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The joint IASB/FASB Conceptual Framework project

International financial accounting
Introduction
The International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) are currently cooperating to develop a common conceptual framework that is both complete and internally consistent. The entire project should be completed in eight phases. These eight phases will cover the entire spectrum of financial reporting, 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.

Background
The Conceptual Framework is an essential element in the development of principles based accounting standards. The Conceptual Framework makes standards setting more efficient by providing a common set of terms and premises for analyzing accounting issues. Without a framework, accounting standards might be based on the most expedient solution to a particular issue, rather than a solution that is consistent with a unified theory of accounting. Each time a debate on an accounting issue arises, it isn't necessary to reinvent the wheel. IASB and the FASB are working on a common Conceptual Framework to promote the convergence of International Financial Reporting Standards (IFRS) and U.S. GAAP, ultimately leading to a single set of high-quality global accounting standards (Gore & Zimmerman 2007).

As the IASB and FASB pursue a common framework, the Boards face numerous challenges and controversies. These include challenges and controversies like differing views on whether the framework should apply to only the private sector or be broader, areas where some existing accounting standards preceded the concepts that support them, and differing views of the status of the framework in the GAAP hierarchy (McGregor & Street 2007).

One key difference between the FASB's and IASB's Conceptual Frameworks is that FASB's Conceptual Framework was written to guide it in issuing standards, but was not explicitly intended to help preparers and auditors. In contrast, IASB places its Conceptual Framework higher in the "hierarchy" of accounting standards, and expressly designed its Conceptual Framework not only for its own use, but also for preparers and users of financial statements (Heffes 2005).

Purpose
The purpose of this essay is to present the IASB and FASB joint conceptual framework project and to consider and evaluate its objectives. Another objective is to compare the current existing frameworks with the new joint conceptual framework in order to identify the biggest differences. This paper will treat and present the four active phases of the project.
**Objective of financial reporting**

The main objective of general financial reporting is defined as providing information about financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economics decisions such as present and potential equity investors, lenders, and similar resource allocation decisions (Rachez). Relevance, faithful representation, comparability (including consistency) and understandability are identified among the characteristics of financial information that make the decision-useful. The objective of financial reporting is the foundation of the conceptual framework. Other aspects of the framework (qualitative characteristics, elements of financial statements, recognition and measurement) will build on that foundation with the aim of ensuring that financial reporting achieves its objective (FASB 2009a).

**The joint conceptual project**

IASB and FASB embarked a project to develop a common conceptual framework that is both complete and internally consistent. Such a framework would provide a foundation for developing future accounting standards and is essential to fulfilling the Boards’ goal of developing standards that are principles-based, internally consistent, internationally converged, and that lead to financial reporting that provides the information needed for investment, credit, and similar decisions.

The framework, which will deal with a wide range of issues, will build on the existing IASB and FASB frameworks and consider developments since they issued their original frameworks (IASB challenges). IASB and FASB’s need to identify the differences between IFRS and US GAAP and find the best global solutions to these differences to eliminate variety of differences between International Financial Reporting Standards and US GAAP (Rimmel).

The project to revise the existing IASB and FASB Conceptual Frameworks will involve the examination of the foundations of financial reporting and, indeed, accounting itself. In essence, every accounting concept and principle which financial reporting rests upon will be reexamined and other reaffirmed, revised, or discarded. This project will have far-reaching implications and will influence the direction of financial reporting for years to come (Gore & Zimmerman 2007).

A primary motivation for the joint project is to converge the frameworks of the two boards in order to provide a consistent intellectual foundation for the convergence of the two sets of standards. Convergence is not, however, the only motivation: improvement is equally important (Whittington 2008). IASB and FASB will also save money by working on the rules together. (Rimmel).
The eight phases
FASB and IASB are planning to manage the project in a series of steps. The entire project should be completed in eight phases. Each of the first seven phases will address and involve planning, research, initial Board deliberations, public comment, and redeliberations on major aspects of the Boards’ frameworks. The eighth phase will be used to address any remaining issues (FASB 2009a). Each phase will involve the issuance of a preliminary views document, followed by an exposure draft so that constituents can provide feedback regarding the boards' decisions. These eight phases will cover the entire spectrum of financial reporting, 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. There are only four active phases at the moment; those are A-D in the table below. The four inactive phases are shown in the table as well but will not be treated in this paper (Gore & Zimmerman 2007).

