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Conceptual Framework For Financial Accounting and Reporting: Report on a Symposium

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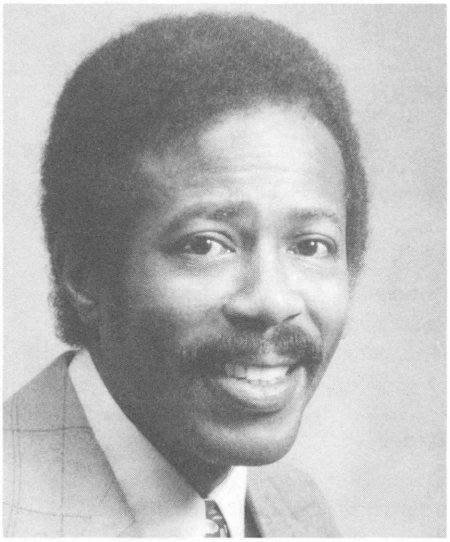

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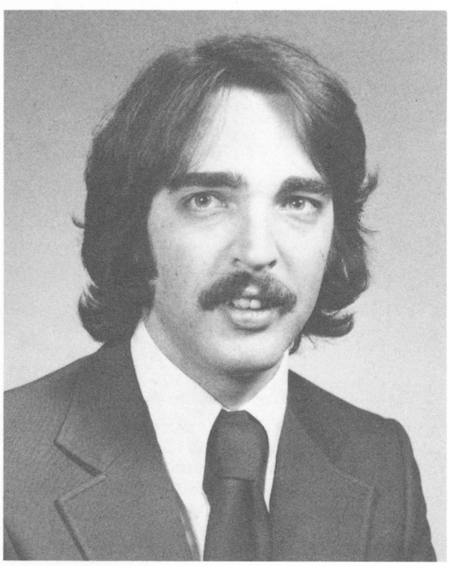

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The authors summarize the proceedings of a Symposium they organized last spring. This report was solicited by the Editor of THE WOMAN CPA, who attended the Symposium, in order to give wider circulation to the points of view expressed by the main speakers and discussants and thereby to encourage discussion of this subject in the accounting profession.

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Dr. Cramer, whose research emphasizes financial accounting theory, is the author and co-author of several books and numerous articles in professional journals. He is an active member of many professional organizations, including the AICPA where he serves on the Committee on Minority Recruitment and Equal Opportunity and the AAA where he is on the Committee to Coordinate AAA Responses to Pronouncements of Other Accounting Organizations. He has served as a consultant to the Financial Accounting Standards Board and was recently appointed by Secretary of the Treasury Simon to the Advisory Committee on Federal Consolidated Financial Statements.

Dr. Cramer was the organizer of the Symposium.

Dr. Charles A. Neyhart, Jr. is Assistant Professor of Accounting at Oregon State University. He is a member of the American Accounting Association and has been published in a number of accounting journals.

Dr. Neyhart assisted with the planning of the Symposium and was a participant in the proceedings.

"The Conceptual Framework for Financial Accounting and Reporting: Present and Future" was the theme for a Symposium sponsored by the Arthur Andersen Faculty Fellow, The Pennsylvania State University. The subject matter of the occasion related to the most pressing problem facing the accounting profession at the present time. The event was held April 29-30, 1976, in Pittsburgh, Pennsylvania. The guest list of sixty persons included representatives from academia, public accounting, the business community, professional organizations, and rule-making bodies.

Sheldon I. Ausman, Managing Partner of the Pittsburgh Office of Arthur Andersen & Co., represented the Firm with opening remarks. Three major papers were presented. William J. Schrader of the Pennsylvania State University discussed the historical approach to the conceptual framework; Arthur R. Wyatt, Arthur Andersen & Co. (Chicago) presented his views regarding the substantive content of a conceptual framework for financial accounting and reporting; and William G. Shenkir, Financial Accounting Standards Board, discussed current efforts to develop a conceptual framework. Each of the three papers was critiqued by two discussants, followed by open participation by those in attendance. Luncheon speakers were Quiester Craig, North Carolina A & T University, and Kenneth P. Johnson, Coopers & Lybrand (New York). George H. Sorter, New York University, moderated the concluding panel discussion — a synthesis of the issues and prognosis. Panelists were Johnnie L. Clark, Atlanta University, and Jacob G. Birnberg, University of Pittsburgh.

Many important issues were identified and discussed in depth. However, the group by no means reached a consensus. Essentially, the two-day Symposium confirmed that much remains to be done before agreement can be reached about the future direction of the conceptual framework.

In this article we will first summarize each of the three major papers and related discussion. We will then set forth our interpretation of the Symposium, drawing attention to the need for a definition of financial accounting and a determination of the nature and extent of the data base content of a conceptual framework for financial accounting and reporting. We believe that the need for agreement on these issues is critical to the development of a conceptual framework. We conclude our discussion by outlining the *components approach* to the disclosure of entity activities. We perceive this to be a logical and feasible approach for resolving major conflicts in financial accounting and reporting that are attributable to the existence of competing definitions of financial accounting.

