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## EXPLORING THE ROLE OF ACCOUNTING HISTORY FOLLOWING THE ADOPTION OF IFRS IN EUROPE. THE CASE OF ITALY

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### RESUMEN

La adopción de los “International Financial Reporting Standards” (IFRS), impuesto por el Reglamento (CE) número 1606/2002, puede ser particularmente perturbador en los países donde la tradición teórico-contable y la normativa del sector están particularmente desarrolladas. Esta investigación presenta un estudio que subraya la importancia de las soluciones contables anteriores que se han desarrollado a escala nacional para enfrentar el desafío de adoptar un conjunto de normas internacionales de contabilidad que se han desarrollado exógenamente como los IFRS en el actual escenario europeo. La investigación pone su atención sobre Italia y reconsidera el método de contabilidad “patrimonial” que se desarrolló durante la década de 1880 por Fabio Besta (1845-1922), un erudito italiano que se considera unánimemente el iniciador de la moderna teoría de la contabilidad en Italia. Su enfoque se utilizó en Italia hasta los años '70 y luego fue sustituido por otro enfoque, el del estudioso Gino Zappa (1879-1960). Fabio Besta pasó de una teoría de contabilidad “personalista” a una “materialista” (o “no personalista”). Él presentó nuevas ideas bastante similares en muchos aspectos a los métodos teóricos de contabilidad anglo-americanos modernos (Zambon, 2001; Viganò y Mattessich, 2007). La teoría de la contabilidad “patrimonial” pone su atención sobre la riqueza de una empresa, como se refleja en el estado de situación patrimonial, y en sus valoraciones. Esta teoría, nos evoca la llamada “perspectiva de activos y pasivos”, que es el enfoque utilizado por varios organismos normativos, como por ejemplo FASB e IASB, para desarrollar marcos conceptuales. Este enfoque define el objetivo de los estados contables de proporcionar información sobre la posición financiera de la empresa, entendida como la riqueza de la empresa misma. Los activos y pasivos son definidos como recursos y obligaciones y se consideran como los principales indicadores de la riqueza de una empresa. Los ingresos y los gastos vienen indirectamente definidos en términos de cambios en activos y pasivos (Sprouse y Moonitz 1962). Como consecuencia, la ganancia del período mide el incremento o la disminución del patrimonio neto de la empresa (FASB, 1976). Este trabajo empieza con un análisis de la teoría de Besta y luego sigue con un análisis comparativo de esta teoría con el marco conceptual de los IFRS y sus medidas de evaluación. El análisis comparativo lleva varias similitudes. Ambos enfoques se han construido sobre las mismas bases teóricas, es decir, la perspectiva contable “patrimonial” y la visión reduccionista de la riqueza de una empresa. En conclusión, este documento evalúa a Fabio Besta con una visión nueva en la era de los IFRS. Sus perspectivas teóricas podrían ayudar a entender mejor y al mismo tiempo a juzgar el actual contexto contable con el objetivo de mejor integrar a los estudiosos contemporáneos en el nuevo escenario internacional donde los principios contables se están desarrollando.

### ABSTRACT

The mandatory adoption of the International Financial Reporting Standards (IFRS), enforced by Regulation (EC) No. 1606/2002, may be particularly upsetting in the European countries with strong traditions of accounting theory and regulation. This paper presents an investigation that stresses the importance of previous accounting solutions which were developed nationally to face the challenge of adopting an exogenously developed set of international accounting standards, such as IFRS, in the current EU setting. The research

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focuses on Italy and reviews the “patrimonial” accounting approach developed in the 1880s by Fabio Besta (1845-1922), an Italian scholar who is unanimously considered to be the initiator of the modern accounting theory in Italy. His approach was in use in Italy until the 1970s, after which the approach of another scholar, Gino Zappa (1879-1960), has been followed. Fabio Besta shifted from a *personalistic* to a *materialistic* (or non-personalistic) theory of accounts. He put forward new ideas quite similar in many respects to the modern Anglo-American theoretical approaches to accounting (Zambon, 2001; Viganò and Mattessich, 2007). The “patrimonial” accounting theory focuses on the firm’s wealth, as reflected in the balance sheet, and on its valuation. It evokes the so-called “asset and liability view”, which is the approach used by several standard-setting bodies, e.g. FASB and IASB, to develop conceptual frameworks (Johnson, 2004). Such an approach defines the objective of financial statements as providing information on the firm’s financial position interpreted as the firm’s wealth. Assets and liabilities are defined as resources and obligations and are regarded to be the primary indicators of the wealth of a firm. Revenues and expenses are indirectly defined in terms of changes in assets and liabilities (Sprouse and Moonitz, 1962). Accordingly, income measures the increase or decrease in the firm’s wealth (FASB, 1976). This paper begins with an analysis of Besta’s theory, and then proceeds to compare Besta’s theory with the IFRS conceptual framework and measurement criteria, showing several similarities. In particular, it emerges that both approaches are built on the same theoretical foundations, namely the “patrimonial” accounting perspective and the atomistic-reductionist view of the firm’s wealth. In conclusion, this study appraises anew Fabio Besta’s thought in the age of IFRS. His theoretical perspectives might help to understand better and thereby more effectively evaluate the present accounting context, such to possibly favour a better contribution from contemporary accounting researchers in the new international scenario where accounting standards have been developing.

**PALABRAS CLAVE:**

*Italia, Historia de la contabilidad, Teoría de la contabilidad, Autores, IFRS.*

**KEYWORDS:**

*Italy, Accounting history, Accounting theory, Authors, IFRS.*

## **1. Introduction**

One of the most important changes in the Italian accounting regulation is attributable to the decision of the European Union to implement the International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB), in order to increase comparability of published financial statements. Since January 1<sup>st</sup> 2005, all Italian companies listed on the European stock markets have been required to prepare their consolidated financial statements in accordance with IFRS<sup>1</sup>. This requirement has also been extended to their annual accounts since 2006<sup>2</sup>.

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<sup>1</sup> Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002. For ease of exposition, hereinafter the term “IFRS” is used to refer to both IFRS issued by the International Accounting Standards Board (IASB) and to the International Accounting Standards (IAS) issued by the International Accounting Standards Committee ( IASC), which was the IASB’s predecessor.