Table over all phases

<table>
<thead>
<tr>
<th>Phases</th>
<th>Subjects</th>
<th>Current status</th>
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<tbody>
<tr>
<td>A</td>
<td>Objective and qualitative characteristics</td>
<td>Exposure draft (29.05.2008)</td>
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<td>B</td>
<td>Elements and recognition</td>
<td>Board discussions, preliminary views in planning</td>
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| C      | Measurement                                 | - Planning and staff studies  
| D      | Reporting entity                           | Discussion Paper (29.05.2008) |
| E      | Presentation of financial statements and notes disclosures, including limitations of financial reports | Research studies, performed by other institutions. Discussion Paper: “Management Commentary” (27.11.2005) |
| F      | Objective and status of framework          |                                |
| G      | Application for non-profit sector          |                                |
| H      | Remaining issues, if any                   |                                |

(Kirsch)
Phase A, the Objectives and Qualitative Characteristics phase
The aim of the first phase, Objectives and Qualitative Characteristics phase is to consider: The objective of financial reporting, the qualitative characteristics of financial reporting information and The trade-offs among qualitative characteristics and how they relate to the concepts of materiality and cost-benefit relationships (FASB 2009b).

This first phase is critical for two reasons. First, it is essential that a consensus be reached concerning the objectives and desirable features of financial reports, to provide legitimacy and momentum for the rest of the project. Second, the objectives and qualitative characteristics will serve as the basis for evaluating alternatives related to the crucial recognition and measurement issues to be decided in later phases of the project (Gore & Zimmerman 2007).

The qualitative characteristics are the attributes that make financial information useful. In developing standards, the boards will consider the qualitative characteristics so that information reported in financial reports is useful and meets the objective of general purpose financial reporting. A definition of the qualitative characteristics follows:

- **Relevance** is defined as information that is capable of making a difference in the decisions of users by helping them to evaluate the potential effects of past, present, or future transactions, or other events on future cash flows or to confirm or correct previous evaluations (Kirsh). The Preliminary view elevates relevance to the first item to be considered in the sequential-process approach, based on the assertion that information that is irrelevant is useless. Information which is relevant but so inaccurate as to be misleading may be even worse than useless; it might even be harmful to those who rely on it (Gore & Zimmerman 2007).
- **Faithful representation** is defined as information must be a faithful representation of the real-world economic phenomena that it purports to represent.
- **Completeness** should make sure that financial reporting is including all information that is necessary for faithful representation of economic phenomena that the information purports to represent.
- **Neutrality** is supposed to ensure that there is no bias intended to attain a predetermined result or to induce a particular behavior.
- **Comparability** enables users to identify similarities and differences between two sets of economic phenomena.
- **Consistency** refers to the use of the same accounting policies and procedures, either from period to period within an entity or in a single period across entities.
- **Verifiability** means that different knowledgeable and independent observers would reach general consensus, although not necessarily complete agreement.
- **Timeliness** ensures that information is available to decision makers before it loses its capacity to influence decisions.
- **Understandability** enables users who have reasonable knowledge of business and economic activities and financial reporting and studying with due diligence, to comprehend its meaning.
- **Reliability** Information in financial statements is reliable if it is free from material error and bias and can be depended upon by users to represent events and transactions faithfully.
- **Substance over form** ensures that the financial statements will show the financial reality of the entity (substance), other than the legal form of transaction (form).
• *Prudence* is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated.

• *Materiality* – Information is material if its omission or misstatement could influence decisions that users make on the basis of an entity’s financial information.