A Summarization of the Major Papers and Related Discussion

Historical Approach

In his presentation, William J. Schrader sought to explain what he perceives to be critical choices confronting accountants today. He pointed out that they are not the popular choices of accounting methods nor the equally popular choices of valuation bases. These are, in his view, tertiary issues in accounting. He sees as the primary choice *what our subject matter(s) will be.*

Schrader noted significantly that every discipline is differentiated from others by its subject matter rather than its method. This observation, central to Schrader's analysis, makes it possible not only to arrive at concise definitions of various disciplines, but more importantly enables one to distinguish among different "accounting" disciplines based exclusively on their respective subject matters, or data bases. Thus, within this perspective:

> Accounting$_1$ denotes a discipline represented by current GAAP. Its data set consists of "exchanges" of consideration between the entity under observation and the rest of the universe.
>
> Accounting$_2$ denotes another discipline currently gaining substantial support. Its data set is comprised of elements of entity "wealth."
>
> Accounting$_3$ denotes another discipline of some concern to accountants. Its data set consists of "expected cash flows" of the entity.

These same fields, respectively, are *implied* in the popular references to: (1) Historical cost, (2) Current value, and (3) Discounted value.

Schrader asserted that these three fields are just as distinctive as the fields of biology or jurisprudence. It is, in his view, improper to debate these as measurements. Although complimentary disciplines, they deal with entirely different phenomena, for all of which the measurement problem remains. It is a necessary condition to Schrader's analysis to distinguish operational processes (including measurement) from what is being processed.

Schrader then directed his attention to Accounting$_1$ — delineating its fundamental elements within the context of an input-output framework and providing an interpretive evaluation of the inferences that comprise the end product of this discipline. This field, commonly considered "conventional" accounting, is defined broadly as the observation and interpretation of the historical transactions of an entity.

Schematically, Accounting$_1$ is a system with these elements:

Inputs		**Accounting System**		**Outputs**
Measured Elements of Transactions	→	Operations: The "Program" Classifying Selecting Matching	→	Income Statements (Generally "Periodic")

Inputs are screened as experiences of the entity under observation and as exchanges of economic and financial forms of consideration with the rest of the universe. Accordingly, the discipline is historical in character. "Historical" cost is the only measurement that is tenable in this discipline, because *what is being* measured is an event, an historical phenomenon. There are, to be sure, problems arising from instability in measuring units over time but the same problem is present in Accounting$_2$ and Accounting$_3$ as well. Distinguishing the reciprocal elements in the exchange and labeling them generates a data base within the system.

The "program" is directed toward the interpretation of the data base and it generates the output income statements with their inferences (i.e., judgments of the experiences or performance of the entity) called income or profit. Whatever remains in the system at any evaluation point is presented as a "balance sheet." It is not a set of objects or things, but that subset of events experienced by the entity about which judgment has been suspended or deferred.

In Accounting$_1$ the income statement is the paramount financial report; it is the only statement which can even be described in systems terms as "output." It is clearly a subset of events involving reciprocal flows of goods and services, familiarly known as "costs" and "revenues" in this discipline, rather than a statement of values or value changes. It may reasonably be represented as a "Statement of Operations," but the complementary statement listing the residues in the system is not a "Statement of Financial Condition," and much of the present criticism of accounting arises from the misrepresentation or misconception that it is.

Schrader concluded his presentation by stating that when one perceives and processes historical events, one expects to gain understanding of successes and failures; tendencies and potentialities; capacities to initiate and to adapt; indications of growth, maturity, or decline. In short, history enables one to see an entity as what it has become. Memory (history) is the indispensible prerequisite to understanding the present and anticipating the future. And those potentials are what make it worthwhile to engage in the art of Accounting$_1$.

In their respective discussions, both Mimi Burke, Financial Accounting Standards Board, and Lewis F. Davidson, University of North Carolina (Chapel Hill), were in substantial agreement with what they perceived to be Schrader's principal thesis. Davidson reiterated a number of Schrader's views, but was explicit in delineating the need to carefully define or bound the data base. The manner in which one partitions the economic system (i.e., to define the entity) is crucial in determining the nature of the output of the accounting system and the inferences one might properly draw regarding the performance of the entity.

Burke, in an extensive analysis of historical cost financial reporting (including a comparison of the historical cost, price-level adjusted, and current value bases), drew attention to the question of whether historical cost has lost its usefulness as a basis for financial reporting. Drawing on the professional literature to support her analysis, she examined carefully the popular assertions that historical cost is inadequate for the present needs of an inflationary economy or that a changed emphasis in objectives of financial reporting has rendered that basis obsolete.

In her opinion historical cost is a time-honored and time-proven basis of reporting that has provided useful information in the past, and is likely to do so currently. She noted in her analysis that historical cost has been responsibe to change as the economy has become more complex, citing numerous departures from a strict cost accounting as evidence. She admitted that major changes have been slow in coming but this may be attributable to a lack of convincing evidence of a critical need for change.

