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THE EVOLUTION OF THE CONCEPTUAL FRAMEWORK FOR BUSINESS ENTERPRISES IN THE UNITED STATES

Abstract: Institutional efforts in the U.S. to develop a conceptual framework for business enterprises can be traced to the Paton and Littleton monograph in 1940 and later to the two Accounting Research Studies by Moonitz and Sprouse in 1962-1963. A committee of the American Accounting Association issued an influential report in which it advocated a "decision usefulness" approach in 1966, which was carried forward in 1973 by the report of the American Institute of CPAs' Trueblood Committee. All of this laid the groundwork for the conceptual framework project of the Financial Accounting Standards Board (FASB), which published six concepts statements between 1978 and 1985. A seventh concepts statement is likely to be published in 2000. It is still not clear how the FASB's conceptual framework has influenced the setting of accounting standards, and some academic commentators are skeptical of the usefulness of all normative conceptual framework projects.

THE BEGINNINGS[1]

The earliest attempts to develop a "conceptual framework" in the U.S. accounting literature were by William A. Paton and John B. Canning. In his *Accounting Theory* [1922], Paton presented "a restatement of the theory of accounting consistent with the conditions and needs of the business enterprise *par excellence*, the large corporation" [pp. iii-iv], and in the final

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[1]For a review of the early efforts by the American Accounting Association and the American Institute of (Certified Public) Accountants, see Storey [1964] and Zeff [1972, pp. 129-178; 1984].

chapter he discussed a series of basic assumptions, or "postulates," that underpin the structure of modern accounting. In *The Economics of Accountancy* [1929], Canning was the first to develop and present a conceptual framework for asset valuation and measurement founded explicitly on future expectations. Paton's book was an expansion of his doctoral dissertation done at the University of Michigan, and Canning's was his doctoral dissertation accepted by the University of Chicago. Through these works, Paton and Canning influenced many other writers over the years [for Canning, see Zeff, 2000].

Probably the first institutional attempt to lay the foundations of a conceptual framework was the "Tentative Statement of Accounting Principles Affecting Corporate Reports," issued in 1936 by the executive committee of the American Accounting Association (AAA) and published in *The Accounting Review*.[2] The main reason for preparing the "Tentative Statement," a paean to historical cost accounting, was to provide authoritative guidance to the recently established Securities and Exchange Commission (SEC). In fact, the SEC's accounting staff frequently cited the "Tentative Statement" with favor, as well as the revisions thereof issued in 1941 and 1948 and the eight supplementary statements issued between 1950 and 1954. The final revision of the Statement, issued in 1957, proved to be too venturesome beyond established practice for easy acceptance by the SEC.

An outgrowth of the AAA's 1936 "Tentative Statement" was perhaps the most influential monograph in the U.S. accounting literature, *An Introduction to Corporate Accounting Standards*, written by Paton and A. C. Littleton, two of the foremost accounting academics of their day, and published in 1940 by the AAA. Above all, it was an elegant explication and rationalization of the historical cost accounting model that was already widely accepted in the U.S. It met with general acclaim and was used for many years in accounting courses throughout the country. The Paton and Littleton monograph, as it came to be known, probably did as much as any single publication to perpetuate

[2]The most comprehensive review and analysis of the evolution of the efforts to formulate a conceptual framework in the U.S. is Storey and Storey's *The Framework of Financial Accounting Concepts and Standards* [1998], which should be consulted by any serious student of the subject. Reed K. Storey, the senior author of this study, was a long-time member of the FASB's research staff and was a major contributor to the board's conceptual framework project. For a skeptic's view of conceptual framework projects, see Macve [1997].

the use of historical cost accounting in the U.S. Their monograph also popularized the use of "matching" costs and revenues, widely known as the matching convention. Reed K. Storey [1981, p. 90], who devoted most of his professional career to guiding the research for the Accounting Principles Board and the Financial Accounting Standards Board, wrote:

> The [Paton and Littleton] monograph was a startling exception to the general proposition that academic writing has had little effect on accounting practice. . . . Generations of accountants learned to use it as scripture. . . .
>
> During the 40 years since the Paton and Littleton monograph, accounting practice has developed substantially along the lines specified in the monograph, and rationalization and theory consistent with the monograph have been widely used and have been common in authoritative pronouncements.

Two years before the Paton and Littleton monograph appeared, the American Institute of Accountants (AIA) published *A Statement of Accounting Principles*, by Thomas H. Sanders, Henry Rand Hatfield, and Underhill Moore — two accounting academics and a law academic — which was, in large measure, a defense of accepted practice. The monograph had been commissioned in 1935 by the Haskins & Sells Foundation in order that the fledgling SEC, which had declared an interest in prescribing the form and content of financial statements in registration statements, might be provided with some authoritative guidance on best accounting practice. In 1938-1939, the AIA became even more active in providing guidance to the SEC when it authorized its Committee on Accounting Procedure (CAP) to issue Accounting Research Bulletins. In one of its first decisions, the committee rejected the option of developing a comprehensive statement of accounting principles — a kind of "conceptual framework" — because the project would take perhaps five years to complete, during which time the SEC might lose patience with the committee and instead begin to make its own accounting rules [Zeff, 1972, p. 137]. Several times in the 1940s and 1950s during the tenure of the CAP, proposals to develop a set of basic accounting concepts were expressed, and in the 1940s the Institute's research department actually issued an eight-page review of basic accounting principles [AIA, 1945]. However, none of these initiatives was taken up by the committee as part of its program of work [Zeff, 1972, pp. 141-143].

Also during the 1940s and 1950s, both within the Institute's committee and between the committee and the SEC's accounting staff, an accumulated frustration arose from disagreements on a number of controversial accounting issues, including deferred tax accounting, historical cost v. current value, the propriety of general price-level adjustments, and the treatment of unusual items in the profit and loss statement. Representatives on the committee from the major public accounting firms differed philosophically on the pervasive issue of whether to impose a greater degree of uniformity or to permit flexibility in the choice of accounting methods [see Zeff, 1984, pp. 458-459]. This continuing discord reflected unfavorably on the work of the committee. Believing that a stronger research component was needed to support the committee's deliberations, the Institute's incoming president, Alvin R. Jennings [1958, p. 32], proposed establishment of a research foundation that would "carry on continuous examination and re-examination of basic accounting assumptions and to develop authoritative statements for the guidance of both industry and our profession." At the same time, Leonard Spacek [1957, p. 21], the pugnacious managing partner of Arthur Andersen & Co., was publicly criticizing the accounting profession for not establishing the premises and principles of accounting. Pressure began to build for a better approach to establishing "generally accepted accounting principles" (GAAP) than was being done on a case-by-case basis by the CAP. It was hoped that a program of fundamental research could enable the committee to resolve some of its deep disagreements and also to persuade the SEC of the merit of new approaches. Jennings thereupon set up a Special Committee on Research Program to study and make recommendations on the Institute's role in establishing accounting principles, including especially the research component.

ERA OF THE ACCOUNTING PRINCIPLES BOARD

The Institute's Special Committee on Research Program was composed of leading figures from the ranks of auditors, preparers, and academics, and also included the SEC chief accountant. In its path-breaking report published in 1958, the committee proposed the establishment of both an Accounting Principles Board (APB) to replace the CAP and an accounting research division to support the APB. The committee identified four broad levels at which financial accounting should be addressed: postulates, principles, rules or other guides for the

application of principles to specific situations, and research [Report to Council of the Special Committee on Research Program, 1958, p. 63]. The term "postulates" had been little used in the accounting literature. The committee asserted that postulates "are few in number and are the basic assumptions on which principles rest. They necessarily are derived from the economic and political environment and from the modes of thought and customs of all segments of the business community" [p. 63]. It added that "a fairly broad set of co-ordinated accounting principles should be formulated on the basis of the postulates" [p. 63]. The first priority of the research division was to commission studies on the accounting postulates and broad accounting principles. The committee said that "the results of these [studies], as adopted by the [Accounting Principles] Board, should serve as the foundation for the entire body of future pronouncements by the Institute on accounting matters, to which each new release should be related" [p. 67]. Thus was born the first institutional program to establish a conceptual framework — with principles predicated on postulates — although the term "conceptual framework" itself did not come into vogue until the 1970s.

The Institute accepted the committee's recommendations, and in 1959 the APB succeeded the CAP. An accounting professor at the University of California at Berkeley, Maurice Moonitz, was appointed the full-time director of accounting research, and he proceeded to commission the research studies on postulates and broad principles. Moonitz assigned to himself the project on postulates, and he collaborated with his Berkeley colleague, Robert T. Sprouse, on the research study dealing with broad principles.

