Towards a Better Accounting Conceptual Framework

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Abstract:

This research aims to develop an approach to evaluate the accounting conceptual framework. The developed approach ensures the effectiveness of the framework to increase the quality of financial reporting. The research relies on the deductive approach by looking at what it has been able to access from literature in terms of how to obtain a better Conceptual Framework. The research concludes with a proposal for 5C criteria for evaluating the conceptual framework, which are: Comprehensive, Coherence, Communicative, Confidence, and Well-Constructed.

Keywords: *Conceptual Framework, Financial Reporting, Comprehensive, Coherence, Communicative, Confidence, and Well-Constructed.*

Introduction:

Contemporarily, with the globalization and growth of the economy, capital markets are more interconnected than before. Thus, the need for the information presented in the financial

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statements of companies became even more vital. The latter is because users would like to know how their managers handle their invested resources and how efficient those resources are. These reasons make it necessary to further develop the Conceptual Framework for financial reporting so that the users get valuable information (Malikova O., & Brabec Z., 2011, p.1).

The conceptual framework attempts to operationalize the accounting theory (Higson A., 2003, p.62). The conceptual framework provides the objectives and the fundamental concepts in which the standards are rooted, which underlie the preparation of financial reports. Although it is not a standard and will not immediately change or override any existing standards, it might affect entities developing or selecting accounting policies (Bala S., 2012, p.1).

Additionally, without a framework, accounting standards might be based on the most appropriate solutions to a particular issue rather than a solution consistent with a unified theory of accounting (Gore R., & Zimmerman D., 2007, p. 30). Also, standard-setting ends up being based on the individual concepts that each member of the standard-setting body has developed. So, agreeing on issues would be more challenging to reach, as the membership of the standard-setting body changes over time, the mix of personal conceptual frameworks changes (Bullen H., & Crook K., 2005, p. 1). As a result, significantly different conclusions might be reached on similar or even identical issues than they did previously, making standard-setting ineffective. For the users, it would mean inconsistent, obscure relevant information, reduced understandability, ending up in less valuable financial reports (Tomaszewski S., & Choi Y., 2018, p. 48).

1- Historical Background of the Conceptual Framework:

Accounting is a language that developed centuries ago because of the need to control assets, record financial transactions, and communicate the results of those transactions to investors and other users of financial statements. Over time transactions became more complicated, with greater demands. As a result, a set of generated rules was developed to ensure an orderly processing and a more consistent reporting of financial data. As business becomes more complex, the associated accounting practice evolved in a somewhat random manner. As a result, the accounting rules increased and lacked consistency and coherence (Vorstor Q., 2007, p.3).

Towards the close of the nineteenth century, several factors contributed to developing a body of accounting theory and the standardization of accounting practice. Such factors included technological changes, the development of economics as a field of study, the establishment of professional accounting, regulatory bodies, and the globalization and growth of worlds markets (Gerber M. et al., 2014, p.398).

The first institutional attempt to lay the foundation of a Conceptual Framework was the *Tentative Statement of Accounting Principles Affecting Corporate Reports*, issued by the executive committee of the American Accounting Association (AAA) in 1936. This framework was the most influential monograph in the US accounting literature, *An Introduction to Corporate Accounting Standards* published by

Paton and A.C. Littleton, two of the foremost accounting academics of their day, and published in 1940 by AAA. The primary motivation for preparing the *Tentative Statement* is to provide authoritative guidance to the recently established Securities and Exchange Commission (SEC) (Baker C., & Burlaud A., 2015, p.56,57).

In 1938-1939, the American Institute of Accountants (AIA) became more active in guiding the SEC to enable its Committee on Accounting Procedure (CAP) to issue Accounting Research Bulletins (ARB). One of the initial decisions was to reject developing a comprehensive statement of accounting principles, a kind of Conceptual Framework. Because the project would take five years to complete, the SEC might lose patience with the committee and instead make its own accounting rules (Zeff S., 1999, p.91).

Several times during the CAP's tenure in the 1940s and 1950s, the SEC, the Top management of the major public accounting firms, and specific academics debated whether accounting standards should be founded on logical and a consistent set of accounting principles. And what these principles might be, or whether accounting standards setting should be primarily a reflection of accounting practices (Baker C., 2017, p.115). In the 1940s, the Institute's research department issued an eight-page review of basic accounting principles. However, the committee took up none of these initiatives as part of its work program (Zeff S., 1999, p.91).

