CONCEPTUAL FRAMEWORK FOR FINANCIAL ACCOUNTING AND REPORTING: THE SEARCH FOR OBJECTIVES

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Abstract

Accounting from ancient times to these modern days has gone through different stages. This was necessitated to meet the needs of its users and achieve its objectives. In an attempt to determine these objectives, different surveys and reports have been published by standard setting bodies in different countries. This paper x-rays the different reports published on the objectives of financial reporting and how these reports have affected the financial statements prepared for users. The paper also highlights the attempt by different countries in determining the objectives of financial reporting and concludes with the hope that as Accounting evolves, the search for more objectives will continue.

Introduction

Managers of organizations make decisions on a daily basis. Some of these decisions are made under uncertainty. To be able to make the right decisions especially under complex situations, the necessary information should be made available to them at the right time. Accounting has made decision making a lot easier because it plays the role of providing the necessary information to decision makers. The specific need of management in terms of information for decision making may vary and depend on factors which are peculiar to the decision maker within the organization. In the early stages of accounting development, the information- providing role of accounting was seen to be limited only to organizations. This was due to the fact that financial statements were prepared primarily to reveal the wealth and income earned at the end of the accounting period by the proprietor of a firm. However, the role of accounting has been changing with the economic and social development over the past few decades.

Demski (1973) is of the view that accounting information may also have public value apart from its private value. This is because accounting information may influence individual investor's assessment and through these assessment, the structure of securities prices. This may further influence the distribution of costs of capital to various uses in the economy.

The objective of this paper therefore, is to identify the objectives of financial statements. The main focus will be on the different attempts made at identifying the users of the financial statements and the objectives for such financial statements with emphasis on the Trueblood report, Corporate and Stamp reports.

Literature Review

Accounting has been defined variously by different authors. Each of these definitions attempts to demarcate its field of study. Developing a single definition for accounting has been difficult. The first difficulty is due to the dynamic nature of accounting. According to Glautier and Underdown (1986:3), "the changing environment continually extends the boundaries of accounting which makes defining the scope of the subject problematic".

The second difficulty in having a universal definition for accounting is based on the question on whether accounting is an art or science. According to AICPA (1953:5), "accounting is an art". This has been criticized by scholars and researchers who are of the view that accounting is a science and not an art. Belkaoui (1996) is of the view that accounting is a science. He describes accounting as a multi-paradigmatic social science based on the models of human intention and rationality. However, a more comprehensive and acceptable definition is that of the American Accounting Association (AAA).

According to Adeniji (2004:4), the AAA defines accounting as "the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information ". From this definition, accounting is viewed not as an end in itself but a language that is useful in decision making. This implies that the continued existence of accounting is dependent on its usefulness to the society and users of accounting information.

Accounting has been practiced since the beginning of recorded history. Business transactions and land sales were recorded by about 3000 B.C. The introduction of money as a medium of exchange provided the necessary impetus for the development of modern accounting. The Chinese were the originators of this practice before it appeared in Europe. Sophisticated forms of government accounting existed in China as early as 2000 B.C. Banking and other commercial activities led to the maintenance of accounts in ancient Greece. The Romans kept their accounts on wax tablet which perished with the fall of the Roman civilization. The economic development of the middle ages helped in the development of accounting. Large scale businesses were carried on by banks and churches in Europe (Porwal, 2006).

According to Williamson (2002:1), "the most famous event in history was the publication of the work of Luca Pacioli considered by many to be the father of modern accounting". The double entry system laid down by Pacioli was applied earlier in Europe and was introduced in England towards the end of the 19th century.

The Industrial Revolution which began in the middle of the 18th century gave an impetus to the development of financial accounting and reporting. The growth of large scale enterprises was as a result of the invention of production machinery. This required capitals greater than what could be provided by one person or family. More and more persons were invited to invest their savings in such venture (Porwal, 2006).

As more people invested in these large ventures, this led to the separation of owners who provided the capital from the management, managing the daily affairs of the business. There was the need to periodically provide reports to these owners on the wealth owned by them. According to Porwal (2006:58), "this led to the preparation of the balance sheet". With economic and social developments, and also the need to make adequate decisions, there was a need to determine the users of these reports and what their expectations are. This led to a number of international reports being published since the early 1970s. The essence of these reports is to determine amongst others, the purpose of accounting information and the content of the financial statements. These reports focused on the needs of external users and identify decision usefulness as the main aim of accounting information.

Some of these reports include; Trueblood report, Corporate report, Stamp report and Solomon's report.

Trueblood Report

In view of the criticisms of corporate financial reporting, there was the need for a conceptual framework of financial accounting and reporting. The American Institute of Certified Public Accountants (AICPA) constituted a study group headed by Robert Trueblood in 1971. The main thrust of this study group was to determine the objectives of financial statements. The group came out with their report and was made public in 1973. The report is popularly referred to as the "Trueblood Report". According to Williamson (2002:5), "Trueblood discussed twelve objectives of financial reporting". The objectives are; decision making, cash flows, earnings, management ability, disclosure and statement of financial position. Others are; uncompleted transactions, expected information, forecast, government and social concerns objectives.

As a result of these objectives identified in the Trueblood report, there was the need for additional financial statements to be prepared alongside the income statements. Subsequently, the Financial Accounting Standard Board (FASB) issued a concept statement on objectives of financial reporting. The documents that constituted financial statements were; the income statement, balance sheet and cash flow statements. However, the Trueblood report has been criticized because its emphasis focused on the needs of external users. Moreover, it was discovered that the Trueblood report could not be implemented in Great Britain due to the fact that some of their recommendations are not compatible with the structure and environment of Great Britain. This led to the constitution of another committee in Great Britain to determine the users and objectives of financial statements and reporting.