Moonitz's *The Basic Postulates of Accounting*, Accounting Research Study No. 1, was published in 1961, and it consisted of an exposition and explanation of three tiers of accounting postulates, treating the environment, the field of accounting, and the imperatives (such as going concern, objectivity, consistency, the monetary unit, materiality and conservatism, and disclosure). It was not clear from Moonitz's study whether he favored historical cost accounting or a version of current value accounting; thus, many readers found his study to be too abstract and general to engage their interest and critical thought. The follow-up study by Sprouse and Moonitz, *A Tentative Set of Broad Accounting Principles for Business Enterprises*, Accounting Research Study No. 3, which was published in 1962, evinced no such neutrality. Drawing on Moonitz's postulates,

the authors argued that less reliance should be placed on the realization concept "as an essential feature of accounting" [p. 15] and that the use of current values should be expanded, which, in view of the SEC's long-standing antipathy to departures from historical cost accounting, immediately became controversial if not objectionable. Sprouse and Moonitz advocated the use of current replacement costs for merchandise inventories and for plant and equipment, as well as the use of discounted present values for receivables and payables to be settled in cash. In the early 1960s, the use of present values of expected future cash receipts was virtually unknown in U.S. financial reporting, and current values (except in "lower of cost or market") were hardly to be found. Sprouse and Moonitz also recommended that the holding gain or loss from revaluing inventories should be taken to profit [p. 30]. Nine of the 12 members of the project advisory committees for the postulates and principles studies commented on Sprouse and Moonitz's recommendations in a section appended to their study, and the reactions of eight of the nine ranged from tepid to dismissive. Three of the sternest critics were the SEC chief accountant and two previous SEC chief accountants. The APB itself, which was charged with deciding whether to adopt the two research studies or not, issued a famous statement in which it discarded the two studies as "too radically different from present generally accepted accounting principles for acceptance at this time" [APB, 1962].

Moonitz and Sprouse had thought their assignment was to develop a rational argument for a sound approach to financial reporting. Most members of the APB and other leaders of the accounting profession, by contrast, looked upon basic research as an instrument for rationalizing the *status quo* (in the tradition of the Paton and Littleton monograph), rather than as a normative argument for fundamental change in accounting. Above all, the SEC was at that time a conservative regulator, which regarded departures from the "objectivity" of historical cost accounting as possessing the potential to deceive the readers of financial statements. In the 1960s, the SEC saw its mission chiefly as one of guarding against misleading financial statements rather than of improving the information content of the statements. As a result of the APB's rejection of the postulates and principles studies, the cause of basic accounting research as a foundation stone for pronouncements on specific subjects suffered a severe setback, and the board instead began to deal with specific issues, much as had the CAP before it,

without a body of underlying concepts on which to draw.

One of the project advisory committee members, Paul Grady, a retired partner of Price Waterhouse & Co. who was a protégé of the former *doyen* of the accounting profession, George O. May, argued that a summary of GAAP would be timely. He believed, much as did his academic mentor, A. C. Littleton, that theoretical explanations should be derived inductively from practice. The APB commissioned Grady to undertake such a study, and in 1965 the Institute published his *Inventory of Generally Accepted Accounting Principles for Business Enterprises* (Accounting Research Study No. 5), which, he hoped, would be kept up to date by periodic supplements. The study was in great demand overseas, for it was seen as an authoritative compilation of accepted U.S. practice. Although Grady's study undertook to identify basic concepts, objectives, and principles implicit in current pronouncements, it offered little to portend an improvement in practice. At the least, his study purported to show that accounting rested on basic concepts, objectives, and principles, contrary to the view held by skeptics.

In the mid-1960s, the APB responded to the recommendation of a special committee that the board "enumerate and describe the basic concepts to which accounting principles *should be* oriented" and "state the accounting principles to which practices and procedures *should* conform" [emphasis supplied; Zeff, 1972, p. 196]. This was, at last, a charge that the board should adopt a normative stance toward the development of basic concepts, and not just synthesize accepted practice. It was intended that the final product would be an Opinion of the board, carrying status as a mandatory pronouncement. The board and one of its committees labored for five years, during which its members had great difficulty reaching agreement on the normative propositions. In the end, it was easiest to achieve agreement on a mostly descriptive statement, which was published as Statement No. 4 in 1970 under the title, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises*. As a Statement, instead of an Opinion, the document was not mandatory and its contents could be ignored. The issuance of a mostly descriptive statement greatly disappointed those who had hoped that the board finally would provide a blueprint for principled improvement in financial reporting. A member of the APB, George R. Catlett of Arthur Andersen & Co., dissented to the Statement "because in his view it fails to provide what purports to be 'a basis for guiding the future

development of financial accounting'" [APB, 1970, p. 105]. Nonetheless, even as a descriptive statement, the document was comprehensive, perceptive, and deeply analytical, and its contents have frequently been cited when insights into existing practice were being discussed.

AAA'S *A STATEMENT OF BASIC ACCOUNTING THEORY*

While the CAP and the APB, which were composed mostly of accounting practitioners, were unable or unwilling to develop a normative set of underlying concepts and basic principles, committees of accounting academics had no such reluctance. In 1966, a committee of the American Accounting Association published a pioneering monograph, entitled *A Statement of Basic Accounting Theory* (*ASOBAT*), which redirected attention away from the inherent virtues of asset valuation models and toward the "decision usefulness" of financial statements.[3] It defined accounting as "the process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information" [AAA, 1966, p. 1]. While that definition would hardly be exceptional today, in the 1960s, when theorists were actively debating the superiority of alternative asset valuation models [see, for example, Nelson, 1973; Henderson and Peirson, 1983, chs. 8 and 9; Lee, 1996], an explicit orientation toward the users of information was a breath of fresh air. The committee [AAA, 1966, pp. 23-24] also placed emphasis on futurity:

> The committee suggests that accounting information for external users should reflect their needs by reporting measurements and formulations thought to be relevant in the making of forecasts without implying that the information supplied is wholly adequate for such prediction.
>
> Almost all external users of financial information reported by a profit-oriented firm are involved in efforts to predict the earnings of the firm for some future period. Such predictions are most crucial in the case of present and prospective equity investors and their representatives — considered by many to be the most important of the user groups. . . . The past earnings of the

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[3]For a discussion of the "decision usefulness" approach, see the AAA's *Statement on Accounting Theory and Theory Acceptance* [AAA, 1977, pp. 10-21]; much fuller coverage appears in Staubus [forthcoming].

> firm are considered to be the most important single item of information relevant to the prediction of future earnings. It follows from this that past earnings should be measured and disclosed in such a manner as to give a user as much aid as practicable in efforts to make this prediction with a minimum of uncertainty [pp. 23-24].[4]

The committee identified and elaborated upon "four basic standards for accounting information . . . that provide criteria to be used in evaluating potential accounting information": relevance, verifiability, freedom from bias, and quantifiability [p. 8]. It then judged a number of accounting problem areas against those standards [pp. 27-36]. In one of its more important judgments, on historical cost v. current value, the committee [pp. 30-31] concluded, after weighing verifiability against relevance, that financial reporting should display information drawn from both models (which was a radical recommendation at the time):

> The presentation of historical [transaction-based] information alone excludes the full impact of the environment on the firm; presentation of current cost information alone obscures the record of consummated market transactions. The committee recommends that both kinds of information be presented in a multi-valued report, in which the two kinds of information appear in adjacent columns.

In a little-noticed section of the report, the committee [p. 29] suggested that "accountants usually have required too narrow a view of compliance with the standard of quantifiability" and that, in the light of the uncertainty surrounding accounting measurements, "there is no compelling reason why the accountant should not report in terms of interval estimates or probability distributions."

Robert R. Sterling [1967a, pp. 99-100], an important accounting theorist of the day, assessed *ASOBAT* as follows:

> The committee has invited us to view accounting as a measurement-information system. This new view precludes some questions but poses others. In their refer-

[4]In 1969, another AAA committee issued a major report on the extent to which current financial reporting practices satisfy the needs of investors and creditors in the light of *ASOBAT*'s suggested standards for accounting information [AAA, 1969].

> ence frame, it is no longer appropriate to argue about which convention or assumption comes closest to the 'actual' cost or income; it is not appropriate to assume that if we carefully describe (fully disclose) the methods used, then the figures will be meaningful, or that only invested costs or transaction data are the subject matter of accounting or that by its very name accounting reflects costs. Under the new view, measurements in accounting are a function of some end.
>
> This is a change in 'world-view' and is the stuff that revolutions are made of [footnote omitted].