Burke noted further that, although historical cost financial statements do not satisfy all needs of users of financial statements, new proposals have not offered any solid evidence that they would be more useful. She contends that statements which purport to reflect "economic realism" may be theoretically perfect, but if this solution is unduly difficult to implement and too complex to understand, the implementation problems may well outweigh the benefits. We should be careful to be swayed not by rhetoric but by results obtained through comprehensive experimentation and study of the complex issues involved.

Burke stated that holding the line on

historical cost is not a refusal to recognize or go along with change, but a cautious insistence that substitutes demonstrate their utility and reliability beyond that which is being replaced. In the meantime, as a valid alternative basis evolves, interim measures could be adopted. Instead of abruptly replacing the historical cost basis of financial reporting, disclosure could provide the same information with less risk. Material disparities between historical cost and current value, as well as price level adjusted information, could be disclosed. Meanwhile the challenge is to develop a valid approach to portraying economic reality — one that is neither too simplistic that it does not fulfill the purpose for which it was designed, nor so complex that it confuses when it should enlighten.

Future Approach

In a presentation entitled "The Future is Now," Arthur R. Wyatt set forth his views concerning the substantive orientation of a conceptual framework. In his opinion what is urgently required is to secure agreement on a *single* conceptual framework within which existing and emerging problems can be resolved on an internally consistent basis. Wyatt argued that a framework containing excessive compromises will result in accounting standards that are internally inconsistent and of diminished understandability and credibility. In his view, the single framework is a necessary condition to the success of the FASB.

Wyatt outlined several alternatives that could possibly constitute the principal emphasis or focus of a conceptual framework. These are: (1) the *stewardship concept,* emphasizing the stewardship responsibility of management to protect real invested capital; (2) an *income determination* approach, with principal emphasis on identifying, measuring, and timing of revenues and expenses; (3) a *cash flow* framework, emphasizing past, current, or future net cash returns to investors; (4) an *asset-liability valuation* approach, with emphasis on identifying and measuring assets and liabilities and changes in them; and (5) a *user-oriented* approach emphasizing the satisfaction of information needs of financial statement users.

In Wyatt's view a conceptual framework that places principal emphasis on asset and liability measurement holds the greatest promise to the profession as a vehicle for progress and for eliminating the maze of inconsistencies that exist in present practice. Wyatt noted several advantages that would accrue to this approach. First, it would bear a high degree of relevance to economic reality, given that such reality relates to the effects on assets and liabilities of transactions and events. Second, the approach would provide a basis for de-emphasizing income, particularly as reflected in earnings per share and income growth. The focus would change to command over economic resources rather than on income measurement. Third, the approach would permit holding gains and losses to be reported in the period in which changes in economic values occur. This would tend to avoid abuses commonly associated with the timing of revenues and expenses under present realization and matching concepts.

Wyatt then went on to discuss some notions central to his proposed approach. In his view, the overall purpose of financial statements is to communicate information to users concerning the nature and value of the economic resources of a business enterprise, the interests of creditors and the equity owners in the economic resources, and the changes in the nature and value of those resources from period to period. Economic resources would be viewed as those elements of wealth that possess the three basic characteristics of utility, scarcity, and exchangeability which in combination give the resources economic value.

While some would view this objective as being based on a desire to move to wider use of current values, Wyatt contended that this characterization simply skips a step in the evolution of this conceptual framework. Only after agreement is reached on fundamental issues does one face the question of measurement. Measurement in terms of current values simply appears to be the preferable approach to achieving the objective of communicating the best information available.

With respect to the role of cost, Wyatt contends that the proposed approach does not demand abandonment of the transactions-oriented cost basis. Cost will, in many instances, provide a reliable means of conveying value information. However, Wyatt was of the belief that this approach will effect an attitude change in accountants so that they will acknowledge value information as the goal and will regard cost simply as a means of conveying such information. Cost would lose its status of an objective and the relevance of cost would be challenged when significant value changes in economic resources emerge.

Wyatt observed that a conceptual framework that focuses principal attention on the economic resources and the equity interests in them and that adopts a current value measurement basis also determines the companion earnings concept. Periodic earnings will be determined by the change in the owners' equity shown by comparative balance sheets, after a provision for the maintenance of owners' capital to reflect the effects of inflation and after allowing for additional investments by owners and distributions to owners. The purpose of the income statement would be to provide a summary analysis of the significant events and factors that gave rise to an increase or decrease in the net economic resources of the entity for the period. Only those changes resulting from additional investments by, or distributions to, the owners would be reflected outside the income statement.

The format of the income statement would be somewhat different, including a number of elements not commonly found in income statements currently. Wyatt suggested the following format:

1. Operating income — with emphasis placed on disclosing the magnitude of fixed and variable expenses rather than more traditional breakdowns. Such disclosure would be important in assessing risks with respect to the future.