To solve these conflicts, the American Institute of Certified Public Accountants (AICPA) created a Special Committee on Research Program of the AICPA composed of preparers of financial statements, auditors, academics, and the Chief Accountant, the SEC. The special committee proposed the formation of the Accounting Principles Board (APB) and a Research Division to complement the APB's work in a report issued in 1958. One of the goals of the APB was to formulate principles, standardize accounting practice, and take the lead in solving accounting issues (Baker C., & Burlaud A., 2015, p.58).

The APB published thirty-one opinions and four standards during its existence, Accounting Research Study no. 1, entitled *The basic postulates of accounting* (1961), and Accounting Research Study no.3, allowed *A tentative set of comprehensive accounting for business enterprises* (1962). These documents identified three primary levels of accounting theory: postulates, principles, and rules. The special committee recommended that postulates be kept to a minimum and lead logically to the principles and the rules. The economic and political environment were to be used to generate postulates in which businesses operate. In addition, these documents included definitions (e.g., of asset and liability). The APB, on the other hand, rejected Studies 1 and 3 because some of their substance was too different from current practice. Eventually, the APB rendered a descriptive statement published as Statement no.4 under the title, *Basic concepts and accounting principles core of financial statements of business enterprises* (1970) (Nobes C., & Stadler C., 2015, p. 575).

Meanwhile, the American Accounting Association (AAA), the organization of academic accountants in the USA, submitted *A Statement of Basic Accounting Theory* (ASOBAT) in 1966 due to the failure of the AICPA Research Division to produce a coherent set of financial accounting principles. Prompted the American Accounting Association to form a special committee to develop a cohesive set of principles. It took a deductive approach rather than drawing on existing practice. The APB never accepted ASOBAT. In ASOBAT, financial accounting was defined as the process of identifying, measuring, and communicating economic information so that users can make informed judgments and decisions. ASOBAT proposed the user perspective; it put decision usefulness at the top of its objectives for accounting and set out four primary standards for accounting information to evaluate potential information: relevance, verifiability, freedom from bias, and quantifiability (Zeff S., 1999, p.96).

In 1971, the AICPA set up two committees (Wheat and Trueblood). The first was the Study Group on the Establishment of Accounting Principles. This committee resulted in the disbanding of the APB and recommended creating the Financial Accounting Standards Board (FASB) as an independent standard-setting body. The second committee was the Study Group on the Objectives of Financial Statements (the Trueblood Committee), was composed of leading practitioners, academics, and users of accounting information, and was charged with proposing the fundamental objectives of financial statements to guide the improvement of financial reporting. In 1973, the Trueblood Committee issued a report entitled *Objectives of Financial Statements*. This document supported the view of ASOBAT, which believed that the primary purpose of financial reporting should be helpful for decision making. This emphasis on decision usefulness and, mainly, benefit investors' and creditors' decision-making became the primary basis for the FASB Conceptual Framework (Zeff S., 1999, pp.99,100,101).

1.1 A brief history of FASB Conceptual Framework:

The FASB is a private-sector body with seven full-time members whose mission is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information, and to develop accounting concepts (Paz V., & Griffin T., 2009, p. 55).

The FASB was established in 1973 with the express objective to formulate a Conceptual Framework of accounting. FASB Firstly issued a Discussion Memorandum, *"Conceptual Framework for Accounting and Reporting: Consideration of the Report of the Study Group on the Objectives of Financial Statements,"* dated June 6, 1974, and held a public hearing on September 23 and 24, 1974 on the objectives of financial statements (FASB, CON1,1978, p.16).

The FASB's original Conceptual Framework was issued in a series of seven Statements of Financial Accounting Concepts (SFACs or Concept Statements) between 1978 Statement No.1 and 2000 Statement No.7 (Tomaszewski S., & Choi Y., 2018, p.48). and the Last statement of Financial Accounting Concepts Number 8 issued in 2010 and amended in 2018.

1.2 A brief history of IASB Conceptual Framework:

In London, the International Accounting Standards Committee (IASC) was established on the 29th of June 1973 as a result of an agreement by the accounting bodies in Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the

UK, Ireland, and the USA, and the Board of the IASC consisted of these countries now. It was the predecessor body of the International Accounting Standards Board (IASB). (Camfferman K., & Zeff S., 2007, p.48-49).