A BIG EIGHT FIRM ANNOUNCES ITS OWN STATEMENT OF OBJECTIVES

In 1972, the Big Eight firm of Arthur Andersen & Co. (AA) issued a 130-page booklet entitled *Objectives of Financial Statements for Business Enterprises*. The development of this unique publication grew out of the firm's frustration with the failure of the APB to agree on a normative statement of concepts and principles in its Statement No. 4 in 1970 [Wyatt, 1999, p. 161]. The firm focused on "objectives" because the Institute's Trueblood Committee was then engaged in a major study of the objectives of financial statements (see the next section). AA's booklet was critical of existing accounting practice, especially its emphasis on conservatism and historical cost as a goal instead of as a method toward a goal [pp. 34-38]. It emphasized instead that "financial statements must be fair to all users and should provide the basis for resolving [their] conflicting interests..." [p. 8], a view that the firm's former managing partner and chairman, Leonard Spacek, had been advocating in speeches since the 1950s [see *A Search for Fairness...*, 1969]. The firm [p. 116] concluded that the overall purpose of financial statements:

> . . . is to communicate information concerning the nature and value of the economic resources of a business enterprise, the interests of creditors and the equity of owners in the economic resources, and the changes in the nature and value of those resources from period to period.

One implication of this objective was that assets should be measured at current value, and the firm recommended that unrealized holding gains and losses be disclosed in the income statement [chs. 7 and 8].

AA's proposal was a bold one, and it was the only accounting firm to issue such an elaborate statement of its views.

THE TRUEBLOOD REPORT: *OBJECTIVES OF FINANCIAL STATEMENTS*

The decision usefulness approach that found acceptance in *ASOBAT* was carried forward into a major report issued in 1973 by a special committee of the American Institute of Certified Public Accountants (AICPA)[5] on the objectives of financial statements. The committee was formed in 1971, after three of the Big Eight firms (including AA) had made known their concerns over the ineffectiveness of the APB, including its inability to resist pressures from special interests, especially preparers [see Zeff, 1984, pp. 463-464]. The AICPA formed two special committees in this crisis setting. The first, known as the Study Group on the Establishment of Accounting Principles, or the Wheat Committee, met to recommend improvements in the process of establishing those principles. In its report [*Establishing Financial Accounting Standards*, 1972], the committee proposed a full-time, independent body known as the Financial Accounting Standards Board (FASB) under the wing of a new Financial Accounting Foundation. The AICPA promptly approved the Wheat Committee's report and created the FASB to succeed the APB in July 1973. The second special committee, the Study Group on the Objectives of Financial Statements, or the Trueblood Committee, was composed of leading practitioners, academics, and users of accounting information, and was charged with proposing the fundamental objectives of financial statements to guide the improvement of financial reporting. It was to produce a normative statement, not an inference drawn from practice. Importantly, the research director of the Trueblood Committee, George H. Sorter, an accounting professor at the University of Chicago, had been one of the most influential members of the AAA committee that had developed *ASOBAT*.[6] Sorter also played a major role in the drafting of the Trueblood Committee's report.[7]

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[5]In 1957, the American Institute of Accountants changed its name to the American Institute of Certified Public Accountants.

[6]Telephone interview with Charles T. Zlatkovich, chairman of the *ASOBAT* Committee, April 3, 1999.

[7]Telephone interview with Oscar S. Gellein, a member of the Trueblood Committee, March 19, 1999. See Sorter [1973] for a discussion of the main points in the Trueblood report and of the approach used by the committee.

The Trueblood Committee's report, *Objectives of Financial Statements*, which was issued in October 1973, embraced *ASOBAT*'s decision usefulness approach and focused even more specifically on future cash flows [p. 20]:

> An objective of financial statements is to provide information useful to investors and creditors for predicting, comparing, and evaluating potential cash flows to them in terms of amount, timing, and related uncertainty.

The committee said that financial statements should "serve primarily those users who have limited authority, ability, or resources to obtain information and who rely on financial statements as their principal source of information about an enterprise's economic activities" [p. 17]. While the committee devoted primary attention to investors and creditors, it also regarded managers and employees as coming within the set of financial statement users, and it concluded, "While users may differ, their economic decisions are similar. Each user measures sacrifices and benefits in terms of the actual or prospective disbursement or receipt of cash" [p. 18].

Following in the steps of *ASOBAT*, the committee thought it desirable to enumerate several "qualitative characteristics of reporting": relevance and materiality, form and substance, reliability, freedom from bias, comparability, consistency, and understandability [ch. 10]. The committee concluded, much as had the AAA committee that had prepared *ASOBAT*, that "the objectives of financial statements cannot be best served by the exclusive use of a single valuation basis" [p. 41]. The Trueblood Committee considered an even broader array of valuation bases than did the AAA committee: historical cost, exit values, current replacement cost, and discounted cash flows, and it counseled that "the specific combination of valuation bases to be used is an implementation issue" [p. 42]. The committee helpfully suggested how each of the valuation bases could be fitted to the information requirements they most likely would fulfill.

In two sections of the Trueblood report that are often overlooked, the committee commented on the fallibility of single numbers in financial statements as well as on the use of financial statements to help achieve social goals. As to the former, the committee followed *ASOBAT* by observing that "measurements in terms of single numbers that do not indicate possible ranges and dispersions pose problems in describing events subject to uncertainty" [p. 39]. This is a point that has

seldom been raised explicitly in policy-making circles. The committee concluded by suggesting [p. 40]:

> To satisfy the individual preferences of users for predicting and controlling the impact of current events on enterprise earning power, some apparently simple quantifications should be supplemented to represent their actual complexities by disclosing ranges of precision, reliability, and uncertainty.

In a broader societal context, the Trueblood Committee stated that the social goals of enterprise are no less important than the economic goals. Citing pollution as an example, the committee drew attention to "those enterprise activities which require sacrifices from those who do not benefit" [p. 54]. It concluded that [p. 55]:

> An objective of financial statements is to report on those activities of the enterprise affecting society which can be determined and described or measured and which are important to the role of the enterprise in its social environment.

The Trueblood report was remarkable for the freshness of its approach. It did much to refocus discussions in the accounting policy arena from stewardship reporting to providing information useful for decision makers. The report became a kind of blueprint for the conceptual framework project that the newly established FASB was just beginning.[8]

ERA OF THE FASB: EARLY DEVELOPMENTS

The Wheat Committee, in its report which recommended the establishment of the FASB, did not envision that the board would undertake to develop a conceptual framework. In its report, the committee [1972, pp. 19, 78] wrote as follows:

> The need for a fundamental conceptual foundation has been much debated in accounting circles for many years. We believe this debate may have produced more heat than light. Financial accounting and reporting are

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[8]The transcript of proceedings from the Trueblood Committee's public hearing held in May 1972 was published in a two-volume typescript. In addition, significant research, reference, and resource materials that were considered by the Trueblood Committee during the development of its report were reproduced in *Objectives of Financial Statements: Selected Papers* [1974]. For a discussion of the Trueblood report, see "Studies on Financial Accounting Objectives: 1974" [1974].

> not grounded in natural laws as are the physical sciences, but must rest on a set of conventions or standards designed to achieve what are perceived to be the desired objectives of financial accounting and reporting. We understand the primary work of the [Trueblood Committee] to be the development of such objectives and some guidelines for their achievement.
>
> The work of the ongoing standard-setting body should be to develop standards for preparing financial accounting information that will be consistent with these objectives.

and

> We do not believe that the [FASB's] staff should be expected to conduct a broad, fundamental research program dealing with basic concepts on an ongoing basis, since we believe that this type of research is best left to those in the academic field.

Nonetheless, in November 1973, five months into its first year of operation as successor to the APB, the FASB ["Board Meets with Trueblood Study Group," 1973] reported that it would be tackling "the entire hierarchy of financial accounting theory," beginning with the Trueblood report:

> Once objectives are agreed upon, the Board intends to address itself to the entire hierarchy of financial accounting theory, including qualitative characteristics, the types of information needed by users of financial statements, and basic accounting concepts.

A month later, in December 1973, the board announced that its project on "Broad Qualitative Standards for Financial Reporting," which had been set the previous April, was being enlarged under a new and more impressive title, "Conceptual Framework for Accounting and Reporting: Objectives, Qualitative Characteristics and Information" ["Task Force Appointed," 1973, p. 1]. There was thus no doubt that the board intended to develop a full-fledged conceptual framework, and the board's term, "conceptual framework," came to be widely used for such an undertaking.[9]

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[9]Gore [1992] has provided a critical analysis of the development of the board's conceptual framework project. See Agrawal [1987] for an analysis of the logical structure of the conceptual framework. For insights into the dynamic within the board and the politics affecting its decisions on the conceptual framework, see Miller et al. [1998, ch. 4].

