising from underlying events, available to be identified, tested for recognition, and measured, independently, but also in its (consistent) claim that the categorisation of items is carried out according to its financial performance element definitions.

On the evidence of much of the Framework's other discussion of income and expenses (including its espousal of the standard analytical relationship of elements) and of its authors' ambition for evolutionary rather than revolutionary reform, what the Framework authors are really seeking to do in the handling of income and expenses is to preserve the fundamental structure of the contemporary statement of financial performance, an outcome that can be achieved by taking the depiction of income and expenses as a matter of classification,[21] though the system employs constructs (such as the earnings cycle) little mentioned in the Framework. Because the classification system emerges from the methodology behind the structure of the contemporary statement of financial performance, the adoption of this approach would, arguably, actually bring the Framework into better alignment with the fundamentals of current practice.

Pragmatist philosophy offers the opportunity to obtain warrant for a classification system for financial performance, including one following the lines of the fundamental structure of the contemporary statement of financial performance. Taking, for example, John Dewey's approach, employed in Rutherford (2022) and referred to briefly in the introductory section, knowledge is the outcome of inquiry, which is 'the controlled or directed transformation of an indeterminate situation into one that is so determinate in its constituent distinctions and relations as to convert the elements of the original situation into a unified whole' (Dewey 1938: 104–105, emphasis omitted) and, consequently, claims to knowledge are to be judged by 'their pertinency and efficacy in "satisfying" conditions that are rigorously set by the

[21] The Framework discusses the classification of income and expenses (paragraph 7.14-19) but by this it means the components of income and expenses respectively, which, on the argument of this paper, are sub-classes of top-level classes. Further, on the argument of this paper, income and expenses are the outcome of classification rather than merely available to be classified.

problem they are employed to resolve' (Dewey 1941: 182–183). Repeated perceptual experience of particular characteristics or traits enables patterns to be recognised, from which emerge kinds; in 'functional correspondence' (Dewey 1938: 280) to the establishment of kinds, conceptual operations define categories which derive their validity as 'instrumental intermediar[ies]' (p. 277) in the pursuit of knowledge. Hence,

[f]or Dewey, classification and not prediction is the true aim of explanation. Classification is a broader kind than prediction, including the latter within it. Prediction and the empirical process of discovering regularities in nature are means of grouping together kinds of events which bear a certain resemblance. All phenomena which exhibit common behaviour are classified in our schema of knowledge by their possession of this common trait (Bedford 1993: 458).

Pragmatism, then, warrants the contemporary classification of the statement of financial performance to the extent that it aids the resolution of the problem-situation it addresses.

The Framework does contain a (brief) discussion of classification within the chapter on presentation and disclosure (Chap.7). It defines classification as 'the sorting of assets, liabilities, equity, income or expenses on the basis of shared characteristics for presentation and disclosure purposes. Such characteristics include – but are not limited to – the nature of the item, its role (or function) within the business activities conducted by the entity, and how it is measured' (paragraph 7.7). The essential features of classification on this definition, and as taken up in its further discussion (paragraphs 7.2(b), 7.4(b) and 7.8), are consistent with pragmatism and the approach of this paper but, by viewing classification as part of presentation and disclosure, which it sees as a matter of communication (paragraphs 7.1-2) the Framework appears to suggest that it is not quite so fundamental as identification, testing for recognition, and measurement. Because pragmatists view the outcomes of inquiry as socially constructed, they tend to give communication a central role in the process:

When communication occurs all natural events are subject to reconsideration and revision; they are readapted to meet the requirements of conversation, whether it be public discourse or that preliminary discourse termed thinking. Events turn into objects; things with a meaning. They may be referred to when they do not exist, and thus be operative among things distant in space and time, through vicarious presence in a new medium (Dewey 1925: 132).

For pragmatists, then, treating classification as an aspect of communication is not to downgrade it in quite the way the Framework seems to envisage. Importantly, the Framework does see the purpose of presentation and disclosure, and thus classification, as promoting relevance and faithful presentation (paragraph 7.3), that is the usefulness of information, an approach which is entirely consonant with the pragmatist warrant.

Extended testing of the classification system embodied in the fundamental structure of the contemporary statement of financial performance against the pragmatist warrant, or the purpose espoused by the Framework, is beyond the scope of this paper. It can be argued, however, that the survival of that structure, in history and contemporary practice, demonstrates that it is contributing to the meeting of a social need for the resolution of a problem-situation,[22] so that its classification system does deserve warrant. Consequently, if the Framework's characterisation of the objective of financial reporting (essentially investment decision-usefulness, paragraph 1.2) is in alignment with the problem-situation finan-

[22] There may, of course, be other, unmet, needs, which it might or might not be useful for the Framework to address, but that issue is outside the scope of this paper.

cial reporting is successfully resolving, and given that the remainder of the Framework is explicitly built on its adoption of that objective (paragraph 1.1), then the classification system embodied in the fundamental structure of the contemporary statement of financial performance would, indeed, be an appropriate component of the Framework.