• *Cost vs. Benefit* – The benefit of financial reporting information should justify the costs of providing and using it.

• *Weighing qualitative characteristics* – Sometimes qualitative characteristics can be contradicting. (Kirsch)

As mentioned before, the IASB and FASB are revising the current frameworks, and are trying to work out a new, globally accepted and superior way of categorizing the qualitative characteristics build upon the existing frameworks. The qualitative characteristics of the joint conceptual framework have been decided and are categorized as following in the picture:

In the joint conceptual framework are the two fundamental qualitative characteristics relevance and faithful representation. Faithful representation consists of three supplementary characteristics; neutrality, completeness and free from material errors. Further there are four enhancing qualitative characteristics: comparability, verifiability, timeliness and understandability. These are complementary to the two fundamental qualitative characteristics and enhance the fundamental qualitative characteristics by distinguishing more useful information from less-useful information. They should also be maximized to the extent possible, but will not on their own make information decision-useful. Finally there are two constraints that might limit the information provided by financial reporting: materiality and cost.
There have been changes from the IASB -Framework where both neutrality and prudence were used. Prudence has been removed due to being too cautious and therefore giving a biased view of the reporting entity. It has agreed upon that neutrality is of larger importance and it is incompatible with conservatism (prudence) and therefore prudence has been left out of the conceptual framework. The principle that says that financial reporting should be free from material errors substitutes the former principle of prudence in the case of uncertainty. Regarding to completeness there can be potential conflicts with materiality, considering benefits and costs of information and also understandability (Kirsch).

In determining the qualitative characteristics of financial reports, the Preliminary view has also made several modifications to the current FASB framework: It replaces the hierarchy of qualitative characteristics with a sequential process approach and also replaces the concept of reliability with faithful representation (Gore & Zimmerman 2007).

Although the qualitative characteristics are the most abstract part of the Conceptual Framework, some of these changes mentioned above likely will result in considerable changes in the future direction of financial reporting. Accountants have to pay close attention to what is included in the qualitative characteristics and what is not (Gore & Zimmerman 2007).

**Phase B, the Elements and Recognition phase**

Phase B is focused on the definition of two basic elements, assets and liabilities. The objectives of this phase are to refine and converge the Boards frameworks as follow: Revise and clarify the definitions of asset and liability, to resolve differences regarding other elements and their definitions and to revise the recognition criteria concepts to eliminate differences and provide a basis for resolving issues such as derecognition and unit of account (FASB 2009c).

The asset definition of an asset has hitherto received most attention in Phase B, for the reason that this will provide the foundation for the other elements in the ‘balance sheet’ approach. The current IASB Framework has defined an asset as: “An asset is a resource controlled by an entity as a result of past events and from which future benefits are expected to flow to the entity” (Whittington 2008).

The new definition deletes two significant phrases from the original: ‘as a result of past events’ and ‘from which future benefits may be expected to flow’. Both of these are likely to affect the recognition criteria. The recognition criteria have not even yet been discussed in the conceptual framework revision. The current planned definition of an asset in the joint conceptual framework is: ‘An asset is a present economic resource to which the entity has a present right or other privileged access’ (Whittington 2008).

The other element that has received the most attention is liabilities. The Boards have proposed a parallel definition to that of assets. The IASB’s current Framework definition is: “A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits” (Whittington 2008)
The Liability definition mirrors the definition of assets, so do also the changes in the definition. Like in the case of assets, the reference to past events is removed, as also is the reference to expectation of future flows. Thus, the same implications arise for assets as for liabilities, particularly with consider to recognition criteria. The Boards current proposed definition of a liability is: “A liability is a present economic burden for which the entity has a present economic obligation” (Whittington 2008).