Robert T. Sprouse, an original member of the board who served as its vice chairman from 1975 to 1985, has said that two factors drove the board to embark on a conceptual framework. First, the board felt obliged to carry on the work of the Trueblood Committee [Sprouse, 1988, p. 124]. Second, the board required a framework of concepts to help it address the six technical projects on its initial agenda: research and development, contingencies, leases, foreign currency translation, business segments, and materiality. Sprouse [1984/85, p. 25][10] has written:

> Almost immediately the board recognized the need to develop certain fundamental concepts that it could look to for rational and consistent guidance in analyzing and resolving issues. The absence of an established concept of something as basic as an asset was a handicap in addressing accounting for research and development costs; the absence of an established concept of something equally as basic as a liability made resolving the issues in accounting for contingencies more difficult. Those first experiences strengthened the new board's recognition of the importance of establishing a conceptual framework for analyzing issues and relating its decisions to that framework.

The following year, in June 1974, the board issued its first discussion memorandum in the "Conceptual Framework for Accounting and Reporting" project, dealing with the objectives and qualitative characteristics recommended by the Trueblood Committee [FASB, 1974]. Discussion memoranda are objective analyses of issues facing the board, without any indication of the board's views or preferences. The board held a public hearing on the discussion memorandum in September 1974.

In December 1976, the board issued two important documents relating to the conceptual framework project. One was *Tentative Conclusions on Objectives of Financial Statements of Business Enterprises* [FASB, 1976], based on an analysis of the written comments received and oral testimony at the public hearing held on the June 1974 discussion memorandum. The other document was a 360-page discussion memorandum subtitled *Elements of Financial Statements and Their Measurement*. The discussion memorandum on elements also included an extensive treatment of both the qualitative characteristics of

[10]See also Kirk [1989, pp. 89-90].

financial information and the measurement of the elements. Both the board's tentative conclusions on objectives and the contents of its lengthy discussion memorandum on the rest of the conceptual framework were the subject of a public hearing set for June 1977.

The board's tentative conclusions on objectives were noteworthy for the inclusion of an appendix on modern capital market theory, which represented the first acknowledgment by a U.S. standard setter of this important stream of research in the finance literature. The December 1976 discussion memorandum devoted an important section to the choice to be made between the "asset and liability view" and the more traditional "revenue and expense view" (associated with the Paton and Littleton monograph) for defining earnings [paras. 32-70 and ch. 5]. Under the "asset and liability view," which the board eventually came to favor, the definition of earnings depends on the definitions of assets and liabilities, so that a balance sheet test must be invoked to validate the existence of earnings, revenues, and expenses.[11] The discussion memorandum also contained a chapter on the important distinction between "financial capital maintenance" and "physical capital maintenance" [ch. 6], which had not received much explicit attention in the U.S. accounting literature. It also presented an extensive discussion of the "attributes of assets": historical cost, current cost, exit value, and present value [ch. 8].

Between 1974 and 1985, the FASB issued 30 publications (eight discussion memoranda, seven research reports, eight exposure drafts, one invitation to comment, and six concepts statements) in its massive conceptual framework project, totaling over 3,000 pages.[12] In addition, the board received more

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[11]Storey and Storey [1998] have written that the board's adoption of the primacy of the asset and liability view "still is undoubtedly the most controversial, and the most misunderstood and misrepresented, concept in the entire conceptual framework" [p. 76], chiefly because the asset and liability view was seen by many as a device to "impose some kind of current value accounting on an unwilling world" [p. 83]. They discussed the controversy at some length [pp. 47-66, 76-85].

Robert T. Sprouse believed that the asset and liability view would rid balance sheets of "what-you-may-call-its," which were the unintelligible residues produced by the matching convention [Sprouse, 1966]. Also see Sprouse [1977, pp. 12-13; 1988, pp. 126-127].

[12]For a complete list of the publications, see Gore [1992, Appendix 2]. One discussion memorandum, two research reports, two exposure drafts, and two concepts statements (4 and 6) constituted the adaptation of the conceptual framework to nonbusiness entities, which is not discussed in this paper. Two

than 1,000 letters of comment in response to its discussion memoranda and exposure drafts, and it held eight public hearings covering 20 days of oral testimony, which was transcribed and placed on the public record. The written record and the amount of board member and staff time dedicated to the project were immense. It was estimated that, in the early 1980s, the conceptual framework project accounted for as much as 40 percent of the board's technical staff time [Van Riper, 1994, p. 81].

ERA OF THE FASB: THE CONCEPTS STATEMENTS[13]

The FASB issued six Statements of Financial Accounting Concepts, known as concepts statements, of which two (Nos. 4 and 6) represented adaptations to nonbusiness entities. The FASB [Concepts Statement 2, pp. i-ii] stated the purpose of the concepts statements as follows:

> Statements in the series are intended to set forth objectives and fundamentals that will be the basis for development of financial accounting and reporting standards. . . .
>
> The conceptual framework is a coherent system of interrelated objectives and fundamentals that is expected to lead to consistent standards and that prescribes the nature, function, and limits of financial accounting and reporting. It is expected to serve the public interest by providing structure and direction to financial accounting and reporting to facilitate the provision of evenhanded financial and related information that is useful in assisting capital and other markets to function efficiently in allocating scarce resources in the economy. . . .

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discussion memoranda and the invitation to comment, which dealt with matters of the display of accounting information, treated subjects that were included in the exposure draft entitled *Reporting Income, Cash Flows, and Financial Position of Business Enterprises* [FASB, 1981] but which did not eventually mature into a concepts statement. Included in the above enumeration of FASB documents is the discussion memorandum on *Criteria for Determining Materiality,* issued on March 21, 1975, which was not formally part of the conceptual framework project. Nonetheless, the conceptual aspects of the materiality project were incorporated into the qualitative characteristics project in 1978.

[13]For more extensive discussion of the board's concepts statements, see Davies et al. [1997, pp. 46-63], Pacter [1983], Solomons [1986], Wolk et al. [1992, ch. 6], and Miller et al. [1998, pp. 105-115].

> Statements of Financial Accounting Concepts do not establish standards prescribing accounting procedures or disclosure practices for particular items or events, which are issued by the Board as Statements of Financial Accounting Standards. Rather, Statements in this series describe concepts and relations that will underlie future financial accounting standards and practices and in due course serve as a basis for evaluating existing standards and practices.

Objectives: The comments received on the discussion memorandum on objectives proved to be an education for board members. In 1975, the board conducted a survey of opinion on the Trueblood recommendations. Marshall S. Armstrong [1977, p. 77], the board chairman, reported one finding that disturbed him:

> In our first discussion memorandum on the conceptual framework of accounting, the most important project on our agenda, we sought an expression of opinion from respondents on the following as a basic objective of financial statements; it is taken directly from the Trueblood report:
>
> 'The basic objective of financial statements is to provide information useful for making economic decisions.'
>
> Could there be disagreement with a statement such as this? I am sure you will be astounded to learn that only 37 percent of our respondents were able to recommend the adoption of this objective. Twenty-two percent recommended that it be rejected out of hand; and 10 percent insisted that it needed further study. It is difficult to believe that only 37 percent can agree that the basic objective of financial statements is to provide information useful for making economic decisions. I think this suggests the problem quite clearly.
>
> Those who disagreed took the position that the basic function of financial statements was to report on management's stewardship of corporate assets and that the informational needs of readers was of secondary importance. It follows from this line of thinking that management can best determine the principles to be employed in reporting on their firms, and that standards — standards almost of any sort — can only impede management in its effort to fulfill this responsibility.

Two accounting academics observed that the respondents to the FASB survey probably thought of furthering their own personal interests rather than promoting the interests of readers generally. Reflecting on Armstrong's expression of concern, Dopuch and Sunder [1980, p. 13][14] wrote:

> Why should we believe all groups of interested parties would adopt the provision of information useful for making economic decisions as their motivation for being involved in the financial reporting process? For example, we should not be surprised if auditors, like everyone else, seek to maximize their own wealth through participation in the accounting process. If the provision of economically useful information implies greater exposure to the risk of being sued without corresponding benefits of higher compensation, they will not see the provision of economically useful information (however defined) as *their* objective of the financial accounting process.