<sup>2</sup> See the Legislative Decree No. 38/2005 of 28 February 2005.

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The IASB financial statement model is perceived as being the opposite of the Italian financial reporting approach. The introduction of IFRS seems to represent a radical change in, or even a break from, the national accounting traditions (see, among others, Di Pietra, 2006; Pozzoli, 2006). Italian accounting is regarded as creditor- and legal-oriented, whereas the IASB model is characterized by a capital market and shareholder orientation with a strong professional origin. The IASB model has been predominantly established by Anglo-Saxons (Flower *et al.*, 2002) which means their accounting influence is rather prevalent.

The rules governing accounting in Italy, a country with a “civil law-based” legal system of Roman derivation, are enshrined in legislation. The state exercises its authority through a number of regulatory instruments. These are laws enacted by the Parliament (*legge*), and legislative decrees (*decreti legislativi*) and law decrees (*decreti legge*) prepared by the Government within the limits of the Constitution<sup>3</sup>. The first official reference to financial reporting in Italian law might be dated back to the Commercial Code of 1865 and its revised version of 1882. Nevertheless, no detailed rules on formats and valuations were given. Later, financial reporting was governed by the 1942 Civil Code (C.C.) in a more comprehensive way. A fundamental evolution occurred with the Law No. 216/1974, in which the format and minimum content of the income statement were legally defined. Lastly, the Legislative Decree No. 127/1991 implemented both the Fourth and the Seventh European Directives on individual and consolidated accounts. As a result, accounting regulations in the 1990s experienced wide changes through an extensive revision of the Civil Code regarding the preparation of annual accounts, the balance sheet and income statement layout, valuation criteria, the note to the accounts and the management report<sup>4</sup>.

Within the above legalistic context, accounting standards set by the Italian professional body (CNDRC – *Consiglio Nazionale dei Dottori Commercialisti e Ragionieri*) have always only played an interpretative role of the legal rules and they have never been officially recognized as law<sup>5</sup>. On the contrary, following the adoption of IFRS, accounting standards have become the basis for mandatory financial communication, as is the case in common law countries. Moreover, while the Italian legal rules provide a reference framework to deductively derive accounting standards, IFRS refer to an accounting model created and developed on the basis of an inductive approach, where professional practice orients accounting standards.

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<sup>3</sup> For further details see Di Pietra *et al.* (2001).

<sup>4</sup> For an overview (in English) on accounting regulation in Italy, see Riccaboni and Ghirri (1994), Di Pietra *et al.* (2001) and Zambon (2001, 2002).

<sup>5</sup> CNDRC, which issued national accounting standards from 1975, was replaced in 2001 by the Italian accounting body (OIC - *Organismo Italiano di Contabilità*). It pursues more diverse and more ambitious aims. See [www.fondazioneoic.it](http://www.fondazioneoic.it)

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Given such brief considerations, it seems that the adoption of IFRS has been changing the Italian accounting practices, and has above all been moving them towards the Anglo-Saxon ways. This has been a groundbreaking change.

The aim of this study is to stress the importance of considering previous accounting solutions which were developed nationally to face the challenge of adopting an exogenously developed set of international accounting standards, such as IFRS, in the current EU setting. For this purpose, the paper examines the “patrimonial” accounting theory developed in the 1880s by an Italian scholar, Fabio Besta, and discusses the topicality of its issues in the age of the implementation of IFRS. In fact, Besta’s theory and the IASB model share the same “patrimonial” accounting approach, in which conceptual primacy is given to the firm’s wealth measurement. Besta’s theory recalls the “asset and liability view”, the approach used by several standard-setting bodies around the world to develop conceptual frameworks, IASB included (Johnson, 2004). The “asset and liability view” focuses on the firm’s wealth, as reflected in its resources (assets) and its obligations (liabilities). Profits result from changes in those assets and liabilities that increase the firm’s wealth, and losses result from changes that decrease its wealth (FASB, 1976). Thus, revenues and expenses are indirectly defined in terms of changes in assets and liabilities (Sprouse and Moonitz, 1962).

Fabio Besta described his theory in his seminal work *‘La Ragioneria’* (Accountancy), which was published between 1891 and 1916<sup>6</sup>. He was professor of accountancy at the University of Venice at the time. The work is still considered a milestone in modern accounting (see, among others, Giannessi, 1980; Ceriani, 2006). Besta had many disciples who developed and refined his ideas, such as Vittorio Alfieri (1863-1930), Pietro D’Alvise (1860-1943), Vincenzo Vianello (1866-1935), Francesco De Gobbis (1863-1942), Pietro Rigobon (1868-1955), Carlo Ghidiglia (1870-1913) and many others who further elaborated on his thought.

This paper first examines the basic contents of Besta’s theory and then proceeds with a comparative analysis of Besta’s theory and the IASB model which underlines the key common assumptions and differences between the two approaches. In so doing, contents of accounting are understood under the light of their political, economical and social context (Hopwood, 1983; Napier, 1989; Carnegie and Napier, 1996).

This study, in conclusion, leads to the reappraisal of this Author in the age of IFRS, whose thought was made obsolete by Gino Zappa’s (1879-1960) innovative ideas on accounting. Besta’s ideas might help contemporary accounting researchers to appreciate better and thereby critique more effectively the present accounting context (Carnegie and Napier, 1996), with the purpose of improving their contribution in the new international scenario where accounting standards have been developing.

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<sup>6</sup> It is divided in three volumes and embraces, on the whole, the complex subject of accountancy.

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In addition, this study takes into consideration the need to share knowledge and to spread research about scholars operating in a non-“Anglo-Saxon” context (Carnegie and Napier, 2002).

The remainder of the paper is organised as follows. Section 2 analyses the Italian accounting traditions and, in particular, Besta’s ideas on accounting in his work “*La Ragioneria*”. Section 3 provides a brief review of the IASB accounting model mainly through the *Framework for the Preparation and Presentation of Financial Statements* (IASB, 1989) and through those IFRS which are considered the most significant for the research purpose. Section 4 compares the two approaches with regard to the theoretical foundations, the principles for the preparation of the financial statement and the measurement criteria of the financial statement elements. Section 5 reports concluding remarks.