The Boards current existing definitions of an asset and liability are very similar, and the boards have agreed that the current frameworks definition of an asset and liability have these following shortcomings: Some users do misinterpret the terms “expected” (IASB definition) and “probable” (FASB definition) to mean that there must be a high possibility of future economic benefits or on the other hand outflow of economic benefits for the definition to be met; this excludes asset items with a low probability of future economic benefits and excludes liability items with a low possibility of future outflow of economic benefits. The definitions of an asset and liability place too much emphasis on identifying the future flow of economic benefits or future outflow of economic benefits, instead of focusing on the item that presently exists, an economic resource or an economic obligation. The definitions also place undue weight on identifying the past transactions or events that gave rise to the asset or to the liability, instead of focusing on whether the entity had access to the economic resource or had an economic obligation at the balance sheet date (FASB 2009c).

Other elements like equity, income and expenses that are defined in the current IASB Framework have not yet been addressed, and neither has the important and potentially contentious issue of recognition been defined (Whittington 2008). The Boards’ approach will focus initially on converging and defining only those key elements that are defined today in the IASB and FASB Frameworks. As well, the Boards will need to consider the extent to which, and if so how, to define elements that are not defined today (FASB 2009c).

**Phase C, the Measurement phase**

The objective of the Measurement phase is to provide guidance for selecting measurement bases that satisfy the objectives and qualitative characteristics of financial reporting and to create specific measurement concepts, principles, and terms (FASB 2009d).

Measurement is a critical aspect of financial reporting, however, it is also one of the most under-developed and incomplete areas of the current conceptual frameworks and has been affected most by the passage of time (McGregor & Street 2007). The FASB and IASB frameworks just simply provide a list of measurement bases used in present practice and indicate that the use of different bases is expected to continue. Neither of the current frameworks provides any analysis of the strengths and weaknesses of the various measurement bases, nor do they offer any guidance on choosing among the listed bases or considering other alternatives (FASB 2007).

The overall objective of the new measurement framework is therefore to fill in these gaps in coverage, so that standard-setters will have clear, up-to-date guidance to use in determining the measurement requirements for specific accounting standards.
In April 2007 the Boards agreed to a list of nine candidates: past entry price, past exit price, modified past amount, current entry price, current exit price, current equilibrium price, value in use, future entry price, and future exit price. The boards also decided to provide two definitions for each measurement basis candidate, one from the perspective of an asset and one from the perspective of a liability. It also provides examples and terms used as synonyms (FASB 2007).

The Two of the most talked-about measurement basis terms, historical cost and fair value, are noticeably excluded from the list. That is because there is no common understanding of those terms, and their use often leads to miscommunication and misunderstanding. Nevertheless, historical cost and fair value have not been ignored: The measurement basis candidates relating to the past (past entry price, past exit price, and modified past amount) together constitute the notion of historical cost. Similarly, the list of candidates relating to the present (current entry price, current exit price, current equilibrium price, and value in use) encompasses the various notions of fair value (FASB 2007).

Phase D, the Objective of Reporting Entity Phase
This phase of the conceptual framework deals with the reporting entity and has made more progress than phase C, the measurement, probably because it is less controversial (Whittington 2008). The objective of this phase of the project is to develop a reporting entity concept for inclusion in the boards’ joint conceptual framework. Like the other phases of the joint conceptual framework project, the reporting entity phase concentrates on developing a reporting entity concept in the context of general purpose financial reporting. But the boards still needs to determine what constitutes a reporting entity for the purposes of financial reporting (FASB 2009e). The term reporting entity, in its most general sense, refers to the entity that is the subject of a particular set of financial reports.

The General purpose of financial reports is to provide information about a particular reporting entity. Those reports provide information about the entity’s economic resources, claims on those resources, and the effects of transactions and other events and circumstances that change an entity’s resources and the claims on them. It is the entity itself that is the subject of financial reporting, not its owners or others that have an interest in the entity. There is a distinction between the subject of general purpose financial reports and the users of those reports like equity investors and lenders. (FASB 2008).