One might have added that most auditors had probably been educated to believe that accounting serves primarily a stewardship function, and that they would find it somewhat threatening to contemplate that accounting should have a more activist function in economic society. Such preconceptions and predispositions made it difficult for the board to impose a decision usefulness objective on a profession that had been accustomed to view accounting as basically a passive record-keeping activity.

Concepts Statement 1, *Objectives of Financial Reporting by Business Enterprises*, issued in November 1978, closely followed Trueblood's emphasis on futurity, as indicated by the following key passage [para. 37]:

> Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans.

In Statement 1, the board preferred the broader term, financial reporting, over the narrower term, financial statements,

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[14]For further discussion of the "politics" of developing a conceptual framework, see Rappaport [1977], Horngren [1981], Miller [1990], and Van Riper [1994, pp. 20-22, 75-82].

used in the Trueblood report. Donald J. Kirk [1988, p. 13], the FASB chairman when all of the concepts statements were approved, later explained how this decision "blunted" some of the opposition to the evolving conceptual framework, which seemed to many to raise the specter of current value accounting:

> It was thought by this broadening that, as under the securities laws, the needs of users could be satisfied through disclosures, possibly even separate from the financial statements, and, therefore, not require the type of income measurement changes that opponents feared [that is, current value accounting].

David Solomons, an accounting professor at the University of Pennsylvania and the principal draftsman of the Wheat report, wrote a critique of the board's Concepts Statements 1-4 in which he gave the statement on objectives a grade of C, because, he said, "the purposes that the board has defined for financial reporting are excessively narrow" [Solomons, 1986, p. 118]. He wrote [p. 118]:

> . . . while the Trueblood report recognized, however briefly, that business enterprises had a responsibility to society and not just to their stockholders, the board's statement on objectives substantially confines its attention to the needs of investors and creditors, barely recognizes the needs of managers, and ignores altogether the interests of other groups with an interest in enterprise productivity, such as labor and the tax authorities.

To this writer, Solomons' overall evaluation of the statement seems to be more critical than necessary.

Qualitative Characteristics: Concepts Statement 2, *Qualitative Characteristics of Accounting Information*, was issued in May 1980.[15] Donald Kirk [1988, p.13] has written that "defining the characteristics of useful financial information was the least controversial of the conceptual framework projects, in part because readers did not see implications that portended current value accounting."

Statement 2 followed in the tradition of *ASOBAT* and the Trueblood report and, in the decision usefulness mode,

[15]For an analysis of Statement 2, see Storey and Storey [1998, pp. 98-119].

enumerated and explained a hierarchy of qualities of accounting information. David Solomons, who drafted the statement at the invitation of the board, rectified the overemphasis on investors and creditors in Statement 1 [see para. 26 of Statement 2], which he was later to criticize. "Relevance" and "reliability" were the two pillars, and at several places the inevitable tradeoffs between the two were discussed. "Reliability" was supported by "representational faithfulness" (a term coined by Solomons) and "verifiability." Representational faithfulness, which was defined as "correspondence or agreement between a measure or description and the phenomenon it purports to represent" [para. 63], was a more elegant and comprehensive concept than "freedom from bias" in *ASOBAT* and the Trueblood report. In the discussion of verifiability, the term "objectivity" was nowhere to be found, probably to allow for the admissibility of departures from historical cost accounting. "Objectivity" was similarly absent in *ASOBAT* and the Trueblood report. "Verifiability," it was stated, "implies consensus. Verifiability can be measured by looking at the dispersion of a number of independent measurements of some particular phenomenon" [para. 84].

In contrast to *ASOBAT* and the Trueblood report, the board envisioned a role for "conservatism," albeit constrained: "There is a place for a convention such as conservatism — meaning prudence — in financial accounting and reporting, because business and economic activities are surrounded by uncertainty, but it needs to be applied with care" [para. 92]. But the board made clear that "conservatism in financial reporting should no longer connote deliberate, consistent understatement of net assets and profits" [para. 93].[16] The board carefully limited the use of conservatism as follows [para. 95]:

> Conservatism is a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered. Thus, if two estimates of amounts to be received or paid in the future are about equally likely, conservatism dictates using the less optimistic estimate; however, if two amounts are not equally likely, conservatism does not necessarily dictate using the more pessimistic amount rather than the more likely one.

[16]Sterling [1967b] has reported finding considerable support for the hypothesis that conservatism is the fundamental principle of valuation in traditional accounting.

The board's discussion of "neutrality" very much followed from Solomons [1978] and alerted readers to the proper posture of the standard setter in a politicized world [see Kirk, 1988, pp. 13-14]. The essential position set forth in the statement was [para. 106]:

> While rejecting the view that financial accounting standards should be slanted for political reasons or to favor one economic interest or another, the Board recognizes that a standard-setting authority must be alert to the economic impact of the standards that it promulgates.

Finally, "comparability" was introduced as a *desideratum* [paras. 111-122], and it was stated that accounting decisions must satisfy a materiality screen or threshold [paras. 123-132]. Invoking a variant on a passage that has been used since the 1960s to characterize "comparability," the board asserted that greater comparability "is not to be attained by making unlike things look alike any more than by making like things look different" [para. 119].

Statement 2 is perhaps the most admired and most emulated of the board's concepts statements. The analysis is logically and sensibly ordered, it is well explained (reflecting Solomons' penchant for metaphors), and the terms are carefully defined. Miller et al. [1998, p. 110] have written that Statement 2 "provides a set of definitions that the Board and its constituents can and do use to communicate with each other. The definitions bring more rigor to the due process, and possibly to the thought processes of the participants." Former chairman Kirk [1988, p. 13] has written that Statement 2 "has contributed greatly to the understanding of the need for and purpose of standards." Davies et al. [1997, p. 63], three partners in the U.K. firm of Ernst & Young who have studied the FASB's conceptual framework in depth, praised Statement 2 as "outstanding work."

An empirical study of the views of 26 former members of the APB and of the FASB, however, yielded an opposite finding. The subjects were tested for their views on whether the 11 qualitative characteristics were operational, comprehensive, and parsimonious (i.e., free of significant redundancies in meaning). The researchers [Joyce et al., 1982, p. 670] concluded as follows:

> Many of the results reported here are not favorable to the *Statement*. Nine of the 11 qualitative characteris-

> tics clearly fail the tests of operationality. Not only is there considerable disagreement among experienced policy makers on what the qualitative characteristics mean in the context of particular accounting policy issues, there is also considerable disagreement on their relative importance. While the qualitative characteristics appear to comprise a comprehensive set for choosing among accounting alternatives, the set is not a parsimonious one. Thus the *Statement* fails to meet two out of its three desired criteria.
>
> This casts doubt on the ability of the qualitative characteristics defined in the *Statement* to facilitate accounting policy making.

Elements: Concepts Statement 3, *Elements of Financial Statements for Business Enterprises*, was issued in December 1980, seven months after Statement 2. It sets forth the definitions of assets, liabilities, equity, investments by and distributions to owners, and comprehensive income and its components (revenues, expenses, gains, and losses) that are collectively the "elements" of financial statements. As motivation, former board chairman Kirk [1988, p. 15] wrote that the need for workable definitions of assets and liabilities on such projects as research and development costs and accounting for contingencies, both of which were on the board's initial agenda, "served as a catalyst" for the elements project.

This is the statement in which the board made known its preference for the "asset and liability view" over the "revenue and expense view" for defining earnings. While the board did not actually discuss the two views in the statement, one notices that revenues, expenses, and gains and losses were defined in terms of assets and liabilities. Hence, revenues were defined as "inflows or other enhancements of *assets* of an entity or settlements of its *liabilities* (or a combination of both) during a period from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations" [emphasis supplied, footnote omitted; para. 63]. By contrast, the definition of revenues propounded 25 years earlier in the Institute's Accounting Terminology Bulletin No. 2 reflected the traditional "revenue and expense view," without a reference to assets or liabilities. It was: "*Revenue* results from the sale of goods and the rendering of services and is measured by the charge made to customers, clients, or tenants for goods and services furnished to them" [*Proceeds,*

Revenue, Income, Profit, and Earnings, 1955, p. 34].

It was in this statement (presaged in the exposure draft of December 28, 1979) that the board unveiled its new terminology, "comprehensive income," to describe "the change in equity (net assets) of an entity during a period from transactions and other events and circumstances from nonowner sources" [para. 56]. In the context of the choice between financial capital maintenance and physical capital maintenance, on which the board deferred a decision until a later statement, comprehensive income was viewed as "a return *on* financial capital" [para. 58].[17] Comprehensive income would thus include unrealized holding gains and losses, if they were adjudged to be recognizable accruals.