## 2. The “Contemporary” Accounting Age in Italy: Fabio Besta’s Thought

Traditionally, the “contemporary” age in Italy refers to the period from the early nineteenth century to the present<sup>7</sup>. In this period several theories and frameworks have taken shape within the accounting discipline. In particular, in the late 1920s two autonomous and competing approaches clashed in Italian accounting studies: Fabio Besta’s “patrimonial” approach (*approccio patrimoniale*) and Gino Zappa’s “income” approach (*approccio reddituale*). The former was in use in Italy until the 1970s, when the legislator required joint-stock companies to present the “T-format” income statement (so-called “*costi, ricavi e rimanenze*”), which listed expenses on the left and revenues on the right with no attempt to associate specific expenses with specific revenues. This income statement format was the logical result of Zappa’s accounting thought, which is still the most influential one in Italy both from a theoretical and a practical point of view<sup>8</sup>. Without doubt, serious differences exist between the theoretical frameworks of Besta and Zappa. It is worth highlighting the different cognitive purposes assigned to the financial statement. According to Besta, the financial statement’s main emphasis is the measurement of the firm’s wealth; income is considered as a wealth variation. On the other hand, Zappa’s theory focuses on the determination of income and the firm’s wealth is only measured for income determination. It is not easy to find any substantial similarity between the frameworks of the two scholars. Deep divergences arise from the completely different ways of conceiving the accounting discipline and its domain as well as the whole epistemological setting<sup>9</sup>. Leading Italian scholars, anyway, e.g. Giannessi (1979: 418) and Catturi (1997: 167), tend to consider Zappa’s theory as an evolution of Besta’s one. The former, developed later (1920s) than the latter (1880s), was able to detect the fundamental changes in the economic reality of that time.

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<sup>7</sup> Different countries may have different conventions.

<sup>8</sup> For a keen overview (in English) about the “contemporary” age in Italy, see Zan (1994).

<sup>9</sup> See e.g. Galassi (1984), Zan (1994), Viganò (1998), Zambon (2001) and Galassi and Mattessich (2004) for a review (in English) of the key characteristics of Besta’s and Zappa’s theoretical frameworks.

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Nevertheless, the discussion of the value of these two approaches and the assessment of their scientific validity is outside the scope of this paper. In the following, only Besta's theory will be examined in order to point out its topicality in the age of the implementation of IFRS.

### 2.1. Historical framework

The "patrimonial" approach entered the Italian economic system in the second half of the 19<sup>th</sup> century. At this time the political and administrative division was virtually eliminated with the unification in 1861. This period was ruled by family owned firms whose owners, usually joined by family links, exclusively looked at the firm's wealth and its growth. The owner's family components drew what they needed for living from the firm. Therefore, income was drawn whenever necessary. As a consequence, the owner's main purpose was the firm's continuity. It was pursued through the maintenance of the wealth's integrity and the guarantee of a satisfactory return on investments. Although important, income was secondary in respect to the firm's wealth consolidation and growth (Canziani, 1982; Catturi, 1997).

Besta introduced his theory in the above-described economic period, but he further developed and expanded his concepts during the next decades which were characterised by several changes in the economic situation of the country. In fact, at the end of the 19<sup>th</sup> century the industrial revolution started to change the Italian economy. It had been based on handcrafts but began changing into a capitalist economy. Although, compared to other European countries, this happened with a delay and was only partial.

At that time, the Civil Code enacted in 1865 only required firms to keep a journal and to draw up a stocktaking each year. No rules existed concerning general principles, formats and year-end valuations. Regarding joint-stock companies, they were required to distribute dividends only from "actually realized profits". Moreover, their financial statements were mandatorily filed with Commercial Courts and an extract from these statements was published. This approach was substantially confirmed by the second Civil Code of 1882 in which, respect to the previous one, the new general principle that accounts should show with "straightforwardness and truth" (*evidenza e verità*) the financial position and the performance results was stated.<sup>10</sup>

From an accounting viewpoint, the development of Besta's theory burst onto the so-called "personalistic" accounting theory, developed in France thanks to De La Porte (1685, 1712). The "personalistic" theory governed the Italian accounting culture and the economic context throughout the 19<sup>th</sup> century. The scholars Dègrange (father and son) clearly defined it through their works (1795, 1804). Their theory supported the use of five general accounts for bookkeeping referred to the business owner (cash, goods, bills receivable and bills payable, profits and losses).

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<sup>10</sup> For further details see Zambon (2001).

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The main Italian representatives of this current of thought were Francesco Marchi (1867), Giuseppe Cerboni (1886) and Giovanni Rossi (1882), although they also developed severe critical analysis of it. Cerboni, in particular, based his theoretical statement on the concepts of both the firm and its wealth, substantially considered from a juridical point of view. This led him to the idea of the firm as a coordinated set of contracts, where the transactions or events give rise to rights and duties, the sum of which forms the firm's wealth. According to Cerboni, the firm's active actors had to answer for the use of resources, i.e. they were accountable for them. It was possible to effectively control these people through the recognition of their rights and duties, using a system of accounts assigned to the single person. This particular double-entry bookkeeping was named "Logismography" (*Logismografia*) and was originally applied to Government accounting, when Cerboni was appointed as Accountant-General to the Italian Government.

Besta went beyond this approach, since he was fully convinced of the inability of Cerboni's theory to explain the complicated and varied activities of a firm. Besta's different position was clearly reported in his inaugural lecture of 1880, at the opening of the academic year at Venice Royal Commercial High School (*Regia Scuola Superiore di Commercio di Venezia*), where he held the chair of accountancy. On that occasion, he argued that accounts should not refer to people but to objects measurable through their value in order to keep track of their modifications; so he introduced the "value-based" theory of accounts (that is an "impersonal" or "materialistic" approach) in contrast to the "personalistic" one.

## 2.2. Theoretical foundations

The base of Besta's accounting theory lies in the concept of the firm. It is described as:

*"The sum of different phenomena, or transactions, or relationships to be administered relative to an amount of capital forming a single entity, to a single person, to a family or to a generic union"* (Besta, 1922: vol. I, 3, translated).

According to the above-definition, a firm presents two different constituent elements:

- the whole wealth, consisting of positive (assets) and negative (liabilities) elements, that serves to realize the firm's economic activity; in practice, there is no firm without wealth;
- the sum of phenomena, or transactions, as well as of relationships to be administered, which are able to change the wealth composition and extent.

