

# Developing conceptual framework in accounting



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Accounting is playing an important role in nowadays society. It provides financial information to the user to make business decision. However, accountants have to follow accounting standards when they are providing the information. We may question what the principle of those standards is. Financial accounting theory was created as the principle in making standards, and conceptual framework for accounting built up. This essay is going to talk about whether developing a conceptual framework is an impossible possibility. In order to talk about this, I am going through some history of accounting, the definition and compare the conceptual framework under different standards.

Accounting was created for thousands years ago. It dates back more than 7, 000 years which is the time of ancient Babylon, Assyris and Sumeria.

(Friedlob, G. Thomas & Plewa, Franklin James, 1996) At that time, people did accounting for their personal need. With the change of the times, accounting no longer work for personal need. People need common standards for stakeholders to use when making decisions. Countries built up Generally Accepted Accounting Principles (GAAP) to set up rules for accountants to do accounting. When the business is becoming bigger, people find out that it is hard to understand other countries' accounting report. People need international standards, so some international standards come out, Such as International Financial Reporting Standards (IFRS) and Financial Reporting Standards (FRS). They are built by International Accounting Standards Board (IASB), Financial Accounting Standards Board (FASB) and Accounting Standards Board (ASB).

When standard-setters were making standards, they considered about accounting theories. Geoffrey (2007) stated out that three main approaches which are used to create current accounting theories:

The empirical inductive approach. This consists of distillation of theoretical principles from accounting practice.

The deductive approach. This is the logical derivation of theoretical principles by deduction from assumptions.

The new empiricism based on positivism, derived from the Chicago school of economics. This regards theories as worthwhile only if they are testable against empirical evidence. i<sup>¼</sup>^2007i<sup>¼</sup>%o

Financial accounting theories were made in these three steps in present day. In 1976, FASB defined financial accounting theories as ‘ A coherent system of interrelated objectives and fundamentals that can lead to consistent standards.’

According to Elliot (2004), accounting is a mean which used to recording, classifying and summarizing financial activities which include cash flow, transactions and events. It means accounting is really important for users to analyse a company, such as shareholders, investors and employee. For example, investors want to invest a company. They need to know whether a company is good to invest, so they come to accountants and get the financial report. Without accounting standards, they may feel difficult in reading those reports. For this reason, accounting standards are necessary.

To make accounting standards, the conceptual framework of accounting will be need.

Carsberg (1984) described that conceptual framework of accounting is used to provide general support and improve the consistency of financial standards. It can reduce the cost of making the standards by helping the standard-setters on what information should be included and how the information should be displayed. It shows conceptual framework of accounting is necessary in making accounting standards. Conceptual framework set up the principle of accounting, so it improved the consistency of financial report and is beneficial to users in analysing the report.

Furthermore, "...conceptual framework should be viewed as a kind of gyrocompass to help us in navigating our way through the self-interest and contending ideologies that always surrounded debate about regulation." (Edwards, 1981, p. 439) Based on this, Conceptual framework should work as guidance in making accounting standards.

In 1975, The Corporate Report was the one of the reports which is about conceptual framework in the early stage. " Our subject is, in essence, the fundamental aims of published financial reports and the means by which these aims can be achieved." (ASSC, 1975) The report shows the way how financial report should display the financial information. It provided structure for the following standards.

In 2004, IASB/FASB started a project in developing a common conceptual framework for financial report. (Murphy, 2012, p. 1) In 2006, it comes out some information about the framework. For example, it listed some user

groups, such as entity investors, creditors, suppliers. In 2008, more information came out. In 2010, a recent version- Conceptual Framework for Financial Reporting Chapter 1: The Objective of General Purpose Financial Reporting (IASB/FASB, 2010) was released. In this chapter, the efficiency and effectiveness of the entity's management and governing board in discharging their responsibilities to use the entity's resources is included. (IASB/FASB, 2010, para. OB4) In 2012, the IASB discussed how to restart the project on the conceptual framework. This time they believe the framework should focus on elements of financial statements, measurement, reporting entity, presentation and disclosure. (Peter & Alan, 2012) The project of developing a common conceptual framework is so complicated that IASB/FASB took lots of time to do it. Though it is still not complete, we know that it is becoming deeper from identify the users group to the elements of financial report.