Two facets of Statement 3 caused trepidation, especially among practitioners and financial executives — that the board's adoption of the "asset and liability view," together with its comprehensive income proposal, would inevitably lead to some form of current value accounting [see, e.g., Way, 1977, pp. 40-41; Schuetze, 1983, p. 260; Beresford, 1983, p. 67; Pacter, 1983, p. 84; Gore, 1992, pp. 94-95; Van Riper, 1994, p. 75].[18] Expressions emanating from the board and elsewhere that this implication was unfounded may not have allayed many fears. And a forthright statement by Reed K. Storey [1981, pp. 94-96], a senior member of the FASB's research staff, may have added to the anxiety:

> I think the handwriting is already on the wall for the present model (which is often mislabeled 'historical cost accounting') because, among other things, it can't cope with everyday complications, such as changing prices and fluctuating foreign exchange rates. . . .
>
> Those who feel threatened by the conceptual framework or hope that it will maintain the status quo will be disappointed. Change is coming, even if the concep-

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[17]For an extensive treatment of financial v. physical capital maintenance, see Sterling and Lemke [1982].

[18]In fact, as early as 1977, one of the Big Eight accounting firms, Ernst & Ernst, was alarmed that the "asset and liability view" would lead inevitably to current value accounting, which it opposed. Its concern that the board had not clearly explained the implications of its thinking led the firm "to mount a campaign to educate financial executives about the conceptual framework and the potential dangers it presented" [Beresford, 1983, p. 66]. By July of that year, the firm had presented more than 50 conceptual framework seminars around the country to over 5,000 people [Ernst & Ernst, 1977, p. 1].

tual framework is never adopted, because of weaknesses in the existing accounting model.

Solomons, in his critique of the concepts statements, gave Statement 3 a B-. Although he regarded the board's definitions as "a distinct improvement on the earlier definitions in APB Statement no. 4" [1986, p. 120], he nonetheless believed that the definitions were not sufficiently robust to deal with the most difficult accounting problems. He illustrated this point by attempting to apply the definition of liabilities to pensions, and he found it wanting. Yet Solomons, who was an advocate of the "asset and liability view," noted with satisfaction that "the definitions have been formulated in such a way as to leave no room for reasonable doubt about the primacy of assets and liabilities and the dependency of the other elements on these two" [pp. 120-121].

It is of interest that Dennis R. Beresford, who would become FASB chairman in 1987, wrote in 1981, while he was still a partner in Ernst & Whinney (and chairman of the Institute's Accounting Standards Executive Committee), that he found Statements 1, 2, and 3 (and 4) to be "broad, abstract statements or proposals which in my opinion have provided little, if any, help in deciding the accounting issues of the day" [Beresford, 1981, p. 66]. He described himself as a pragmatist, and he was, from the start, a skeptic of the conceptual framework project [see Beresford, 1983].

Recognition and Measurement: In December 1984, a full four years after the issuance of the statement on elements,[19] the board issued Concepts Statement 5 on *Recognition and Measurement in Financial Statements of Business Enterprises*.[20] This was the long-awaited statement that would announce the board's position on the most controversial issues in the conceptual framework project, including its view on which measurement attribute(s) were to be central to the framework. On this statement, the board equivocated badly, which led Solomons [1986, p. 124] to give it a grade of F and "require the board to take the course over again — that is, to scrap the statement and start afresh." It was also the first concepts statement in which a board member dissented.

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[19]Miller [1990] and Gore [1992, pp. 105-109] have explained the delay: the board was divided both on how to proceed and on what to conclude.

[20]For an analysis of Statement 5, see Storey and Storey [1988, pp. 145-160].

Early in the statement, the board gave notice that it would not be advancing the literature in a way so as to alter practice [para. 2]:

> The recognition criteria and guidance in this Statement are generally consistent with current practice and do not imply radical change. Nor do they foreclose the possibility of future changes in practice. The Board intends future change to occur in the gradual, evolutionary way that has characterized past change.

The major disappointment to many readers was the board's disinclination in Statement 5 to make a decision on the preferred measurement attribute. The board enumerated the attributes that are "used in present practice": historical cost, current cost, current market value, net realizable value, and present value of future cash flows [para. 67], but could only conclude the following [para 70]:

> Rather than attempt to select a single attribute and force changes in practice so that all classes of assets and liabilities use that attribute, this concepts Statement suggests that use of different attributes will continue, and discusses how the Board may select the appropriate attribute in particular cases [footnote omitted].

The Trueblood report at least undertook to suggest how different measurement attributes might be more or less helpful in fulfilling certain information requirements [*Objectives of Financial Statements*, 1973, ch. 6]. But the board, after ten years of unrelenting work on the conceptual framework project, could not achieve as much on measurement attributes as the part-time Trueblood Committee had done in 30 months.

On recognition, the board was clearly reluctant to innovate. It did not, for example, undertake to discuss whether to accord recognition to the "firm" commitments under wholly executory contracts, that is, those on which no party has yet performed any of its promises [para. 107]. Yuji Ijiri [1980] argued the case eloquently in a research report written at the invitation of the board, and the subject was again treated in another research report by L. Todd Johnson and Reed K. Storey [1982, ch. 11].

In the section on recognition, Statement 5 did contain a carefully worded proposition that "information based on current prices should be recognized if it is sufficiently relevant and reliable to justify the costs involved and more relevant than alternative information" [para. 90], which Storey and Storey

[1998, p. 159] criticized as "extremely weak guidance." Miller et al. [1998, p. 115] complained that the criteria of "relevant" and "reliable" in this proposition "are too broad to provide helpful guidance either to standards setters or to individual accountants who are attempting to resolve a new issue." David Mosso [1998, p. 7], a member of the board from 1978 to 1987 who continued as a member of the board's senior staff until 1996, has said that this proposition "may sound like a weak endorsement but at the time it was extremely contentious and a major concession to the Board members who favored more market value accounting." He added that "it is the concept that underlies the progress that has been made in marking financial instruments to market." As Kirk has pointed out, the board's assent even to this proposition, hedged as it was, was contingent on how the unrealized holding gains and losses were to be reported. Preparers felt strongly that any unrealized holding gains and losses should not affect earnings. In the end, the board settled on a compromise presentation by which both conventional net income (retitled "earnings" in Statement 5) and comprehensive income, which would essentially consist of earnings plus or minus unrealized holding gains and losses, should be reported. As the choice of measurement attribute could not be disengaged from the income-reporting implications of unrealized holding gains and losses, this compromise was necessary for Statement 5 to survive [Kirk, 1989, pp. 100-103].

As will be seen, one advance that did have future ramifications was the board's focus on comprehensive income. In Statement 5, the board proposed the preparation of both a statement of earnings and a statement of comprehensive income, and it said that the "full set of articulated financial statements discussed in this Statement is based on the concept of financial capital maintenance" [para. 45]. In this somewhat indirect way, it signified that financial capital maintenance had won its favor.[21] The dissenter to Statement 5, John W. March, who was a former partner of Arthur Andersen, objected to comprehensive income "as a concept of income because it includes all recognized changes (including price changes) in assets and liabilities . . . " [p. 32]. March was a partisan of the physical capital maintenance concept [pp. 32-33].

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[21]Robert T. Sprouse [1988, p. 126], the board's vice chairman, later wrote that Concepts Statement 5 "comes down solidly on the side of financial capital maintenance."

Although the board was not prepared in the 1980s to issue a standard requiring that comprehensive income should be reported in the basic financial statements, it returned to the issue vigorously in the mid-1990s. It was then that the board built on the definition of comprehensive income in Statement 3 and on paragraphs 13 and 39-44 of Statement 5 to issue an exposure draft proposing a requirement that net income and comprehensive income be accorded equal prominence in either one or two statements of financial performance [FASB, 1996]. But strong resistance from preparers forced the board to accept a compromise, permitting a third option — to display comprehensive income in the statement of changes in equity [FASB, 1997]. Thus, the board enabled preparers to exclude such items as unrealized gains and losses from a statement of financial performance.[22]

At several places in Statement 5, including two quoted above, the board left change to a process of evolution [also see para. 35]. Solomons [1986, p. 122], in his critique, skewered this approach:

> These appeals to evolution should be seen as what they are — a cop-out. If all that is needed to improve our accounting model is reliance on evolution and the natural selection that results from the development of standards, why was an expensive and protracted conceptual framework project necessary in the first place? It goes without saying that concepts and practices should evolve as conditions change. But if the conceptual framework can do no more than point that out, who needs it? And, for that matter, if progress is simply a matter of waiting for evolution, who needs the FASB?