2. Special or unusual items (operating or nonoperating).

3. Significant holding gains and losses.

4. A one-line provision to maintain invested capital in real terms.

In his view no single measurement approach will likely prove to be of maximum utility for all assets and liabilities. Rather, this appears to be dependent on the functional nature of the economic resources.

Wyatt concluded his presentation by declaring that we cannot continue to postpone the task of identifying the conceptual framework of financial accounting. Once we have settled upon this single conceptual framework we can begin to attach the implementation problems that would arise in a system relying much more heavily on current values than on historical costs. Additional contemplation of our dilemma may no longer be possible. What we urgently need today are some bold steps that will put the accounting process back into the reality of economic activity.

Sybil C. Mobley, Florida A & M University, raised a number of substantive issues in her discussion of the Wyatt paper. Principally, she failed to understand Wyatt's concern with "emphasis" or "focus," feeling that he completely disregarded the interdependence and articulation of the balance sheet and income statement. In her view, the dual impact of economic activity is a fact and it is not a matter of placing emphasis on one side or the other — it is a matter of recording both effects accurately and completely.

She noted having great difficulty in identifying a conceptual framework, finding nothing in Wyatt's proposals to indicate the development of interrelated, internally consistent concepts. Rather than advancing a conceptual framework she contended that Wyatt assumed a conceptual framework and concentrated on alternative principal emphases or themes — which, by identifying some things as principal, are accorded priority. This is to say that accountants will make sure that a certain item is right which automatically implies that other items will be "less" right. Mobley argued that a sound, conceptual framework must be based on ideas or theories that are logical necessities — as such, they will be internally consistent or the logic will not hold. Compromises may be required during implementation, but soundness is certainly a reasonable expectation at the conceptual level. The internal inconsistency of current accounting is that it is internally incomplete. Adjusting entries that update the accounts never get finished. Adjusting entries are conceptually sound but the concept is not consistently applied. Mobley observed that the framework is already present to record holding gains and losses, the effects of inflation, and command over resources — we do not need to resort to single-entry accounting as Wyatt suggests. There is no evidence that single-entry is more conceptually sound than double-entry accounting.

Mobley concluded with the view that the principal change in financial accounting and reporting should be that accountants should provide all relevant information to which they have access; they should no longer be restricted to historical costs. They should be responsive to the economic realities of the day and extend beyond the notions of objective, verifiable evidence.

In reviewing the alternative conceptual frameworks as outlined in the Wyatt paper, Keith W. Lantz, The Pennsylvania State University, agreed with Wyatt that the principal emphasis should be on fundamental issues and not on measurement. Working from an information systems viewpoint, Lantz suggested that the alternative frameworks are really competing information models. The issue, as he sees it, is which information model provides the most relevant information for making decisions related to an individual entity.

Lantz identified three fundamental issues in accounting, stemming from the problem of choosing between two or more alternative sets of information, which he employed as the basis for critically evaluating Wyatt's proposed information model. The first fundamental issue is the purpose of the model. Lantz perceived Wyatt's objective to be to provide more useful information to investors. He considered this objective viable but noted that it is only one of many competing objectives.

The second fundamental issue is whether the proposed information model meets the stated objective. Since Wyatt failed to indicate directly how his information model would be useful to investors, Lantz noted that we must speculate on the relevance of his ideas. As one possible approach Lantz suggested questioning Wyatt's model in the context of modern capital market theory. He argued that if the answer to this question is not available, the only means of obtaining a viable answer is through empirical research, not through theoretical conjecture.

The third fundamental issue is whether the proposed conceptual framework provides a consistent and logical foundation for the development of an information model. Lantz observed that Wyatt's proposed framework suggests measurement of a wealth position, yet Wyatt failed to set forth a justification for the valuation of an entity's wealth position. The proposed conceptual framework does not define the ideal information set for investors, thus is not adequate justification for valuing the entity's wealth position in terms of current values.

In his conclusion, Lantz remarked that he felt Wyatt made some valid points concerning the need for a conceptual framework and in pointing out major weaknesses of alternative frameworks. However, he was of the opinion that Wyatt failed to provide adequate justification for his framework, alleging that the criticisms he made concerning alternative frameworks apply equally well to his own proposal. Lantz warned that there will be no agreement on a conceptual framework until we use the needs of decision makers as a basis of evaluating the relevance of alternative information models.

Current Approach

In his presentation dealing with current efforts to develop a conceptual framework, William G. Shenkir reviewed the FASB's work to date on its ongoing project "A Conceptual Framework for Financial Accounting and Reporting: Objectives, Qualitative Characteristics, and Information." He emphasized that in approaching this project in a series of coordinated steps, the FASB hopes to succeed where previous authoritative bodies have not.

The first phase of this project culminated with the mid-1974 publication of a discussion memorandum that focused exclusively on objectives of financial statements and qualitative characteristics of financial reporting. This memorandum relied principally on the Report of the Study Group on the Objectives of Financial Statements for substantive input and, in so doing, recognized the primacy of objectives in developing a conceptual framework.