After the FASB completed its conceptual framework, the IASC established a 110- paragraph document called the Conceptual Framework in April 1989, *"Framework for the Preparation and Presentation of Financial Statements"* for publication in July 1989. This conceptual framework is based on the FASB's Statements of Financial Accounting Concepts No. 1,2,3, and 5 (Camfferman K., & Zeff S., 2007, p.260).

In September 2002, a memorandum of understanding (the Norwalk Agreement) between the FASB and IASB called for the convergence of the respective organizations' accounting standards, resulting in the joint Conceptual Framework Project of the FASB and IASB (Kaminski K., & Carpenter J., 2011, p.17). In October 2004, the IASB and the FASB decided to start a joint project on a common conceptual framework. The project's purpose was to revise the respective Conceptual Framework to update the existing concepts to reflect better the business practices of today's markets and the current economic environment (Gerber M. et al., 2014, p.398).

That project resulted after the six-year-long cooperation in the boards' 2010 issuance of two chapters of a shared framework that discuss the objective of general-purpose financial reporting and the qualitative characteristics of useful financial information (FASB, CON.8, 2010). However, in 2010 they suspended work on that project to concentrate on other projects.

During a public consultation on the IASB agenda in 2011, international stakeholders encouraged the Board to abandon the former phased approach and to reactivate the Conceptual Framework project within a remarkably challenging time frame (Gebhardt G., et.al, 2014, p.107).

In response, the IASB has set out preliminary views on areas that would potentially have a significant effect on financial reporting in general by restarting its Conceptual Framework project in September 2012 and deciding to implement it in a single phase (EFRAG, 2013).

The first step in the due process was the publication of a Discussion Paper (DP) entitled *A Review of the Conceptual Framework for Financial Reporting*, published in July 2013 (IASB, DP, 2013). In May 2015, after ten public meetings in 2014 and 2015, the IASB issued an Exposure Draft *Conceptual Framework for Financial Reporting.*

Finally, IASB published its Revised Conceptual Framework in March 2018 after 5 years of deliberation since the Discussion Paper was first issued. The Revised Conceptual Framework is effective for annual reporting periods beginning on or after the 1st of January,2020, with earlier application permitted.

2- Definition of the Conceptual Framework:

In general, the conceptual framework is a declaration of theoretical concepts forming references for a particular field of study. At the same time, the Conceptual Framework is a systematization of accountancy's theoretical concepts through a logical structure intended to guide accounting practice in financial reporting (Bran N. et al., 2011, p.54).

According to FASB (2010, par. iv), the Conceptual Framework is a coherent system of interrelated objectives and fundamental concepts that prescribe the nature, function, and limit of financial reporting, expected to develop consistent guidance.

Similarly, the Australian Accounting Research Foundation (AARF) mentioned that the Conceptual Framework is a set of related concepts that describe the nature, subject, purpose, and broad content of financial reporting (AARF Series No.1: AICPA, 1987).

Finally, Pounder B., 2010, (p.20) observed that the concepts addressed by the Conceptual Framework tend to be general, broad in scope, and stable over time to eliminate the need for a standards-setter to re-establish core concepts or update a standard.

3- Purposes of the Conceptual Framework:

The purpose of developing the Conceptual Framework was to create an agreed- upset of concepts and objectives that used in the following (Bran N. et al., 2011, p.55), (Baker C., 2017, p. 109), (Brouwer A. et al., 2015, p. 549), (Walker R., 2003, p. 341)

- Reduce diversity in accounting practice and move toward more excellent uniformity;
- Assist the standard-setters in promoting the harmonization of regulations, accounting standards, and procedures concerning the presentation of financial

statements. Also, in providing the basis that enables the reduction of alternatives accounting treatment allowed by the standards setters;

- Help develop national standards bodies in the development of national standards;
- Present the purest articulation of the standards setters' views on the fundamental concepts that would guide the future accounting standards and practice;
- Guide the preparers of financial statements to address topics not covered by any standards;
- Assist auditors in generating an opinion on a set of standards' compliance;
- Assist financial statement users in understanding the information offered in financial statements;
- Provide information related to the method of formulating standards to those interested in the standard-setter activity;
- Provide a sound foundation for future accounting standards development and review existing ones;
- And assist the standard-setters in identifying existing standards that are inconsistent with the concepts.