Solomons [p. 193] complained that the board's non-committal listing of measurement attributes in Statement 5 showed that it had not progressed beyond its December 2, 1976 discussion memorandum, which had done the same.

Oscar S. Gellein [1986, p. 14], who had served on the board from 1975 to 1978, also was critical of the board's failure to provide conceptual guidance, without which, he said, "there is the risk of reversion to ad hoc rules in determining accounting methods." Wolk et al. [1992, p. 177] wrote that Statement 5

[22]For further discussion of comprehensive income, see Johnson and Reither [1995].

"must be considered a distinct letdown, if not an outright failure."

Storey and Storey [1998, p. 159], who have been staunch supporters of the conceptual framework approach, criticized the board for abdicating its responsibility in Statement 5:

> Whereas a neutral exposition of alternatives was appropriate for a Discussion Memorandum, a litany of present measurement practices with neither conceptual analysis or evaluation nor guidance for making choices was not proper for a Concepts Statement.
>
> In merely describing current practice, Concepts Statement 5 is a throwback to statements of accounting principles produced by the 'distillation of experience' school of thought [e.g., Paul Grady's approach in the APB's Accounting Research Study No. 5] — an essentially practical, not a conceptual, effort. Its prescriptions for improving practice are reminiscent of those of the Committee on Accounting Procedure or the Accounting Principles Board; measurement problems will be resolved on a case-by-case basis. Unfortunately, that approach worked only marginally well for those now-defunct bodies.

One close observer of the board has written that the board's decision not to disturb the *status quo* on recognition and measurement "was led by representatives of the preparer constituency, particularly members of the Financial Executives Institute, and was supported by three Board members [including March]" [Miller, 1990, p. 28].

Role of Statement 33: No reference has previously been made to the board's Statement of Financial Accounting Standards 33, *Financial Reporting and Changing Prices*, issued in September 1979, which required more than 1,300 large corporations to disclose in an unaudited supplementary note certain general price-level information and current cost accounting information.[23] Yet it is impossible to discuss the board's recognition

[23]The current cost accounting portion of Statement 33 reflected the influence of the report of the Sandilands Committee [1975, ch. 12] in the U.K., which gave prominence to the "value to the business" (or "deprival value") approach to current value accounting. For a review of this and other intellectual influences on the board's thinking, including the interaction between Statement 33 and the board's conceptual framework project, see Tweedie and Whittington [1984, ch. 7 and entries in their subject index under *FAS33*].

and measurement project without taking into account the impact on the board of preparers' and users' reactions to Statement 33. As former board chairman Kirk [1988, p. 16], who previously was an audit partner in Price Waterhouse, has written:

> While not formally a part of the conceptual framework project on recognition and measurement, Statement 33 was the laboratory for the conceptual project. It was the testing ground for the application of the current cost system to the most difficult of valuation problems — fixed assets — and the testing ground for the validity and utility of the concept of physical, rather than financial, capital.
>
> . . . the experience with Statement 33 by the time we were debating Concepts Statement No. 5 told me that use of the current cost information was very limited, and that there were serious questions about its reliability. I could find little reason to endorse on a conceptual level a current value or current cost measurement system for future standards when it appeared that the utility of such a system in Statement 33 was going to be seriously challenged.

In August 1984, just as the board was completing work on Statement 5, it was disclosed in the board's *Status Report* that:

> . . . research studies and responses to the Invitation to Comment [entitled *Supplementary Disclosures about the Effects of Changing Prices* (FASB, 1983)] indicate that Statement 33 information has not been widely used. Both the number of users and extent of use have been limited. A large number of responses to the Invitation to Comment indicate that the costs of preparing the disclosures have outweighed the benefits to date ["Financial Reporting and Changing Prices," 1984].

In November 1984, the board issued Statement of Financial Accounting Standards No. 82, in which it eliminated the requirement for supplementary disclosure of the inflation accounting information, and two years later, in December 1986, it issued Statement of Financial Accounting Standards No. 89, in which it eliminated altogether the requirement for the supplementary disclosure on changing prices.

Present Value: In the late 1980s, the board, aware of the increasing importance of present value as a decision-making tool and sensitive to the widely differing approaches adopted over the

years by the FASB and other U.S. standard setters for implementing present value-based measurements, began to develop a common framework for using present value and estimates of future cash flows in accounting measurement.[24] It issued a discussion memorandum in 1990 [*Present Value-Based Measurements in Accounting*], held a public hearing in 1991, published a special report [Upton, 1996], and issued an exposure draft for a proposed standards statement [1997]. In the end, the board concluded that the subject should form part of the conceptual framework project, and it proceeded to issue an exposure draft of a proposed concepts statement [1999]. The proposed statement will not deal with the larger question of recognition but will instead provide "a framework for using future cash flows as the basis for an accounting measurement" [FASB exposure draft, 1999, para. 10]. Publication of the concepts statement is planned for early in the year 2000.

An Assessment: The many disappointments expressed about the concepts statement on recognition and measurement meant that the board's conceptual framework project ended on a "down" note. The hope, perhaps naïve, that the framework might point a clear path toward improvement in financial reporting was not fulfilled.

Richard Macve, a British accounting academic who has been a close student of the FASB's conceptual framework, has been skeptical of such claims. Macve [1997, p. xxii] wrote:

> Given the inherent conceptual limitations of 'income' and 'value' measurement, it remains unrealistic to expect official attempts to develop 'conceptual frameworks' for financial accounting and reporting to be able to provide a coherent basis for the resolution of accounting problems. . . . Moreover, standard setters' major problems are more often political. A framework, however technically correct, cannot solve the political problems of different interests and needs at the level of individual standards [footnote omitted].

Commentators have generally rendered a negative assessment of the board's conceptual framework. Solomons [1986, p. 122], who was a fervent supporter of the board's project, regret-

[24]Miller and Bahnson [1996, pp. 94, 96, 98] have cited defects in the application of present value in seven previous pronouncements.

fully concluded that "my judgment of the project as a whole must be that it has failed." In particular, he regarded Statement 5 as a "dismal failure" [p. 118]. Miller et al. [1998, p. 105], however, saw a silver lining in the dark clouds:

> Although it is probably an overstatement to call the project a complete failure, it is certainly a disappointment. On the other hand, it makes a significant contribution to the accounting literature by establishing that service to user needs is the primary objective of financial accounting. It has also contributed to the efficiency of the due process procedures by defining a number of key terms that are indeed used by the Board and its constituents. These accomplishments may bring more rigor and efficiency to the Board's deliberations, but that conclusion can be safely reached only in the long run.

In regard to user needs, one could argue that the literature had already been enriched by the Trueblood report.

Kenneth Most [1993, pp. 107, 109] saw the project as "seriously flawed," and he registered his "great surprise . . . that the FASB's conceptual framework has been imitated in other countries." Davies et al. [1997, p. 63] opined that the weakness of the board's conceptual framework project was probably most attributable to the "Board's failure to deal with the fundamental issues of recognition and measurement." Archer [1993, p. 113] has written that "the FASB's attempt involved massive effort; but, in terms of conveying an increased degree of either intellectual or institutional authority upon the standard-setting process, the mountains evidently brought forth a mouse."

A favorable review was given by Kevin Stevenson [1987, p. 49], director of the Australian Accounting Research Foundation, who said, "I must say I regard the work of the FASB on their conceptual framework as extremely valuable." His disappointment with Statement 5 was that "it did not provide a full analysis of the issues" [p. 51].

In late 1984, Arthur Andersen, once it had seen the board's exposure draft [1983] on recognition and measurement, issued a second edition of its *Objectives of Financial Statements for Business Enterprises*, in which it restated the importance it attributed to value. The firm pointedly differentiated the reference to "economic resources" in its overall objective (see above) from the board's, arguing that there is a "vast difference . . . since we specifically call for the 'nature and value' of economic resources, while the FASB merely asks for information about

them" [1984, p. 8n]. The firm reiterated its support for financial capital maintenance, and it expanded its recommended coverage of current value accounting to include liabilities. As a contribution to the dialogue, the firm's revised booklet constituted an implied criticism of the board's noncommittal position on measurement.

Reaction to the board's conceptual framework necessarily depended on one's expectations. At one extreme, Sterling [1982, p. 106] argued as follows:

> In my view the next essential step [after Concepts Statements 1-3] is to display replicable logical connections between the concepts and the conclusions about specific practices. Provision of such connections is likely to require honing the concepts to make them logically fertile. . . . if the concepts aren't honed to the point where the logical connections are at least plausible, preferably replicable, the framework is likely to be at best useless and at worst used to rationalize preconceived positions that are likely to be contradictory.