The memorandum raised a number of both general and specific questions with respect to the objectives and qualitative characteristics contained in the Report. Additionally, a tentative hierarchical arrangement, demonstrating the way in which the many elements or components of financial accounting and reporting might fit together to form a cohesive and operable whole, was discussed and analyzed. Referring to this arrangement, Shenkir pointed out that the initial phase of the conceptual framework project dealt exclusively with the basic, formative aspects of the framework. Specifically, the framework commences with objectives, which provide a basis for the remainder of the elements.The hierarchy provides for more than one *basic objective,* if necessary, and allows for the existence of supportive *subsidiary objectives.* At the next level are the *qualitative characteristics* which are defined as those attributes of accounting information that tend to enhance its usefulness. At a commensurate level in the hierarchy is the section captioned *information needed,* which involves identifying the nature and extent of financial information needed by users of financial statements.

In analyzing public response to the memorandum on the Report of the Study Group, Shenkir noted that reactions were, not unexpectedly, mixed. This diversity of opinion was manifested in 25 percent of the respondents recommending immediate adoption; whereas 21 percent recommended that the objectives be summarily rejected. Shenkir went on to outline several concerns raised by respondents with respect to Objectives 1 through 6. The level of support for these objectives, which focus on the delineation of financial information to be communicated to users, was substantially greater than that for the remaining objectives. Among the issues raised and discussed briefly were questions of: the user approach versus accounting under the stewardship concept, specifying primary statement users versus responding to multiple users with diverse needs, accrual accounting versus an approach that emphasizes current and prospective cash flows, reporting on past transactions and events versus prediction of future occurences, and questions of interpretation and implementation.

The next phase of the FASB project, underway since the initial public hearing in late 1974, is expected to result in the publication of a second discussion memorandum in the very near future. It is anticipated that this memorandum will begin with the Board's tentative conclusions with respect to the objectives of financial statements based on the Report of the Study Group, the first discussion memorandum, letters of comment, and the public hearing on that memorandum. The memorandum will also emphasize the *fundamental element* of financial statements and accordingly will contain definitions of assets, liabilities, capital, earnings, revenues, and expense. The measurement of these fundamental issues is also contemplated in the memorandum. Five attributes, which relate economic resources and obligations to the unit of measurement, will probably be examined as prospective valuation bases.

Shenkir concluded his presentation with a brief discussion of what he perceived as issues basic to the development of a conceptual framework. The first issue involves the perspective or emphasis around which a framework could be developed. He suggested and outlined two possibilities: an *internal* perspective focusing on the accounting process, and an *external* perspective in which the emphasis is on financial statement users and their information needs. The second basic issue centers on the relative importance of the balance sheet approach (with the emphasis on identifying and measuring assets and liabilities) and the income statement approach (with the emphasis on identifying, measuring, and timing of revenues and expenses). Shenkir observed that these approaches hold several implications for a conceptual framework, namely: a different wording and emphasis in defining fundamentals of accounting, differences in the manner in which specific accounting issues would be resolved, and differences in attitude toward income smoothing. Shenkir maintained that a decision on this matter is critical in establishing a conceptual framework for financial accounting and reporting.

The first discussant, Martin S. Gans, Touche Ross & Co. (San Francisco), argued in his remarks that the course of the FASB as outlined by Shenkir will tend to be overly time-consuming, and consequently it will be difficult to forestall action by the SEC and/or to repel the then existing pronouncements of the FASB. Gans contended that the FASB is proceeding in the standard-setting process without first establishing a framework adequate to substantiate its conclusions. He perceived two objectives that implicitly underlie existing Board pronouncements: (1) The users of financial statements want only "happy surprises" as evidenced, for example, by FASB *Statement No. 2.* (2) The preparers of financial statements would rather be exactly wrong than vaguely right. Gans claimed that the Board is trading between the concepts of relevance and objectivity, usually favoring the latter. He then went on to suggest some simple areas on which reasonable people ought to agree:

1. Valuing the firm is not an objective of financial statements. That is a task better left to the marketplace.

2. Information helpful to one set of users is usually helpful to all users.

3. The crux of whether financial reporting is good or bad can be measured simply: Is the information useful?

4. Usefulness usually means helping people predict the amount, the timing, and the attendant uncertainty of future cash flows.

5. Users of financial statements want to predict the amount, the timing, and the attendant uncertainty of future cash flows.

Throughout his discussion Gans was critical of the FASB's treatment of certain provisions of the Report of the Study Group on the Objectives of Financial Statements, particularly in its rejection of those objectives relating to social measurement and governmental accounting. He cited the issues of "sensitive payments" and municipal bankruptcy as support for his contention that these objectives represent important considerations in a conceptual framework and should not be overlooked by the Board. Gans concluded his remarks by noting that we have a tendency to emphasize certainty, yet almost every problem we face involves uncertainty and risk. Consequently, progress in financial accounting and reporting requires employing the best available solutions that are supported by a rationale or objective. Most importantly, the problems related to the human element must be recognized. The Report of the Study Group can assist greatly in this endeavor.