It is important to emphasise that this conclusion relates to the *fundamental* structure of the contemporary statement of financial performance – essentially income and expenses deriving from the adoption of an earnings cycle with a single crystallisation point, and that point located where it actually is, and income and expense items addressed in disarticulation while other changes in assets and liabilities are articulated. It does not entail a conservative approach to the detail of the statement, where there is, no doubt, plenty of scope for Wellsian pragmatist reform.

The implications of this paper's conclusions are threefold. The first relates to the role and status of income and expenses within the Framework. The primacy given to assets and liabilities in the Framework's ontological scheme generated a good deal of dissent in the early life of the project and remained controversial for many years (Ernst & Young 1996; Storey and Storey 1998). In more recent times, perhaps as a result of the way the Framework has actually been used by standard-setters, it has come to be widely accept that the primacy of assets and liabilities does not have to threaten the role and usefulness of the statement of financial performance in the way feared, concern now focusing on the need to separate out components of comprehensive income, distinguishing, for example, between financial performance from operating activities and other gains and losses (European Financial Reporting Advisory Group 2013b: paragraph 31; Financial Reporting Council 2015: paragraphs 4.1-3). While this paper's demonstration that income and expenses, defined as the Framework defines them, cannot be elements of the financial statements, defined as the Framework defines them, may appear at first sight further to underline their subordinate status, taking the alternative approach advanced here, providing as it does a clearer and more rigorous exposition of income and expenses, actually strengthens the conceptualisation of financial performance and thus buttresses the role and status of income and expenses and better supports the use of the Framework in devising sections of accounting standards addressing the statement of financial performance.

The second implication concerns the construction of the Framework itself. Clearly, the argument of this paper requires that the conceptual status of income and expenses be revised. But of equal importance, is the paper's argument as it relates to the Framework's treatment of classification, presentation, disclosure and communication. These deserve to be taken earlier in the Framework, given more prominence, and treated more rigorously and expansively, perhaps employing the Deweyan rationale alluded to in the paper. An important effect of such a treatment would be to diminish the quasi-positivistic tone of parts of the Framework's exposition: however attractive implications of positivism may make the Framework to 'naïve realist' practitioners, they are off-putting to scholars who see the world of accounting as socially constructed and the change may encourage the academy to re-engage with the theorisation of doctrinal accounting.

The third implication concerns the design of the sections of accounting standards dealing with the statement of financial performance. An enlarged and conceptually more rigorous discussion of classification in the Framework would support a more expansive treatment of income and expenses in accounting standards. The IASB has adopted the practice of specifying an overall objective for disclosures required by a standard, many of which relate

to financial performance (International Accounting Standards Board 2016b: paragraph BC215). By focusing on disclosure, this essentially takes for granted the issue of classification, which actually deserves to be addressed directly. Disclosure objectives tend to be drawn in fairly narrow terms; for example, in the case of lease disclosures by lessees, the objective refers to providing 'a basis for users of financial statements to assess the effect that leases have on the … financial performance … of the lessee' (International Accounting Standards Board 2016b: paragraph 51). A classification objective drawn from a Framework revised along the lines envisaged in this paper would be more likely to refer to, and draw on, the objective of financial reporting specified in the Framework, namely, 'to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity' (paragraph 1.2).

If the consequence of accepting the twin arguments of this paper – that income and expenses are not elements as presented by the Framework but are potentially, and probably actually, conceptually valid constructs in the form of categories within a classification system – is to leave the fundamental structure of the statement of financial performance embodied in practice and the Framework intact and unaltered, do the arguments of this paper matter? Plainly those who regard the Framework as an irrelevance to practice will not even ask themselves that question. Those who regard the Framework as a conceit designed to lend intellectual credibility or political clout to an irremediably practical craft will see the only role of revisions in the Framework as being to bring it into line with practice and so will see no point in this paper. But standard-setters, and perhaps the profession more widely, are increasingly coming to view the Framework as a valuable means of improving practice (Financial Accounting Standards Board 2013; International Accounting Standards Board 2013) and colleagues who take this view will, I hope, accept that a conceptual framework ought to be intellectually robust, logically sound, and coherent with the experience it seeks to capture; on this footing, arguments like those in this paper do, indeed, matter.

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