CONCEPTUAL FRAMEWORK

Learning Objectives

- Definition of CF & its objectives
- The need for CF
- Historical Dev. of the search for CF in US, UK, Canada & Malaysia
- Components of CF
- MASB Proposed Framework & its scope
- Benefits & Limitations
Conceptual framework

- Definition of conceptual framework:
  ‘A constitution, a coherent system of inter-related objectives and fundamentals that can lead to consistent standards and that prescribes the nature, function and limits of financial accounting and financial reporting’

- *Objectives* means identify goals and purposes of accounting.

- *Fundamentals* means underlying concepts of accounting that guide the selection of events to be accounted for, the measurement of those events, summarizing and communicating to third parties.
Conceptual framework is developed to guide the development of accounting practices.

CF can act as constitution for the standard setting process & help to resolves dispute.

CF provide accounting with the basic principles on which to build standards of acceptable practice for preparing & presenting accounting information.
Proposed Malaysian Conceptual Framework

- Malaysia develops its MASB framework incognizant in material aspects of International Accounting Standards (IASC) Framework.
- The framework is modified to suit peculiar needs of promulgating accountings standards that suit particular needs of the Malaysian Economy.
- As a standard setting body MASB promulgate standards that forms part of regulatory compliance in financial reporting as embodied in the Financial Reporting Act 1997.
- Non-compliance would result in corrective action based on relevant requirements.
- Framework acts as a basis to reconcile any differences between existing local legislation and guidelines issued by regulatory authorities and existing or proposed accounting standards.
Scope of the Proposed Malaysian Framework

- Definition of financial statements.
- Purpose of financial statements.
- Qualitative characteristics of financial statements.
- Identification, definition and criteria of recognition of elements of financial statements.
- Concepts of capital maintenance and basis measurement of the elements of financial statements.
Historical Development of the Search for CF

- The search for CF began with the need to develop concepts to guide accounting standards board in establishing accounting standards and to provide frame of reference to discuss accounting issues.

- The focus of CF was on the achievement of overall objectives of financial reporting.
Historical Development - US

- Started as early as 1940’s
- 1972 – the Wheat Committee (AICPA) published a report on ‘Establishment of Accounting principles’.
- 1973 - The Trueblood Committee studied and published a report on ‘Objectives of Financial Statements’.
- 1976 – The FASB project on CF started. The FASB’s CF is the most advanced project in the creation of an accounting constitution.
1975 – The committee on Corporate Report concluded that:

➢ All company reports should conform to a number of specific characteristics.

➢ There are a wide range of users of accounting information. The information needs of these users have to be accommodated by the company reports.

1987 – The Dearing Report concluded that the lack of a CF is a handicap to those involved in standard setting as well as those applying them.

1988 – The Solomons Report stated that there must exist a formal framework as a basis for standard setting.
Historical Development - Canada

“Corporate reporting” by Edward Stamp (1980) dealt with the purpose of a CF and its benefits to standard setters and users.
Historical Development - Malaysia

- The closest equivalent to an accounting framework in Malaysia would be the requirements of “true and fair view” under the Companies Act 1965.
- Guidance as to what constitutes “true and fair view” is based largely on convention rather than on any particular concept. Compliance with Approved Accounting Standards, Companies Act and requirements of other statutes is the accepted practice.
- This represent a first attempt by Malaysia to set a foundation for the manner in which financial statements should be prepared and presented. It contains guidance that may influence the direction of financial reporting practices in Malaysia.
- The MASB’s framework is similar to the Framework for the Preparation and Presentation of Financial Statements issued by the International Accounting Standard Committee (IASC).
Need of conceptual framework

- Need for a conceptual framework arose as a result of weaknesses in accounting and standard setting practices. Among the problems or weaknesses were:
  - Different treatment of like transactions among accountants in practice, resulting in differing financial statements.
  - Inconsistencies in the issuance of standards (i.e., standards were not built on a logical framework).
  - There are certain influences in the standard setting process which go beyond technical considerations (i.e., resulting in lobbying by third parties).
  - The accounting profession was worried that the government will regulate them.
Objectives of Conceptual Framework