In discussing the Shenkir paper, Charles A. Neyhart, Jr., focused his attention on the course of action or methodology adopted by the FASB in developing a conceptual framework. He identified and discussed what he perceived to be three major limitations of such a course. First, the approach perpetuates an undue reliance on the ill-defined notion of a "consensus," permitting compromise to prevail over decisive but reasoned action. This reliance may tend to foster indecision, inactivity, and an excessive dependence on others. Second, the approach is likely to be overly time-consuming. Existing standards must necessarily be tentative, awaiting completion of the project before being confirmed as belonging or not belonging to the accounting model. This process can only result in ambiguity, an erosion of credibility in the standard-setting process, and a weakening of the pressures to conform to these interim standards. Third, Neyhart raised the oft-repeated question of whether the private sector will be permitted sufficient time to complete this task before the responsibility is actively preempted by the public sector.

Neyhart argued that the tradeoffs between the above limitations and the benefits expected to be gained from this course of action are unrealistic. He suggested that the time-consuming process by which a conceptual framework is being developed is a manifestation of a much broader policy decision, namely: the decision to proceed in this manner was made to ensure that the power to resolve specific accounting issues will remain in the private sector, at least for the foreseeable future. Under this interpretation, the tradeoffs mentioned earlier are much easier to reconcile.

Neyhart believed that there is an unwillingness on the part of those in authority to progress beyond an incremental approach to developing a conceptual framework. An approach where change is effected in small steps, is heavily dependent on present practice, and is politically feasible. This holds important implications for what kind of conceptual framework will ultimately emerge from the FASB, if indeed one will emerge at all. Neyhart expressed the opinion that the course adopted by the FASB represents an abrogation of responsibility and an incorrect response to the political climate within which accounting standards are set. Neyhart concluded with the judgment that regardless of what results from this process, it is probably unlikely that the framework will perform its intended function of providing explicit guidance in the formulation of accounting standards and the evaluation of accounting practices.

Need for a Definition of Financial Accounting

This section sets forth our interpretation of the two-day Symposium. In addition, we raise questions and present our views regarding the need for a definition of accounting and the data base content of a conceptual framework for financial accounting and reporting. The need for agreement on these issues is urgent. It is fair to state, we believe, that *Statement No. 4* of the Accounting Principles Board is proof enough that financial accounting and reporting is severely limited because of the absence of a conceptual framework.

The presentation by Schrader is notable; he was explicit in pointing out what is realized by few. That is, a large part of the confusion which characterizes the profession is traceable to the fact that *competing definitions of financial accounting* exist. Such confusion will persist until agreement is reached about a definition of accounting. The scope of the field must be delimited. Even the so-called cost-based accounting model is beset by internal inconsistency. For example, in some cases certain items, e.g., inventories and marketable securities, are stated at market values which deviate from cost. Thus, even contemporary financial acccounting does not possess the rigor of consistency in terms of logic.

Failure to be precise in specifying the boundaries of financial accounting is the major problem we perceive to have been highlighted by the Symposium. Resolution of this problem is paramount if any arguments are to be pursued within reason by those who hold opposing views. The purpose(s) for which an accounting is rendered for an entity must, of course, be communicated. We believe that this consideration of objectives is intricately linked with and inseparable from the problem of definition. An *acceptable definition of accounting* should be specific on at least two points: First, it should state precisely what the subject matter of the field happens to be. Second, the definition should provide insight concerning the viewpoint superimposed in relation to the information that the accounting process is intended to generate. Two such viewpoints appear to exist at the present time, that is, the *user approach* and the *accountability approach*. Whether these two approaches are compatible is an empirical question. We believe, tentatively, that they are in the sense that information can be provided in one set of financial statements which will satisfy the conditions of both viewpoints.

Subject Matter Consideration

It is crucial that the profession reach agreement about what financial accounting can and cannot accomplish efficiently and effectively in terms of providing information about the operations, status and prospects of the entity. Stated simply, a definition of accounting should provide insight into the types of information that financial accounting has a comparative advantage in providing. Only then can the data base be clearly specified with respect to what information is admissible to the accounts. Scope delimitation of the type envisioned is absolutely indispensible for specifying the *accounting* information that should be reflected in financial statements.

When agreement is reached concerning a definition of accounting, the profession may then be able to recognize explicitly that different sources exist for providing different types of information about the entity. Information that financial accounting can provide represents at best a subset of the total package of information which may be required. This observation does not diminish the importance of accounting. It may indeed enhance the credibility and professional status of the field. The accounting profession alone has the expertise for determining what should be incontrovertibly designated as accounting data. In addition, accountants have more experience in developing formats for disclosing information in financial statements.