From this conceptualization, the overwhelming importance of wealth for the firm's existence emerges. In this respect, a firm cannot be managed efficaciously if the extent of its wealth is unknown, and if its actual changes due to each economic event, of internal and

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external origin, cannot be monitored. Thus, the accounting information system has wealth as the main investigation topic (Besta, 1922: vol. II, 275-7). Within this theoretical framework, Besta defines the accounting discipline as “the science of economic control”. At the theoretical level, it develops the “laws of economic control” of all kinds of firms; at the practical level, it becomes the precise application of these norms and rules (Besta, 1922: vol. I, 31).

“*Patrimonial*” approach. Coherently with these ideas, Besta proposes an accounting system known as “patrimonial”. On the one hand, it aims to recognize all the firm’s wealth components and their changes in time, including also those related to the economic transformation of the inputs into outputs; on the other hand, it aims to measure the net worth and its increasing (profit) or decreasing (loss) variation. In the light of these assumptions, the accounting period income corresponds to the accounting measurement of the change in the net worth in that period or, alternatively, to the sum of individual changes in assets and liabilities during the same period (Besta, 1922: vol. I, 99). In fact, for the “patrimonial” approach, what really exists is the firm’s wealth from which income derives, that is periodically added to wealth. Thus, the balance sheet becomes the main account of the financial statement. From this account, the net worth measure emerges as the residual of assets after deducting all liabilities. It can be identified by the following accounting equality (Besta, 1922: vol. I, 72)

$$ASSETS - LIABILITIES = NET WORTH$$

As can be noticed, Besta’s “patrimonial” approach appears fairly similar to the proprietary theory developed in the United States between the end of the 19<sup>th</sup> and the beginning of the 20<sup>th</sup> century<sup>11</sup>. Under this approach, assets, liabilities and proprietorship constitute the three basic aspects of a firm’s situation and, similar to Besta’s thought, the function of accounting is to record, analyse, and report on the changes and status of these three aspects from time to time (Chow, 1942). The basic accounting equation is expressed as follows

$$ASSETS - LIABILITIES = PROPRIETORSHIP$$

From this equation, it emerges that proprietorship increases by profits and decreases by losses (Chow, 1942), thus income of an accounting period is the proprietorship net increase. In other words, income can be meant as a function of proprietorship, that is, as its

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<sup>11</sup> Among several scholars who developed this approach, the first ones were Sprague (1907), Hatfield (1909) and Kester (1917-18). According to the proprietary theory, the firm is not separated from its proprietor and, therefore, all assets and liabilities are owned by the firm’s proprietor.



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derivation. Given such a framework, several authors (see, among others, Belkaoui, 1995; Anthony, 1987) emphasize that the proprietary view tends to be “balance sheet oriented”<sup>12</sup>.

Compared to the proprietary theory, Besta’s one differs in the role of the proprietor. Under the proprietary theory, the proprietor is the centre of accounting concepts and processes; on the contrary, since in Besta’s approach the concept of firm is pivotal, the centre of accounting concepts and processes is the firm and not the proprietor.

*Double-entry book-keeping method.* In order to apply the double-entry accounting to the “patrimonial” system, Besta identifies two series of accounts which are reflected in the terms of the net worth accounting equality seen before; they are (Besta, 1922: vol. II, 326):

1. the basic accounts (also known as original series), composed of accounts “opened” to the firm’s assets and liabilities;
2. the derived accounts (also known as derivative series), that are “opened” to recognize the firm’s net worth and its changes.

For the accomplishment of the double-entry accounting, it is required that for each modification in the basic accounts there is a corresponding change in the derived accounts. The firm’s transactions or events that give rise to changes in the basic accounts are called by Besta “administrative facts” (Besta, 1922: vol. III, 3). These changes can be classified as Active Changes (*AC*) and Passive Changes (*PC*). *AC* depend on increasing assets or decreasing liabilities, whereas *PC* depend on decreasing assets and increasing liabilities (Besta, 1922: vol. II, 304).

According to the nature of the administrative facts, the passive and active changes can be related by the following estimative relation (Besta, 1922: vol. III, 5):

$$AC \begin{matrix} \geq \\ < \end{matrix} PC$$

It follows that five basic cases can be considered as regards the effect these changes have on the net worth (Richichi, 1947: 16-7), namely:

$$AC = PC \tag{1}$$

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<sup>12</sup> According to Galassi and Mattessich (2004: 63) “Besta’s thought still moved within the framework of the proprietary theory [...]; above all, his system still rested on the balance sheet and its valuations”. For a comprehensive revisit of this theory see, among others, Zambon (1996).

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If equality (1) holds, administrative facts are called “permutative” and the simple replacement of one firm wealth element with another takes place. The administrative fact is simply recognized in the basic accounts and the firm’s net worth remains unchanged.

Instead, in the case  $AC > PC$ , the  $AC-PC$  difference is balanced with a residual component called Active Net Change ( $ANC$ ), having the same nature as  $AC$ :

$$AC = PC + ANC \quad (2)$$

In (2), the equality is obtained by recognizing  $ANC$  in the derived accounts (so that it balances  $AC$ ) and it measures the net worth increase. In this case, the administrative facts are called “mixed”.

If  $PC = 0$ , then

$$AC = ANC \quad (3)$$

Administrative facts related to equality (3) are called “modificative”. They involve a single  $AC$  that is balanced with a variation in the net worth. The latter exhibits an equivalent increasing amount. In this case, the administrative fact is recognized using both basic and derived accounts.

Analogously, if  $AC < PC$

$$PC = AC + PNC \quad (4)$$

if  $AC=0$

$$PC = PNC \quad (5)$$

Equality (4) refers to a “mixed” administrative fact, whereas equality (5) to a “modificative” one. For both cases, the decrease in the firm’s net worth is measured by the Passive Net Change ( $PNC$ ).

Coherently with this accounting perspective, Besta considers only the “modificative” and the “mixed” facts responsible for the net worth increases and decreases. These net worth changes are defined as “gross” profits and losses and their algebraic sum produces the accounting period income (Besta, 1922: vol. I, 100). Thus, the income statement is an aggregation of partial results associated with specific individual firm wealth items, whose structure is named as “gross results”. Table 1 shows the resulting Income statement structure.