The Corporate Report

In Great Britain, the Institute of Chartered Accountants in England and Wales (ICAEW) published the corporate report in 1975. According to Porwal (2006:133), "the basic philosophy in the report was that financial statements should be appropriate to their expected use by the potential users". To satisfy the fundamental objectives of annual financial reports, seven characteristics that the financial statement should have were cited. They are; relevance, understandability, reliability, completeness, objectivity, timeliness and comparability. The corporate report suggested the need for the following additional information to satisfy the informational needs of all user groups.

1. Statement of value added to show how the wealth was produced and how it has been distributed among stakeholders.
2. An employee report dealing with the size and composition of workforce, efficiency, productivity, industrial relations, benefits earned and personal policies.
3. A statement of money exchanges with government showing tax.
4. A statement of transactions in foreign currency showing overseas borrowings and repayment.
5. A statement of future prospects showing forecasts of profits, employment and investment.

The recommendations of the corporate report show that it envisaged a more socially responsible role for accounting. Under this social perspective, accountability is regarded as existing not only between the management of a company and its shareholders, but also between the management, the company and the society. However, it was also discovered that the corporate report was not comprehensive and this resulted into the constitution of another committee referred to as the "stamp committee" to determine the objectives of financial reporting in Canada.

The Stamp Report

In Canada, the Institute of Chartered Accountants (CICA) published the stamp report in 1980. The stamp report on corporate reporting identified four major objectives of financial reporting:

1. To provide useful information to all the potential users of such information in a form and time frame that is relevant to their needs.
2. To provide information to minimize uncertainty about the validity of information and to enable the users to make their own assessment of risk associated with the enterprise.
3. To develop standards governing financial reporting which allow ample scope for innovation and evolution as improvements become feasible.
4. To be directed towards the needs to users who are capable of comprehending a complete set of financial statements.

According to Porwal (2006:135), "it will be seen that these objectives concern accountability, uncertainty and risk, change and innovation. The construct of flexibility may also contribute towards the attainment of the objectives stated in the stamp report". From the stamp repot, the standard governing financial report should be more flexible. This is due to the fact that a flexible information system and reporting standard will not inhibit innovation, experimentation and evolution in adapting to the changing demands of users but rather promote it.

Solomon's Report

In 1989, the Institute of Chartered Accountants of England and Wales (ICAEW) commissioned the Solomon's report. According to Koornhof (1998:37), "the report re-iterated that decision usefulness is the main objective of financial reporting". Accordingly, financial reports should provide information that will be useful to a variety of users who have interest in:

- Assessing financial performance and the position of the enterprise.
- Assessing the performance of those responsible for its management.
- Making decisions about investing in lending in extending credit to doing business with or being employed by the enterprise.

However, decision usefulness as the main objective of accounting information cannot remain static but will evolve and change over time. According to Koornhof (1998:37), "it will be influenced by political, social, economic and technological changes in the environment". It should be noted that changes in the environment may not only influence the nature and objectives of accounting information but also the needs of its users. This will require accounting information system to be flexible so that it can adapt to the changing demands of its users. Hendrisken and Brenda(1992) are of the view that the decision usefulness of accounting information will depend on the qualitative characteristics of the information. These qualitative characteristics should be;

- Robust, i.e. stand the test of time,
- Pervasive, i.e. apply to all accounting entities,
- Implementable to objective verification.

In their conceptual framework, FASB (1980) distinguished between two categories of qualities, namely: user-specific and decision qualities. User specific qualities refer to aspects such as understandability and decision useful qualities on the ability of the users. For example, their knowledge of accounting and willingness to study accounting information. These qualities of users determine the level of complexity of information that should be reported. Decision-specific qualities concern the qualities required of information such as timeliness, relevance and completeness (Koornhof, 1998).

Discussion

Accounting is still an evolving discipline. This discipline is influenced by political, social and technological changes in the environment. From the reports x-rayed so far, decision-usefulness seems to be favoured as the main objective of financial reporting. However, according to Koornhof (1998:38), "this is not only the purpose of the accounting discipline". At present, there is no comprehensive theory of accounting and therefore no general purpose for accounting. Kuhn (1970) as cited in Koornhof (1998) is of the view that accounting is still in a revolutionary phase. This may be due to the fact that other professions evolve from theory to practice while accounting on the other hand evolves from practice to theory.

Standard setting bodies in different countries all over the world are into research to determine the objectives that the financial statements should meet. For instance, in October 1998, the South Africa Institute of Chartered Accountants (SAICA) issued a statement that for financial statement to truly reflect its objectives, enterprises are encouraged to include in their financial review:

- The main factors and influences determining performance, including changes in the environment in which the enterprises operate, the enterprises' response to those changes and their effect on them.
- The enterprises' source of funding, policy on gearing and its risk management policies.
- The strengths and resources of the enterprises not reflected in the balance sheet.

Recently, FASB (2006) is of the view that to meet the objective of financial reporting, the "fair value" should be used in reporting accounting information. However, the suggestion met with strong resistance because it is believed that such reporting may not truly reflect the objective of the financial statement.

Conclusion

As we move through different developmental stages in the world over, it is believed that the objectives that the financial statement seeks to achieve will not be static. Rather, it should move along with developmental stages. At present, there is no comprehensive accounting theory and no generally comprehensive objectives of the financial statements. However, if financial reporting must achieve its relevance in the 21st century, there should be a continued research to its objectives and the expectation of its users. The search continues.

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