As implied above, it is doubtful whether *any* conceptual framework for financial accounting and reporting can be sufficiently broad such that the output of the accounting process provides *all information* about the entity that *all users* will need. To conclude otherwise would mean that alternative sources of information would not be needed. By implication, the accounting profession may well have to consider the important question of what *non-accounting data* are relevant for inclusion in financial statements. Thus, the need for a definition of accounting in no way suggests that certain nonaccounting information should not be disclosed in financial statements if indeed accounting and nonaccounting information *complement* each other in providing full disclosure about the operations, status and prospects of the entity.

Viewpoint Superimposed

The two different viewpoints superimposed in relation to the types of information which financial accounting should provide have been identified above as the *user approach* and the *accountability approach*. The user approach has more recently been advocated by the Study Group on the Objectives of Financial Statements which concluded that financial statements ought to provide investors with information useful for making economic decisions.[1] The viewpoint that financial accounting should "facilitate the smooth functioning of *accountability* relationships among interested parties" is emphasized by Ijiri[2] who comments as follows:

> By definition, accountability presumes a relationship between two parties, namely someone (an accountor) is accountable to someone else (an accountee) for his activities and their consequences. . . . Detailed records are kept by the accountor not because he expects the information to be useful for his own decisions, but because he is expected to keep the records for the benefit of the accountee.
>
> An accountant joins the accountability relationships between an accountor and an accountee as a third party. . . . The primary role of the accountant is to assist the accountor in accounting for his activities and their consequences and, at the same time, provide information to the accountee. Thus, an accountant has a dual relationship, one with the accountor and the other with the accountee.

Ijiri also contrasts the two approaches by indicating that the decision approach depicts the accountant as a servant of the decision maker whereas the accountability approach deals with the conflict of interests between the accountor and the accountee with respect to the flow of information.

Obviously the viewpoint superimposed acts as a major constraint for specifying the data base of financial accounting. The next section of this article contains an illustration that seeks to reconcile the two viewpoints which some consider to be in opposition. The contemporary financial accounting "model" is employed as a frame of reference in an attempt to reconcile the user approach and the accountability approach to information disclosure.

Components Approach to the Disclosure of Entity Activities

Emphasis on the *periodic* evaluation of entity activities suggests the importance of the income statement as well as the balance sheet. This observation is compatible with the approach of contemporary accounting. The balance sheet is observable only because the activities of the entity are partitioned into segments of time. If the entity is evaluated as a completed venture, for example, a balance sheet would not be relevant. The following discussion reveals how accounting data (outputs of the conventional accounting process) and nonaccounting data (which do not presently meet the criteria for admissibility to the accounts) can be combined in a complementary manner to provide information which may satisfy the user approach and the accountability approach simultaneously. The analysis emphasizes the income statement for illustrative purposes only.

In the context of contemporary financial accounting only two types of income can be identified under the most rigorous analysis:

1. *Operating income* which results from the primary economic operations for which the entity was organized, and

2. *Nonoperating income* which results from certain other activities in which the entity specifically engages.

Each of these is discussed below.

The user approach to accounting places the notion of operating income in imminent danger of being obscured unless efforts are made for the accounting process to preserve the relationship between economic inputs and outputs. It is not objectionable that the user approach emphasizes cash flows. By doing so, however, the approach may result in commingling nonhomogeneous data. Although this approach may facilitate the needs of some users, it may be confusing to others. It is this factor which must be guarded against. For example, disclosure of economic activities which the entity engages in specifically as a provider of goods and services seems necessary if indeed accounting is to facilitate the accumulation of macroeconomic data. This type of data is also necessary for disclosing the degree of progress specifically achieved (performance evaluation) by the entity as a participant in the flow of economic goods and services.

Fluctuations in the general price level have the consequence of making the historical cost of certain economic activities nonadditive. Restatement of the data to reflect the impact of changes in the general price level is warranted. In this way historical cost data would be additive. Thus, evaluations could be effected which reveal income as measured in terms of historical cost *and* the resulting impact of changes in the general price level on the data.

The restatement process also reveals general price-level gains and losses which result from holding monetary items. Such gains and losses do not meet the criteria for classification as either economic or financial income in contemporary accounting. They emerge exclusively as a consequence of changes in the general price level; they reflect neither economic operations of the entity nor do they result from the financial transactions in which the entity engages. General price-level gains and losses affect only the wealth position or status of the entity. They should consequently be treated as capital adjustments inasmuch as they represent redistributions of wealth among entities (including governments). The question of *changes in market values* is pursued later in the analysis.

