

# On the Balance Sheet-Based Model of Financial Reporting

Ilia D. Dichev

+ Author & Article Information

*Accounting Horizons* (2008) 22 (4): 453–470.

<https://doi.org/10.2308/acch.2008.22.4.453>

Views ▾	Share ▾	Tools ▾	Cite ▾
---------	---------	---------	--------

**SYNOPSIS:** FASB adopted a balance sheet-based model of financial reporting about 30 years ago, and this model has been gradually expanded and solidified to become the required norm around the world. This article argues that the balance sheet orientation of accounting standard-setting is flawed for the following reasons. First, accounting is supposed to reflect business reality, and thus the essential features of the financial reporting model need to reflect the essential features of the underlying business model. However, the balance sheet orientation of financial reporting is at odds with the economic process of advancing expenses to earn revenues, which governs how most businesses create value, and which represents how managers and investors view most firms. Second, the adoption of the balance sheet approach was driven by conceptual considerations; standard-setters argued that the concept of assets is more fundamental and logically prior to the concept of income. However, this article argues that the concept of income is clearer and practically more useful than the concept of assets, especially with the recent proliferation of intangible assets. Third, earnings is the single most important output of the accounting system. Thus, intuitively, improved financial reporting should lead to improved usefulness of earnings. However, the continual expansion of the balance sheet approach is gradually destroying the forward-looking usefulness of earnings, mainly through the effect of various asset revaluations, which manifest as noise in the process of generating normal operating earnings. During the last 40 years, the volatility of reported earnings has doubled and the persistence of earnings is down by a third, while little has changed in the properties of the underlying business fundamentals.

This content is only available via PDF.

American Accounting Association

You do not currently have access to this content.

Sign in

Don't already have an account? [Register](#)

# Member Login

Log in

Pay-Per-View Access  
\$25.00

**AAA Members: Please log in for free access to content. Note, Teaching Notes are a full member benefit and are not available to student members.**

 [Buy This Article](#)



[View Metrics](#)

## Citing Articles Via

Web Of Science (74)

Google Scholar

CrossRef (117)

## Email Alerts

Article Activity Alert

Publish Ahead of Print Alert

New Issue Alert

[Information for Authors](#)

[Authorship Policy](#)

[Plagiarism Policy](#)

[Data Integrity Policy](#)

[Citing Corrected Articles Policy](#)

[Minimizing Overlapping Decision Rights Policy](#)

[Prior Publication Policy](#)