**Table 1.** Income statement structure within Besta’s “patrimonial” theory.

<b>DEBIT</b>	<b>CREDIT</b>
<ul style="list-style-type: none"> <li>▪ Separate Passive changes (derived from “modificative” facts)</li> <li>▪ Excess of Passive changes over correlated Active changes (derived from “mixed” facts)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Separate Active changes (derived from “modificative” facts)</li> <li>▪ Excess of Active changes over correlated Passive changes (derived from “mixed” facts)</li> </ul>
Balance: <b>PROFIT</b>	Balance: <b>LOSS</b>

*Atomistic-reductionist view.* The determination of the accounting period income above-described rests on the core idea that each item of the firm’s wealth can be observed and measured separately and independently from the others (Besta, 1922: vol. III, 1). In this respect, it is commonly known that Besta’s theory is an “atomistic – reductionist patrimonial” one, since it considers the firm’s wealth as an algebraic sum of value-elements rather than an interconnected system of value-elements (D’Ippolito, 1966: 246). In the same way, one more recent standpoint (Viganò, 1998: 390) considers Besta’s “patrimonial” approach as analytical, adopting an atomistic view: the firm is a simple sum of several components; so, for example, each wealth item is like an independent atom with a proper individuality and a single value.

As for implications, the atomistic-reductionist view of the firm’s wealth allows the calculation of the economic contribution of any singular element in terms of partial results (e.g. productivity, margins, etc.). Then, the “gross results” income statement structure is the logical consequence of that view.

*Methodological issues.* The arrival and popularity of positivism (particularly in Spencer-Comte’s view) played an important role in the creation and development of Besta’s theory (Canziani 1987: 203). At the end of the 19<sup>th</sup> century, positivism in its various forms was the prevailing philosophical research approach.

Besta’s position about the methodology to be applied to accounting studies is as follows:

*“Within applied disciplines, theoretical principles and rules have to be pragmatical; the positivist and empirical method has to be followed in the accounting discipline, as well as in any others, when tracing these principles and rules. In the accounting discipline, more than in other practical sciences, it is important to avoid both straying among pure abstract theories and accepting uncertain general principles, in order to draw accounting rules from a simple inference. Accounting scholars, more than in other disciplines, have to repeat to themselves the maxim that Newton often reminded*

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*himself of: “Physicist, be careful with metaphysics” (Besta, 1922: vol. II, 394, translated).<sup>13</sup>*

Given such a philosophic premise, Besta states that the use of the positivist and empirical approach in accounting studies consists in verifying what really happens within firms in order to derive general principles. For this purpose, it becomes necessary to analyse carefully the firm’s real life either in the past or in the present. Thus, history turns out to be an integral part of Besta’s positivist and empirical method (Besta, 1880: 74-5).

It is worth noticing that a similar “empirical” approach can be found in 1920s in the Anglo-Saxon financial accounting research. A research effort was developed and conducted within the UK during those years, mainly at the London School of Economics, by economists and accountants. In particular, accountants were interested in distilling theoretical principles from existing practices. Whittington (1986) described this method as an empirical inductive approach (Ryan *et al.*, 2002: 100). First of all, this approach involved surveying and synthesizing accounting practices, and then attempting to generalize the principles underlying observed practices. According to Whittington (1986: 7), these researchers produced inductive theories based on the rationalization of the prevailing practices.

### **2.3. General principles for the preparation of financial statements**

Moving to the analysis of the principles for a correct financial statement preparation, it is important to remember that Besta considers the firm’s wealth as an aggregation of heterogeneous goods whose measure has to be determined. To obtain this measurement, all the goods have to be considered under a common feature represented by their value, the only characteristic they share. Proceeding in this way, the firm’s wealth and its elements become values, and an economic conceptualization of wealth is elaborated in opposition to Cerboni’s legal one (seen as the sum of rights and duties) (Besta, 1922: vol. I, 71). In this context, the financial statement is considered as the device to measure the value of the firm’s wealth as well as its single elements.

*Accounting valuation issues.* But, in terms of accounting valuations, which value should be ascribed to each element of the firm’s wealth and to its changes? Within an ideally perfect situation, the book value should state the “actual value” (*valore reale*) of each wealth element, from the moment it is recognized throughout its changes. In other words, consistent with the objective of wealth measurement assigned to the accounting system, the book value has to be as close as possible to the actual value (Besta, 1922: vol. II, 301).

In Besta’s idea, the “actual value” of goods, regardless of their type or form, is their replacement cost (*costo di riproduzione*). It refers to both a physical and an economic replacement cost, that derive from the obtainment of the same goods or of similar or perfect

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<sup>13</sup> See, among others, Alfieri (1923), Cassandro (1972), Perrone (1986) about Besta’s methodological approach.

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substitutes, respectively (Besta, 1922: vol. I, 227-9). However, when one particular commodity is the object of a large number of frequent exchanges on a monetary basis, it is worth assuming its “common or normal price” as the “actual value”. This is included between the minimum and maximum market price (Besta, 1922: vol. I, 232). In a nutshell, the objective of the accounting valuations is to express the most current value of the firm’s wealth.

D’Ippolito (1966: 251) argues that this book-value concept leads to an income composed of realized and unrealized values which is useless for both distributable profit allocation and income-tax return preparation. Indeed, one of the main problems related to the “patrimonial” systems is the uncertainty of the income nature, whether effective or anticipated, with regard to its possible allocation process (Canziani, 1987).

*Prudence and accrual basis concepts.* Nevertheless, Besta recommends prudence in the firm’s wealth assessment, arguing that profits have to be recognized only when they can be calculated with reasonable certainty. Particularly, managers tend to be open-handed in the determination of profits, since they wish to receive consideration for their management activity through the distribution of large dividends. For this reason, limiting the managers discretionary power becomes necessary in order to avoid the distribution of unrealized profits. As a consequence, managers should sometimes be asked to establish their accounting assessments on the “effective cost” (*costo effettivo*). It corresponds to the historical cost, including all the availability fees, which is always measurable with maximum or high precision (Besta, 1922: vol. III, 608-9). Operatively, the usage of the “effective cost” is necessary when goods are not traded on an active market. Thus, only uncertainty in the “actual values” calculation can justify the application of the “effective cost”, provided that it remains lower than the “actual value” (Besta, 1922: vol. I, 417).

