

# Conceptual framework for financial accounting

[Business](#), [Accounting](#)



## Introduction

Financial accounting is a branch of accountancy that deals with the financial statements which helps in informing public as well other concerned people who are not involved in day to day working of a company, about its current financial performance. Different stages involved in financial accounting are governed by certain standards set by organisations such as The International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB). The standards made by IASB are known as International Financial Reporting Standards (IFRS) and by FASB is known as Generally Accepted Accounting Principles (GAAP).

IFRS is applicable in international level and GAAP is used mainly in the United States. What is meant by a 'conceptual framework' for financial accounting? The conceptual framework constitutes the objective, the fundamentals and base for performing financial accounting. Precisely, "A coherent system of interrelated objectives and fundamentals that can lead to consistent standards and that prescribes the nature, function, and limits of financial accounting and financial statements." (Ref 1). It is according or on the basis of the conceptual framework of IASB and FASB, that accounting standards such as IFRS and GAAP are made.

The reasons why such a framework might be useful? The conceptual framework helps in better understanding of the accounting information's given in the financial reports. Other benefits of the conceptual framework are as follows: a. Conceptual framework acts as an established body of concepts and objectives which helps in setting new standards and future

development. b. The framework helps in understanding the financial report and gives the user confidence in financial reporting. It also helps in comparing financial statements issued by different companies. (ref 2) c. The Conceptual Framework promotes harmonization by acting as a base for selecting the most appropriate accounting treatment permitted by the financial accounting standards. (ref 2) d. When new practical problems arise in relation to financial statements, it can be solved by referring to the present framework. (ref 3) e. The Conceptual Framework helps the national bodies in generating new accounting standards in national level. f. It acts as reference guide to the managements while making new financial reports and statements.

The reasons why the IASB and FASB believe it is necessary to develop a joint framework? The International Accounting Standards Board (IASB) is an organization based in London responsible for developing international financial reporting standard and Financial Accounting Standards Board (FASB) is a non-profit organization based in US with the aim of developing accounting principles or standard in the US. Both the organisations have/had separate conceptual frameworks. Often companies refer to the standards set based on these frameworks while preparing the reports.

But due to different frameworks, often when a debate on accounting issues arises, the standards are sometimes rechecked and modified. So both the frameworks might need to be referred as one might not have the guidance set for solving the issue. (Ref 4) The authoritative status's IASB and FASB were different which is again a problem as standards set by the superior board will

be used first. Both the boards had the vision of converging their standards at some point in the future, but if they base on frameworks that are two separate, then they are likely to encounter difficulties.

So with the aim of developing converged, principle-based and internationally accepted standards, in a meeting held October 2004 the boards decided to have a common improved conceptual framework, which will also be consistent enough to act as a foundation for the future development of new standards. The existing frameworks of the IASB and FASB is being merged here to form the new single framework, which also includes the updating, re-examining and discarding of the existing standards which were set two or more decades back.

This step is expected to have good impact on the years to come. But initially the standards will apply to private/business sector only. (Ref 4) The process of developing common conceptual framework was planned to take place in 8 phases. It covers the entire details of financial reporting beginning from the objectives and desired characteristics of financial reports, to the definition of the elements, the recognition and measurement of those elements, and the form and content of financial reports. Ref 4). A timeline is adopted for each stages of the process and is expected to be completed in total three to five years in different phases. Phase Topic A Objectives and qualitative characteristics B Elements, recognition and measurement attributes C Initial and subsequent measurement D Reporting entity

E Presentation and disclosure, including financial reporting boundaries F Framework purpose and status in GAAP hierarchy G Applicability to the not-

for-profit sector H Remaining Issues, if any (Ref 5) On 28 September 2010 the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) issued a Press Release announcing the completion of the first phase (A) of their joint project to develop an improved conceptual framework. Ref 7) This phase mainly dealt with the objectives and qualitative characteristics of financial reporting. Then IASB and FACB together published discussion paper and exposure draft that resulted in more than 320 responses. (Ref 6) At the moment the phases B, C, and D are in progress and were last updated on 11/23/10. These stages are due to be completed soon according to the proposed schedule published in 2005. List of references Reference 1: “ Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement,” FASB Discussion Memorandum (Stamford, Conn. FASB, 1976), page 1 of the “ Scope and Implications of the Conceptual Framework Project” section. Reference 2: Conceptual Framework for Financial Reporting by Islamic Financial Institutions, page 2, <http://www.aaofifi.com/AAOIFI%20%20Conceptual%20Framework%20for%20Financial%20Reporting%20%28Draft%20for%20Public%20Hearing%29.pdf> Reference 3: Conceptual Framework Underlying Financial Accounting, page 28, [http://media.wiley.com/product\\_data/excerpt/87/04710720/0471072087-1.pdf](http://media.wiley.com/product_data/excerpt/87/04710720/0471072087-1.pdf) Reference 4: Building the Foundations of Financial Reporting: The Conceptual Framework, by Richard Gore and Dyan Zimmerman, <http://www.nysscpa.org/cpajournal/2007/807/essentials/p30.htm> Reference 5: Discussion at the Board's February 2005 Meeting, <http://www.iasplus.com/agenda/framework.htm> Reference 6: IASB and FASB complete first <https://assignbuster.com/conceptual-framework-for-financial-accounting/>

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