The boards’ current existing conceptual frameworks do not contain a reporting entity concept. As a result of this, neither framework specifically addresses the reporting entity concept. Because of that there is no reporting entity concept in the boards’ existing conceptual frameworks; there is no obvious established starting point. The first task must be to more clearly establish the objective of this phase of the project.

Furthermore, this phase of the project does not seek to resolve all accounting issues relating to the reporting entity, in particular, issues that arise in standards-level projects or in accounting practices about consolidated financial statements. Therefore, once a reporting entity concept is developed, many issues will probably remain to be addressed at the standards level (FASB 2008).
Challenges and controversies
As stated earlier, the sole objective of financial reporting is to provide information to users in making resource allocation decisions. The management’s stewardship may be defined as accounting for the resources entrusted to management, has been eliminated as an independent objective of financial reporting in the joint conceptual framework project. Instead, in the Preliminary View that the boards send out, suggests that stewardship is encompassed in the objective of providing useful information regarding resource allocation decisions. This issue concerns the very nature of accounting and financial reporting, and may hinge on whether one believes that accounting and financial reports are used as much or more for control and evaluation of management as they are for resource allocation decisions (Gore & Zimmerman 2007).

Given that only a small part of businesses are publicly traded, the boards might be giving too much thought to the capital markets and not enough consideration to the needs of privately held business enterprises. The issue of resource allocation versus stewardship is intertwined with the question of whether the Conceptual Framework should apply to all entities, both public and private. The boards states in the preliminary view that the joint conceptual framework will apply to all entities, based on the premise that the objectives and fundamental principles of financial accounting should apply to all business entities.

The Preliminary view also identifies the need to reflect on cost/benefit constraints in applying accounting standards, which may suggest that some entities could be excused from certain reporting requirements. This is a particularly important decision for the boards, because adopting either the entity or proprietary perspective of accounting will influence several controversial accounting issues, such as accounting for stock options, distinguishing equity from liabilities in cases of instruments that carry some characteristics of both, such as convertible bonds. In the Preliminary view, the boards expressed a preference for the entity perspective, but the boards do not provide clear rationale for this conclusion (Gore & Zimmerman 2007).
Conclusions
The objective of the conceptual project to develop an improved common conceptual framework that gives a sound foundation for developing future accounting standards is an obtainable and realistic objective. There have been some changes from the currently existing frameworks, which might lead to some difficulties at first, because of the new definitions. Such as the definition of an asset, this deletes two significant phrases from the original. Both of these would probable to affect the recognition criteria. The later has not even yet been discussed.

The biggest difference in the joint conceptual framework compared to the existing frameworks is the removal of the management’s stewardship as an independent objective of the financial reporting. Other modifications have been made compared to the present FASB framework such as replacing the hierarchy of qualitative characteristics with a sequential process approach and it also replaces the concept of reliability with faithful representation. There have also been some changes from the IASB -Framework where both neutrality and prudence were used. Prudence has been eliminated due to being too cautious and therefore giving a influenced view of the reporting entity. It has agreed upon that neutrality is of larger importance and it is incompatible with prudence and therefore prudence has been left out of the conceptual framework.

Phase C, the measurement, which is the most under-developed area of the framework. This phase is in an early stage and a lot of work is needed to be done. None of the current frameworks provides any analysis of the strengths and weaknesses of the various measurement bases, nor do they offer any guidance on choosing among the listed bases or considering other alternatives. It’s important that the boards find a good starting point and develop a clear and up-to-date guidance for standard-setters to use in determining the measurement requirements for specific accounting standards, because the measurement is a critical part of financial reporting.

It’s hard to say if IASB and FASB are going to achieve the main objective of the joint conceptual framework, because that not all phases are active and it’s too early to draw any drastic conclusions. But IASB and FASB’s joint conceptual framework is off with a good start.
Source list:


Kirsch, H. Lecture 31 Aug 2009


Rachez, D. Lecture 15 Sep 2009

Rimmel, G. Lecture 29 Sep 2009