And to achieve the above purposes, (Walker R., 2003, p.340, 342) identified the essential features of the conceptual framework, including clarity of expression, internal consistency, the provision of a comprehensive guide to financial reporting practice, avoiding tight specifications, and enables prediction of standards. Also, according to (Sutton D. et al., 2015, P.124), they argued that the primary feature of the Conceptual Framework is to reduce internal conflict among objectives adopted for accounting information and the qualities specified for that information.

4- Importance of the Conceptual Framework:

Moreover, according to Botosan C., 2019, (p. 422), the Conceptual Framework plays a vital role in accounting. It is because Conceptual Framework

- A roadmap for improving financial reporting as before the conceptual framework, accounting standards, and financial reporting was based on vague principles, such as accurate and fair view, prudence, stewardship, conservatism, matching, and earnings process, rather than on a solid set of interrelated concepts reflecting underlying economic phenomena. But after the evolution of the conceptual framework, standard setters are now developing accounting standards with a clear objective in mind to meet user's information needs (Mccahey J., & Mcgregor W., 2013, p.7);
- A mechanism for building consensus by ensuring that individual standard setters are guided by a common set of concepts when evaluating alternative solutions to financial reporting problems and are focused on achieving the same objective for financial reporting;
- A mechanism for internally consistent stable standards by ensuring that the concepts are internally consistent in design and are stable over time, so it supports the promulgation of internally consistent sound standards;
- Finally, the conceptual framework is a mechanism for communication by establishing a precise definition that facilitates discussion of accounting issues.

5- The Essential Features of the Conceptual Framework Financial Reporting:

The Conceptual Framework has essential features according to (Paul J., 2013, p.43), (Walker R., 2003, p.351), (Dennis I., 2018, p.397), (Brouwer A. et al., 2014, p.236), (Solomons D., 1986, pp.115-116) they presented the essential features of a Conceptual Framework as

- A framework that assists standard setters in making standards-setting decisions;
- A framework that gives legitimacy to standards setters practices and predetermines the outcome of standard-setting processes;
- A framework should clearly distinguish the objectives of guiding financial decision-making and ensuring or contributing to accountability;
- A framework should give primary to the former objective in the design of financial statements for business entities;
- A framework should be aspirational. That is, it should focus on ideal concepts that will result in financial statements that meet the objectives of financial reporting, not to justify existing requirements and practice;
- And finally, a framework should focus on economic phenomena (scare resources and claims to scare resources, and changes in those resources and claims) rather than accounting responses to those phenomena.

6- Evaluation of the Conceptual Framework:

Because the Conceptual Framework ensures a high degree of transparency and comparability of financial statements and improves the quality of financial information. It also promotes accountability by narrowing the information gap between the providers of the capital and the people who have entrusted their money. Additionally, it contributes to economic efficiency by helping investors identify opportunities and risks worldwide and thus improving capital allocation (IASB, CF2018, SP1.5). Therefore, the Conceptual Framework should be proper and carefully developed to ensure a sound basis for increasing the quality of financial reporting.

6.1 Reasons for evaluating the Conceptual Framework:

The researcher provides some reasons for evaluating the Conceptual Framework according to (Cade N., Koonce L., et al., 2019, p 554), (IASB, ED2015, p 6), (McCahey J., & McGregor W., 2013, p 2), (Măciucă G. et al., 2015, pp 738,739), (UK Shareholders' Association, 2012), (financial reporting council response to DP/2103/1, January 2014), (EFRAG, 2013, par.6), (Brouwer A. et al., 2015, p 547), and (Gebhardt G. et al., 2014):

- The Conceptual Framework is widely relied upon by standard setters who use the Conceptual Framework when creating new standards and by other parties, including preparers, auditors, lawyers, and students specifically, in both US and international settings. When existing standards do not address a particular transaction or event, IAS 8 Accounting Policies, *Changes in Accounting Estimates and Errors* (para. 11) suggest that preparers and their auditors rely on the Conceptual Framework (part of the International Generally Accepted Accounting Principles) to develop accounting policies.