- Miller (1995) classified the three main goal as:
  - To describe existing practice – the existence of so many accounting concepts requires a need to get an overall picture of what is done in practice and how these concepts are being used in the actual working environment. It aims is to explain what accounting is all about so that we can see the overall picture of accounting.
  - To prescribe future practice – to give some form of direction (guidelines) to future accounting practice by providing alternative solutions to deal with emerging accounting issues and improving current practice. Hence, problems and inconsistencies can be solved by referring to the guidelines provided for in the conceptual framework.
  - To define key term and fundamental issues – to clarify the basic terms used in accounting, so that they can be easily understood by the accounting profession or any other interested parties. This will reduce any misunderstanding or miscommunication in discussion.
Benefits/Advantages of conceptual framework

- Guide the FASB in establishing accounting standards. Thus, standard would tend to be more consistent with one another. This will enhance credibility of accounting information.

- Act as a guidance to the standard setting body to be in better position in choosing the alternatives methods available.

- Provide a frame of reference for resolving accounting questions in the absence of specific promulgated standards.
  - Reduce dispute that may arise during the standard –setting process by referring to whether or not the specific standards conform to conceptual framework.
  - Alternative methods are better assessed and chosen since standard setters will be in a better position to assess the usefulness of alternative methods.
Advantages of CF – cont.

- Improved communication among accountants and standard setting bodies and its constituents.
- Determine the bounds of judgment in preparing financial statements by prescribing the nature, functions and limits of financial accounting and reporting.
- Enhance comparability of financial statements by decreasing the number of alternative accounting methods.
- If standards were derived from a coherent and plausible body of concepts, this will reduce the accountants vulnerability to political pressures.
Advantages of CF – cont.

- Reporting requirement will be more consistent and logical because they will stem from an orderly set of concepts.
- The need for specific accounting standards will be reduced.
- The setting requirement will be more economical because issues should not be re-debated from different viewpoints.
- Enhance the credibility of financial reporting and in turn help to reduce accounting’s vulnerability to political pressure.
Advantages of CF – cont.

- Increase users confident and understanding of financial reporting.
- Provide a measure or bench-mark against which general and specific accounting can be tested in an objective sense.
- Provide a basis of reason, direction and a basis of appeal in the resolution of disputes.
- Provide a consistence approach in the making of decisions concerning the choice of accounting practices, methods and in assisting the setting of accounting standards.
Components of CF (FASB)

- A statement of objectives of financial reporting.
- A specification of qualities of financial information to be disclosed in the financial statements.
- A set of definitions of the elements of financial statements.
- A specification of the criteria for deciding when to recognize the various elements of financial statements.
- A set of measurement rules.
- A set of guidelines for presentations and disclosure of information that is useful in fulfilling objectives of financial reporting.
Components of CF - Text

- Reporting objectives – to provide useful information to investors – (refer to text: pg 48)
- Concepts, assumptions and principles:
  - Concepts – qualitative traits of accounting information as well as reporting assumptions. Qualitative traits refer to the description of what is meant to be useful accounting information (information relevant and reliable that provides understandability).
  - Assumptions – entity, going concern, periodicity, stable monetary value and substance over form.
- Elements of financial statements includes assets, liabilities, equity, investment and distributions, comprehensive income, revenue, expenses, gains and losses.
- Reporting process – identifying a transaction and recording them as an element of the financial statement involve recognition and measurement. Recognition includes definition, measurability, relevance and reliability. (e.g. if it is not measurable it will not be recognized).
  Disclosure implies the adoption of materiality principle.
Limitations of Conceptual Framework

- Timely and costly – time consuming and expensive to set up and operate. Countries with smaller or less developed economies may not be able to afford them.

- Rigidity – the CF may provide too much guidance to accounting and standard setting such that it encourages rigidity by making it difficult to introduce new ideas.

- Conflict between CF and accounting standards which were prepared prior to the development of the CF.

- Possibility that a conceptual framework may benefit only some of the groups identified as users. The framework may not be workable or acceptable to all interested parties.
Tutorials

- Conceptual Framework by Wee Shu Hui, UiTM Sarawak.
- Conceptual Frameworks Around the World by Steve Lawrence, University of East London.
- Mathwes and Parera pp. 94-95