Statements of Standard Accounting Practice (SSAP) 2 (1971) gave out a conceptual framework of accounting before others. It was replaced by FRS 18 in year 2000. It showed that:

“ Accounting policies assist in this process by providing a framework within which elements of financial statements, such as assets and liabilities, are recognized, measured and presented. They enhance the comparability of financial statements by helping to ensure that similar transactions are reflected in similar way.”(ASB, 2000)

It provided a way for how the financial standards should be defined and gives out a way for conceptual framework in how it should develop. From the

recent standard in FRS, we see that the framework is completing. For example, FRS 30 is setting out the definition of Heritage Assets.

“ A tangible asset with historical, artistic, scientific, technological, geophysical or environmental qualities that is held and maintained principally for its contribution to knowledge and culture.” (ASB, 2009)

From above, IASB and FASB which are from United States focus more on the methods on how to disclose the financial information. On the other hand, FRS which is used in United Kingdom put more time in building up the definition of building blocks of financial statements. The aspects they concern about are a part of the conceptual framework of accounting.

To evaluate the statement, we need to look into the statement. “ Developing a conceptual framework is an impossible possibility” We can go through the process of induction which is Observations-Laws/theories-Prediction. This is similar to the work of Geoffrey (2007) which I have mentioned. From observed IFRS and FRS, we may say that developing a conceptual framework is possible. It is the theory we get from the work have done. Then we come to prediction. We need to find out a fact that against our theory. If there are no such of fact, we may say that it is possible to build up a conceptual framework.

We can also analyse it from the sources of knowledge. It includes perception, introspection, memory, intuition, testimony and so on. Through perception, the statement is not right. From above, we know that conceptual framework is made by IASB, FASB and other else. Although they are not perfect, they are rudiment and developing. When reading this statement with

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introspection, it cannot be an impossible job. Conceptual framework works as a guidance of accounting. It cannot be impossible to create guidance. In memory, since I learn about accounting standards, I consider the standards are made with invisible rules which I recently think it is the framework of accounting. From intuition, developing a conceptual framework may cost lots of time and difficult to complete, for it need to be agreed by different accounting facilities. Once it complete, it will benefit a lot in making accounting standards. Come to testimony, the people who agree with the statement may argue that some definitions of conceptual framework are still fuzzy, such as true and fair view. As I have said above, nowadays conceptual frameworks are rudiment. It is too early to assert that it is impossible to develop a conceptual framework.

However, there are some evidences for the statement. Some parts of conceptual framework are based on fallacy. For example, Rayman (2007) has talked about IASB and FASB built their conceptual framework on the present value fallacy. In the IASB/FASB project, the income was showed:

“ That definition of income is grounded in a theory prevalent in economics: that an entity’s income can be objectively determined from the change in its wealth plus what it consumed during a period.”(Hicks, 1946, pp. 178-179) (Bullen and Crook, 2005, p. 7; cf. Joint Working Group of Standard Setters, 2000, p. 233)

This is similar to the work of Sterling (1970) which was provided as fallacy.

“ There is general agreement on the definition of income among the various schools of thought: Income is the difference between wealth at two points in

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time plus consumption during the period. The problem centers around the method of determining the wealth or well-offness.” (Sterling, 1970, p. 19)

It looks like there are some mistakes in building the conceptual framework of accounting, but it is also one of the reasons for IASB/FASB to keep improving IFRS. Another evidence for the statement is True and Fair view. It does not have a clear rule or law for this. It works more like an invisible rule. When accountants making financial report, they should make those report bases on true and fair view. There is nothing specific when we look into the view. It depends on accountants' culture and faith.

Back to the statement I talked about, I think it is still too early to say that developing a conceptual framework is an impossible job. Though it used fallacy in the process of building the framework, it still in the middle of completing. We should give hope to it, for it is so important in making financial standards.

In conclusion, the conceptual framework of accounting is vital. From the definition, we can see that the framework will help a lot in building financial standards which will benefit the users in making financial decision.

Comparing different standards which are used in present day, we find out that they are still not perfect. At the meantime, there are some problems in the standards. Even though, it is still not good to conclude that it is impossible to come out a conceptual framework of accounting. I believe the conceptual framework of accounting will finally come out in the future.