- The Conceptual Framework reflects the current needs of the financial reporting users, including a large group of stakeholders. The objective of this Conceptual Framework is to improve the quality of financial reporting by providing a more complete, precise, and updated set of concepts.
- The Conceptual Framework is the cornerstone of high-quality financial reporting since the quality of financial reporting improves if the accounting standards and the decisions ultimately made in practice are based on a set of logical concepts. Thus, financial reporting can fulfill its role of providing the investors and capital markets with as transparent and accurate a picture as possible.
- Without the Conceptual Framework, lousy accounting practices will defeat good accounting practices.
- The Conceptual Framework includes the characteristics of useful accounting information necessary for preparing high-quality accounting reports, ensuring comparability at an international level for their primary beneficiaries: investors and creditors.
- Evaluating the Conceptual Framework assists in setting out the unambiguous concepts that are generally agreed on to be of important influences on financial reporting. Therefore, it provides a more consistent and robust financial reporting.

- The Conceptual Framework is the primary conceptual source when developing new requirements and guidance.
- The Conceptual Framework assists in developing better and more robust financial reporting that can influence users in making investment decisions and enhance the market's efficiency.
- An ideal framework should be flexible to allow for the evolution of standards. As a result, its prescriptions should be comprehensive but not overly detailed.

Finally, the researcher finds the evaluation is an essential step as it is necessary to improve the Conceptual Framework further to increase the quality of financial reporting.

6.2 Criteria for evaluating the Conceptual Framework:

As the Conceptual Framework is the backbone of financial reporting, this section aims to develop an approach to evaluate the conceptual framework. The developed approach ensures the effectiveness of the framework to increase the quality of financial reporting.

This approach relies on the deductive approach by looking at what it has been able to access from literature (e.g. (Paul J., 2013), (Walker R., 2003,), (Dennis I., 2018,), (Brouwer A. et al., 2014), (Solomons D., 1986), (Sutton D. et al., 2015), and (EFRAG, 2013)) in terms of how to obtain a better Conceptual Framework.

Moreover, this approach concludes with a proposal for 5C criteria for evaluating the conceptual framework:

Comprehensive, Coherence, Communicative, Confidence, and Well-Constructed.

Finally, this study contributes to establishing a basis for evaluating a Conceptual Framework and ensuring the framework's effectiveness. The researcher presents the description of every criterion in table (1).

Table (1)

The description of the 5c criteria to evaluate the IASB Conceptual Framework

Proposed criteria	Description
Comprehensive	This criterion can be achieved by: **First:** providing reasonable objectives and the fundamental concepts in which the standards are rooted, which underlie the preparation of financial reports. **Second:** reducing tight specification **Third:** providing accountants, auditors, and users a common set of definitions, recognition criteria, and measurement bases for the elements of financial reports and how to present them in financial statements.
Coherence	This criterion can be achieved by: **First:** Ensuring that the concepts are internally consistent in design and are stable over time supports the issuance of internal consistency, stable standards. **Second:** reducing internal conflict among objectives adopted for accounting information and the qualities specified for that information **Third:** reducing diversity in accounting practice and moving toward more excellent uniformity.
Communicative	This criterion can be achieved by: **First:** facilitating communication between national and international standard-setting bodies.

	Second: narrowing the information gap between the providers of the capital and people who have entrusted their money. **Third:** helping investors to identify opportunities and risks around the economic phenomena.
Confidence	This criterion can be achieved by: **First: clarity** (establishing precise definitions and criteria that facilities discussion of accounting issues and providing more detailed explanatory and prescriptive information) **Second: understanding** (providing users of financial statements with credible information to understand the relationships between pieces of information and a willingness to study the information with reasonable effort). **Third: transparency** (enhancing comparability to enable investors and other market participants to make informed economic decisions.
well-constructed	This criterion can be achieved by: **First:** The ability to develop more consistent and logical new standards and improve existing ones based on underlying concepts. **Second:** resolving future accounting problems without the necessity of issuing new accounting standards. **Third:** removing re-debate conceptual issues when preparing new accounting standards. **Fourth:** helping entities to select among different accounting policies.

Source: the researcher

7- Conclusion:

The research concludes that the 5c criteria used to evaluate the Conceptual Framework will guide the development of a foundation for improving accounting practice by providing practitioners with a comprehensive, coherent, communicative, confident, and well-constructed frame of reference. It also assists standard-setters in determining whether established concepts will result in the production of information that meets the overall purpose of the financial reporting process.

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