As for the accrual basis concept, in Besta’s theory every change in value in the wealth elements, even a temporary one, is considered as a profit or a loss. More precisely, each increase in the wealth value is a profit, whereas each decrease is a loss. Future changes can further increase, as well as reduce or remove, a previous profit or loss. In this view, the role of the exchange monetary consideration is to measure the amount of the resulting profit or loss, but it is not their cause (Besta, 1922: vol. I, 263-4). Thus, according to the accrual basis, profits and losses are recognized at the moment they occur, not when money is received or paid. However, in the case when the accrual basis is completely in contrast with the prudence concept, this latter prevails. These conceptual issues are similar to those developed later in Zeff and Dharan (1994: 191). They distinguish between “earning” and “realization”. Summarizing, “earning” is a continuous process of value development, whereas “realization” is based on the exchange with a corresponding payment, or a valid promise to pay a monetary consideration.

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*Substance over form.* According to Besta, “de facto” situations have to be considered in the search for the firm’s wealth measurement. He argues that legally owned goods are worthless if they are never owned de facto. The value of goods refers to their accessibility and free use, resulting in their possession. The latter has to be considered complete only when guaranteed without any time constraint (Besta, 1922: vol. I, 72 and followings).

*Comparability.* Finally, Besta asserts the necessity to preserve the evaluation criteria unchanged, in order to allow the comparability of financial statements in time. If the net worth value increases due to changes in the evaluation criteria, the resulting added value cannot be considered as a profit but has to be allocated in a specific reserve. On the contrary, a decrease in the net worth value has to be considered to all purposes as a loss (Besta, 1922: vol. III, 608).

### **3. Rationale of the IASB model**

Following the description of Besta’s theory, this section summarizes the main features of the IASB model before introducing the comparative analysis between the two approaches.

#### **3.1. Early theoretical foundations**

The IASB model is to a certain extent affected by the Anglo-Saxon accounting traditions. This is essentially due to the predominancy of Anglo-Saxon countries in the standard-setting process (see, among others, Briston, 1978; Chandler, 1992 and D’Arcy, 2001). In a nutshell, within the Anglo-Saxon accounting culture what really exists is the firm’s wealth from which income derives, although financial statement information pays attention to this latter as the index of the return of the amount invested by stockholders. The firm’s wealth is considered as an algebraic sum of single items with an individual autonomous existence and value. Thus, the point of view remains mainly “patrimonial-atomistic” (Viganò, 1996: 132). Similarly, the “patrimonial” nature of the Anglo-Saxon accounting is underlined in Zambon (1966: 132) by recalling Paton’s words:

*“... all possible types of occurrences and processes, in all business enterprises, can be dissected into property and equity elements if all necessary data are immediately available. This being the case, expenses and revenues can be rationally explained as phases of the properties and equities”* (Paton, 1922: 142).

Precisely, the IASB model is based on the “asset and liability view”, which is the accounting theoretical approach used by several Anglo-Saxon standard-setting bodies, e.g. FASB, to develop conceptual frameworks (Johnson, 2004). This approach assigns conceptual primacy to the firm’s wealth, as reflected in its economic resources (assets) and its obligations (liabilities); revenues and expenses are indirectly defined in terms of changes in assets and

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liabilities. Accordingly, profit results from changes in assets and liabilities that increase the firm's wealth, and losses result from changes that decrease its wealth<sup>14</sup>.

Finally, between the 1960s and 1970s, the Decision-usefulness Theoretical Approach assumed a predominant role within Anglo-Saxon accounting. This doctrinal orientation has strongly influenced the IASB activity. On the basis of this approach, financial statements must provide useful information to investors in order to make the capital allocation process more effective (see, among others, Staubus, 1961; Sterling 1972).

### 3.2. Conceptual Framework

The description of the IASB model is carried out analyzing the *Framework for the Preparation of Financial Statements*, issued by the IASC in 1989 and adopted by the IASB in 2001. It is an important document adding to IFRS that provides a theoretical reference framework to deductively derive a coherent set of accounting standards. Actually, the IASB standards refer to an accounting model of professional origin that was created and developed on the basis of an inductive approach. Starting from the observation of companies' real behavior in the preparation of financial statements, the standard setters came to the definition of general accounting principles, criteria and techniques. Since 1989, the board has been trying to change its previous approach towards a deductive one. This process is still in progress; in fact, the Conceptual Framework is not considered as an accounting standard. In the case of conflict, the requirements of IFRS prevail over those of the Conceptual Framework (Framework, 1989, paragraph 3, hereinafter abbreviated F.3). In other words, the Framework is hierarchically subordinated to IFRS<sup>15</sup>. In spite of its limitations, the Conceptual Framework is the document from which, anyhow, it is possible to derive the financial statement model that brings together the numerous norms issued by the IASB<sup>16</sup>. A presentation of the theoretical framework issues that are the most pertinent to the present research follows.

*Objective of financial statements and their users.* Coherent with the Decision-usefulness Theoretical Approach, the objective of financial statements is to provide information about an enterprise's financial position, performance and changes in financial position which is useful to a wide range of users for making economic decisions (F.12).

Since investors are the risk capital main providers, the IASB presumes that a financial statement that aims to satisfy investors' information requirements may also fulfill the main expectations of the other users. In order to make their economic decisions, investors need to

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<sup>14</sup> Anthony (1966), Sprouse and Moonitz (1962) are among the main supporters of this doctrine.

<sup>15</sup> An attempt to overcome this subordination is present in the recently revised (2004) IAS 1 (F.17).

<sup>16</sup> It is worth remembering that, since 2004, the IASB has been studying the Conceptual Framework revision to move it closer to the corresponding Financial Accounting Standards Board (FASB) document (Statement of Financial Accounting Concepts).

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know the ability of an enterprise to generate cash and cash equivalents and the timing and certainty of their generation (F.15). The whole IFRS financial statement information system is planned to meet these cognitive requirements.