Three forms of nonoperating income are observable although they have not been adequately contemplated in contemporary financial accounting:

1. Net gains (losses) from transactions involving dispositions of economic assets which are treated as extraordinary items.
2. Net gains (losses) from financial transactions, as distinguished from economic transactions. Financial transactions and events include the phenomena of interest expense and revenue and gains and losses from dispositions or other conversions of financial assets and obligations such as marketable securities owned and bonds payable by the enterprise. These gains (losses) should be disclosed separately since they do not result from primary economic operations.
3. Windfalls and catastrophic events. They can affect both economic and financial balances previously admitted to the accounts.[3]

In accordance with what we term the *component approach* to disclosing periodic financial information about the activities of the entity, it appears that the income statement ought to include the following:

1. Operating income (economic revenue less economic costs)
2. Net gains (losses) from voluntary disposition of economic assets such as machinery used in production
3. a. Net gains (losses) from financial transactions, such as early retirement of debt and voluntary disposition of financial investments
   b. Investment performance, such as dividend and interest income
   c. Other interest expense on debt and interest received on financial balances, such as trade receivables
4. Impact of windfalls and catastrophic events:
   a. Result of involuntary conversion of economic assets, such as through catastrophe
   b. Result of involuntary conversion of investments, such as bankruptcy of a company in which the entity has made an investment
   c. Windfalls

As suggested above, in concept, there should be no objection to expressing the above data in terms of amounts restated for changes in the general price level.

The components approach to the presentation of data in the income statement makes clear the fact that different types of transactions and events may impact differently on the operations (economic *and* financial) and status of the entity. Further, such a disaggregated approach is without bias, except the preceding illustration uses contemporary accounting as a frame of reference. The components approach appears to be compatible with the notion of *accountability* in the sense that it discloses only the results of transactions and events actually experienced by the entity.

Until agreement is reached concerning a definition of financial accounting, it appears reasonable to suggest that certain types of information referred to generally as variations in market values represent nonaccounting data. Disclosure of changes in the values of balance sheet items may indeed represent important information to some who use financial statements. However, it is debatable whether accountants have a comparative advantage in measuring such changes in value. This function is usually reserved for the marketplace, and in some cases appraisals may be necessary. Periodic (unrealized) changes in market values have not been subjected to the transactions test, and their ultimate realization in terms of amount is much more difficult to measure in comparison with the information shown in the above illustration of the components approach to presenting income data.

The point should be emphasized that measurement of current values is an entirely different matter from disclosing such information in annual reports. Whether inclusion of market value data in financial statements will indeed enhance their usefulness is an empirical question. The main emphasis of this discussion is that if such information is included, it should be separately disclosed in terms of components. For example, unrealized

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gether with the financial statements covered by the report were issued as a separate document, then no responsibility for the "other information" would accrue to the auditor. With that "gleam of inspiration" Bea folded the proofs, placed them in her briefcase, and went to bed. That night her dreams were filled with visions of two separate documents where the auditor was responsible only for his/her report and the financial statements covered by that report.

* * *

Note: Only the auditor in this account is fictional. An actual annual report was used to analyze what might happen when an attempt is made to satisfy the requirements of SAS No. 8. This editor does not imply that the problems met by Bea are typical. The particular report was chosen because of its presence in the files of the editor. A "reading" of the report to satisfy the requirements of SAS No. 8 reinforces this writer's opinion that the short Statement may indeed prove to open a Pandora's box.

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holding gains and losses may be influenced by changes in the general price level as well as changes in specific price levels in which case the impact of each should be separately disclosed. Disclosure should also be made of the fact that this information differs from that which has been subjected to the transactions test. Prospective data, such as changes in market values, can be accommodated by the components approach outlined above irrespective of whether an income statement or balance sheet is prepared. If users require information that reveals variations in market values, disclosure of it in financial statements may result in meeting the conditions of the user approach. Disclosure of this type of information, which probably should be considered nonaccounting data at the present time, in combination with accounting data may well help to resolve alleged conflicts between the two viewpoints discussed above.

Concluding Observations

In conclusion, it appears that in the absence of an agreed upon definition of accounting, the debate over a conceptual framework will continue, and little progress will be made to resolve this important issue. It may well be that the debate over the two viewpoints superimposed in financial accounting — that is, the *user approach* and the *accountability approach* — will continue indefinitely unless accountants realize that data yielded by the accounting process alone are insufficient for reconciling the differences suggested by the two approaches. What may be needed is acceptance of the possibility that no matter how the field of financial accounting may ultimately be defined, the need for disclosing nonaccounting data will still exist in order to satisfy the diverse information needs of users of financial statements. Indeed, even the present accounting "model" needs to be extended and improved to satisfy the conditions of the accountability approach. Consider, for example, the present ban against recording executory contracts. It is doubtful whether the information needs of all users can ever be satisfied without disclosing *both* accounting data and relevant nonaccounting data in financial statements.

Notes

[1]A comparison of the Study Group's conceptual framework with contemporary financial accounting is contained in Joe J. Cramer, Jr., "An Eclectic Approach to Financial Reporting," *Business Horizons* (August, 1975), pp. 65-76.

[2]Yuji Ijiri, *Studies in Accounting Research, No. 10,* "Theory of Accounting Measurement," American Accounting Association, 1975, pp. ix-x and 32-33.

[3]Cramer, p. 72.