At the other extreme, Peasnell [1982, p. 255] suggested that the conceptual framework:

> . . . could be intended to do no more than provide very broad general objectives for financial reporting to which no one could take serious objection; the aim would be to 'raise the moral tone' of the profession.

Perhaps closure on specific accounting standards was too much to expect from a conceptual framework.

In 1977, an AAA committee composed of nine academics pessimistically concluded, after three years of study, that "theory closure cannot be dictated" and that "all theory approaches are flawed when viewed from the perspective of some alternative approach" [AAA, 1977, pp. 49, 50]. Each conceptual framework, it added, "implicitly incorporates individual beliefs and premises that cannot be proved or disproved in a logical sense" [p. 48]; hence, the committee concluded that it cannot be demonstrated that one framework is superior to all others.[25]

Dopuch and Sunder [1980] were similarly pessimistic of any attempt to impose a normative conceptual framework on

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[25]Lawrence Revsine was chairman of the committee. For his views on the implication of the report for the development of a conceptual framework, see Revsine [1977, pp. 35-39].

society, for the groups and individuals who are concerned with financial reporting possess their own private motives and objectives. In the end, they argued, standards will inevitably be compromises to appease these conflicting interests.

Storey and Storey [1998, p. 161], on the final page of their comprehensive study, preferred to accentuate the achievements of the board's conceptual framework:

> The FASB has used the completed parts of the framework with considerable success. The Board's constituents also have learned to use the framework, partly at least because they have discovered that they are more likely to influence the Board if they do. Both the Board and the constituents have also found that at times the concepts appear to work better than at other times, and undoubtedly they sometimes could have been more soundly applied. . . . some parts of the conceptual framework are still controversial, partly at least because long-held views die hard. The framework remains unfinished, although the Board gives no sign of completing it in the near future.
>
> Despite the fact that the Board has left it incomplete, the FASB's conceptual framework
>
> - Is the first reasonably successful effort by a standards-setting body to formulate and use an integrated set of financial accounting concepts
> - Has fundamentally changed the way financial accounting standards are set in the United States
> - Has provided a model for the International Accounting Standards Committee and several national standards-setting bodies in other English-speaking countries, which not only have set out their own concepts but also clearly have been influenced by the FASB's Concepts Statements, sometimes to the point of adopting the same or virtually the same set of concepts.

This writer would interpose three reactions to the views expressed by Storey and Storey. (1) Without question, the board has shown that it can bring an immense project of this kind to completion, but whether the effort has been "reasonably successful" is still an open question. (2) One doubts that the board's approach to setting standards has been "fundamentally changed" by the conceptual framework — changed, yes, but not fundamentally. (3) It is true that the board's conceptual frame-

work has been imitated in other countries and by the International Accounting Standards Committee (IASC). But the IASC's framework is no more helpful on measurement than is the FASB's Statement 5. The U.K. Accounting Standards Board (ASB), in the 1999 redraft of its Statement of Principles, also declined to choose between historical cost and current value as the measurement basis [para. 6.4]. And the ASB, unlike the FASB, is not constrained by a conservative securities commission or by an entrenched tradition of historical cost accounting. The Australian Accounting Research Foundation, which began the research for its conceptual framework in the 1970s, has yet to issue even an exposure draft for a concepts statement on recognition and measurement. So, the exportation of the board's conceptual framework has not led to marked success overseas.

When judging the overall product of the FASB's conceptual framework, one can justifiably fault the board for not having chosen, as a matter of principle, the relevant measurement attribute or attributes that should govern the preparation of financial statements. That was, after all, the *raison d'être* for the entire exercise — everything pointed toward that end. What reasons serve to explain the board's indecisiveness? Resistance to change — from preparers, practitioners, and the SEC, as well as within the board — coupled with an indifference, at best, by users constituted a high barrier for the board to surmount. The SEC's well-known antipathy toward departures from historical cost accounting in the financial statements might have been seen by some members of the board as an obstacle to a principled choice. Memories were still fresh of the condemnation by the APB (and by the SEC's chief accountant) of Sprouse and Moonitz's advocacy of current value accounting in their accounting research study published in 1962, resulting in the APB's decision to consign both the postulates and principles studies to oblivion. Some FASB members may not have wanted to risk having the board's conceptual framework similarly marginalized as "too radically different." Furthermore, departures from historical cost accounting represented a potential threat not only to the preparer community but also to accounting practitioners [see Revsine, 1991]. To preparers, the use of current value raised the specter of including potentially volatile unrealized holding gains and losses in the income statement. As regards practitioners, few would have possessed any knowledge of measurement attributes other than modified historical cost accounting because of the monopoly that the latter had so long

enjoyed in the U.S. Practitioners may have feared that their expertise would become obsolete by the imposition of an unfamiliar system of accounting. Macve [1997, p. xxii] has characterized these sources of resistance as "the political problems of different interests and needs." Even within the board, the members differed intellectually and emotionally on the choice of measurement attribute — reflecting what Horngren [1981, p. 90] has called their "individual conceptual frameworks." This built-in resistance to change on so many sides must have been a brooding omnipresence in the board's deliberations.

What has been the practical effect of the board's conceptual framework? Unless one is on the inside and listens to the board deliberations — or, as a researcher, interviews the principals and examines the board's minutes and files — it is difficult to know whether the evolving conceptual framework actually changed minds or was cited in subsequent standards statements to buttress a preconceived view. To be sure, Arthur R. Wyatt [1987, p. 46], who joined the board just after the issuance of Statement 5, has said that "the current FASB members and staff refer to the framework constantly," especially the qualitative characteristics and the definitions of elements. Further, he said that "constituents particularly refer to the conceptual framework when they do not agree with a tentative conclusion that we have reached on a practical issue and argue that it is inappropriate because it does not follow logically from the conceptual framework." But it would be useful to have the findings from an empirical research study.

Former board member Mosso [1998, p. 7] has said that "Concepts Statement 5 laid the groundwork" for the board's decision in 1987 (Statement 95) to replace the funds statement with the statement of cash flows "by further developing Concept Statement 1's emphasis on cash flows as a tool of investment decision making."

To demonstrate impact, Miller [1990, p. 27] has claimed that three subsequent standards statements incorporate the board's preference for the "asset and liability view": Statement 76, on in-substance defeasance [1983]; Statement 87, on pensions [1985]; and Statement 96, on deferred tax [1987]. He noted as well that three of the board's early standards statements, issued between 1974 and 1976, also embraced the "asset and liability view" [Miller, 1990, p. 27]. Evidently, the board did not require a concepts statement in order to adopt this premise in its standards.

As part of his major study of the conceptual framework

project, Gore sought to discern the impact of the completed conceptual framework on three standards statements: Statement 87, on pensions [1985]; Statement 95, on cash flow statements [1987]; and Statement 96, on deferred tax [1987]. Gore [1992, p. 124] concluded that the board's conceptual framework "can claim little effect on the various outcomes."

Yet Daley and Tranter [1990, p. 15] have contended that it is pointless to attempt to judge specific accounting standards in terms of a conceptual framework that includes neutrality as a desired characteristic of reliability. They argued that "the significant role that economic and political pressures play in the development of accounting standards" must be factored in to the conceptual framework and therefore into any such analysis of the conformity of standards to a framework.

To what extent have members who joined the board after the conceptual framework was completed in 1985 "signed on" to the conceptual framework? At the end of 1986, only 12 months after Statement 6 was issued, Chairman Kirk [1986, p. 8] wrote, "I have already noticed that board members who were not involved in the lengthy debates preceding [the six] Concepts Statements, especially No. 5 on recognition and measurement, have less attachment or proprietary interest in them." By 1993, all of the members who voted on Statement 5 had left the board. In a standard-setting body with rotating membership, how long will an approved conceptual framework retain its authoritativeness within the body? To its credit, the board has taken steps to keep the conceptual framework on the table. At some of the board's professional development sessions that are held for the benefit of members and the research staff, issues relating to the conceptual framework are periodically scheduled for discussion. Also, a number of recent agenda projects, especially the current one on present value, has led the board to revisit the earlier concepts statements. Finally, the annual performance review of board members can point up a lack of knowledge of the concepts statements. But the question remains, to what extent do the current board members subscribe to the conceptual framework?

These are interesting questions on which, it is hoped, empirical research will be conducted. Until then, we live with opinions.

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