*Underlying assumptions and qualitative characteristics determining the usefulness of information in financial statements.* The Conceptual Framework sets out a collection of postulates that represents an essential reference for the financial statement preparation. Some of them are briefly recalled also in the IAS 1 (Presentation of Financial Statements). The IASB hierarchically organizes these principles as follows:

1. the underlying assumptions: accrual basis and going concern;
2. the first-level qualitative characteristics: understandability, relevance, reliability and comparability;
3. the second-level qualitative characteristics: materiality, faithful presentation, substance over form, prudence, neutrality and completeness.

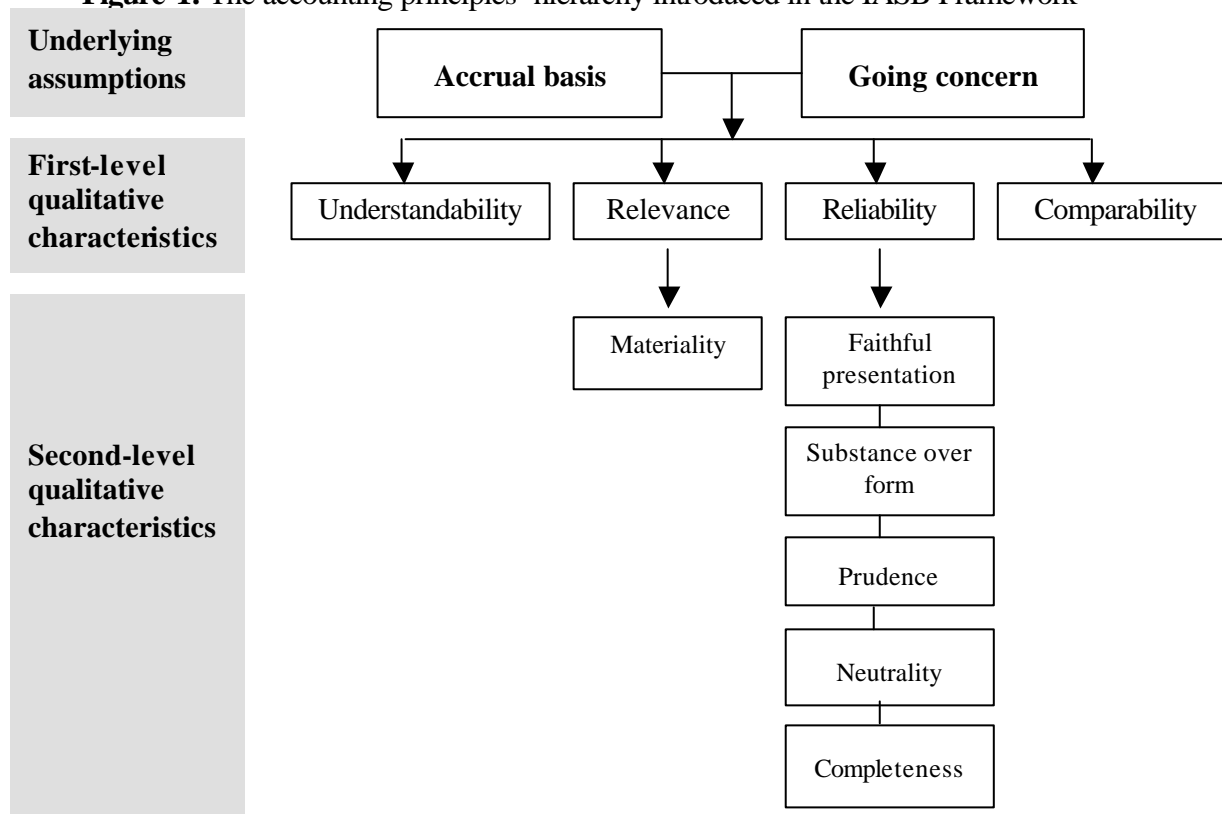
The above-mentioned classification is schematically represented in Figure 1.

The underlying assumptions (accrual basis and going concern) are the basis of the entire financial statement preparation process. The other recognition and classification criteria are based on them. According to the accrual basis, the effects of transactions and other events are recognised when they occur, rather than when cash or its equivalent is received or paid, and are reported in the financial statements of the periods to which they relate (F.22). This means that a transaction or event could occur regardless of the accomplishment of the exchange entitling the payment of a price. Actually, the Conceptual Framework also refers to the matching principle in recognising the effects of transactions or other events. It involves the simultaneous or combined recognitions of revenues and expenses that result directly from the same transactions or other events (F.95). As for the going concern principle, it presumes that an enterprise will continue to operate indefinitely; if that presumption is not valid a different basis of reporting is required (F.23).

Finally, the qualitative characteristics (first and second-level) are the attributes that make the information in financial statements useful to users' economic decisions (F. 24 and followings).



**Figure 1.** The accounting principles' hierarchy introduced in the IASB Framework



*Financial statement elements and their recognition criteria.* Within the Conceptual Framework, the definitions of the financial statement objectives and postulates are followed by the identification of the financial statement elements. The elements directly related to the measurement of the financial position in the balance sheet are termed assets, liabilities and equity; the elements directly related to the performance measurement in the income statement are termed revenues and expenses. The IASB provides a precise definition for each of them. Assets and liabilities are defined as resources and obligations from which economic benefits are expected to flow to or from the enterprise respectively, and equity is the residual of assets after deducting all liabilities. Revenues and expenses are defined in terms of changes in assets and liabilities, that is: revenues are meant as inflows or enhancements of assets or decreases of liabilities that result in equity increases; expenses are meant as outflows or depletions of assets or incurrences of liabilities that result in equity decreases (F.49 and followings). These definitions suggest that the IASB Framework assigns conceptual primacy to the assets and liabilities concepts. Otherwise stated, the centrality of wealth as the major measure of the

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whole system of the firm's values emerges, as well as the value of income as an increasing or decreasing quantity of the firm's wealth itself. These ideas are typical of a "patrimonial" approach.

Financial statement elements are concretely recognized on the balance sheet or the income statement, if they jointly fulfill the following two conditions (F.83): (a) it is probable that any future economic benefit associated with the item will flow to or from the enterprise; (b) the item has a cost or value that can be measured with reliability.

These requirements lead to some important remarks. Firstly, within the assets and liabilities recognition criteria, the requirement of the probability to generate or use economic benefit flows is directly connected to the ability to produce cash flows or cash equivalents. The same remarks also hold for revenues and expenses, since their recognition is connected to a change in the value of assets and liabilities (F.70). Secondly, in coherence with the previously described accrual basis, the revenues and expenses recognition is not accomplished in a precise moment: it can take place at different moments before, at the same time of or after the moment in which an exchange entitling the payment of a price takes place; that is, when the probability of obtaining incoming or outgoing reliable financial flows is perceived (see Lionzo, 2004). Consequently, the recognized revenues and expenses can be: (a) monetary, concerning an event realized on a monetary basis as a consequence of the ordinary and non ordinary activity; (b) non-monetary, concerning an event not realized on a monetary basis deriving from the assessment of both current and non-current elements. This classification leads to an income composed of realized and unrealized values; the last ones include appraisal surpluses.

*Measurement of the elements of financial statements.* IFRS consider two different measurement systems, namely: (a) historical-cost; (b) fair values, based on values apt to disclose the firm and environment conditions in the recognition moment. According to the IASB, fair value is intended as the consideration for the exchange of an asset or the cancellation of a liability between knowledgeable, willing parties in an arm's length transaction<sup>17</sup>. It resembles a "fair market value" concept (see Cairns, 2006; Del Pozzo, 2007).

Although conceptually different, these two systems are not mutually exclusive. Their combined use is prescribed for the determination of financial statement elements. The Framework (F.100) refers to four measurement criteria that would allow the accomplishment of the two systems. These are: (a) historical cost, (b) current cost, (c) realisable (settlement) value, (d) present value.

As in the recognition criteria of the financial statement elements, the choice of the measurement system is based on the possibility to disclose to the users the firm's potential ability to generate cash and cash equivalents in the future. Thus, the measurement criteria of

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<sup>17</sup> The definition of fair value is recalled in several IFRS. The one provided by IAS 16 (IASB: 2003) is used throughout the paper.

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the financial statement elements are directed to disclose their reliable recoverability (assets) and receivability (liabilities). This is done according to an atomistic-reductionist vision of wealth, that does not take into account the systematism and complementarity of the firm's wealth items. That is, all firm's wealth items are assumed as perfectly measurable on an individual basis.

#### **4. The IASB model and Besta's theory: a comparative analysis**

##### **4.1. The comparative analysis method**

The comparative analysis between the IASB model and Besta's theory aims to highlight the common issues between the two approaches as well as their differences, with the intention of pointing out the topicality of Besta's thought. In so doing, the objective is to resort to the help of history to understand better and evaluate more efficaciously current accounting attitudes. For this research, it is useful to divide the analysis into two parts. The first one concerns the basic elements characterizing the two approaches; the second one involves the measurement criteria of some balance sheet items.

Focusing on the basic elements (whose results are reported in Table 2), the comparative analysis is carried out according to the following method: for each element characterizing the IASB model its correspondence with Besta's theory is searched on the basis of three alternative conditions, namely:

1. the element is explicitly referred to within Besta's theory. It is the situation in which a concept is basically equivalent to the IASB one, even in the case when a different terminology is used;
2. the element is implicitly referred to within Besta's theory, that is, the specific concept is not developed explicitly but it can be gathered or inferred;
3. the element is not referred to within Besta's theory.

Concerning the second part of the analysis (see Table 3), categories of balance sheet elements are identified to realize a comparison among the measurement criteria of some firm wealth elements. For each category, the similarity is recognized by distinguishing between three alternative levels: high, low and null. This distinction is made according to the substantial equivalence between the two approaches with respect to each measurement criterion.

##### **4.2. Results**

The comparative analysis provides interesting results, since it allows the detection of various connections between Besta's theory and the IASB model. In the following, the results of the basic elements analysis are presented beforehand, the similarities among the measurement criteria of some balance sheet elements afterwards. For the accomplishment of

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the whole analysis, it is essential to retain that the two approaches were developed in two different historical moments.

*The elements characterizing the two approaches.* The comparative analysis reveals that the two approaches share the same theoretical foundations, namely the “patrimonial” accounting approach and the atomistic-reductionist vision of wealth (Table 2). As previously described, both Besta’s theory and the IASB model use an accounting approach based on wealth. The IASB model is founded on the “asset and liability view” which focuses on the firm’s wealth, as reflected in the balance sheet, and on its changes. The same theoretical perspective holds for Besta’s theory, where the accounting system is named “patrimonial”. Within these two approaches the definitions of revenue and expense are strictly related to the concepts of assets and liabilities; that is, revenues and expenses express variations of assets and liabilities. Accordingly, income results from changes in those assets and liabilities that increase or decrease the firm’s wealth during the accounting period.

**Table 2.** Comparison between the basic elements characterizing the IASB model and Besta's theory.

IASB model	Correspondence with Besta's theory
<b>Theoretical foundations:</b>	
Patrimonial approach	Explicitly referred to
Atomistic-reductionist vision of wealth	Explicitly referred to
<b>Objective of financial statement:</b>	
To provide information about the enterprise ability to generate cash and cash equivalents that are useful for users' economic decisions.	Not referred to
<b>Users of financial statement:</b>	
Present and potential investors	Implicitly referred to
<b>Underlying assumptions:</b>	
Accrual basis	Explicitly referred to
Going concern	Implicitly referred to
<b>Qualitative characteristics that determine the usefulness of information:</b>	
Understandability	Not referred to
Relevance:	Not referred to
- materiality	Not referred to
Reliability	Not referred to
- faithful presentation	Implicitly referred to
- substance over form	Explicitly referred to
- prudence	Explicitly referred to
- neutrality	Not referred to
- completeness	Not referred to
Comparability	Explicitly referred to
<b>Definition of financial statement elements:</b>	
- assets	Explicitly referred to (some aspects)
- liabilities	Explicitly referred to (some aspects)
- equity	Explicitly referred to
- income	Explicitly referred to (some aspects)
- expenses	Explicitly referred to (some aspects)
<b>Recognition of financial statement elements:</b>	
It is probable that any future economic benefit associated with the item will flow to or from the enterprise.	Not referred to
The item has a cost or value that can be measured with reliability	Explicitly referred to
<b>Measurement of financial statement elements:</b>	
Historical-Cost	Explicitly referred to
Fair values	Explicitly referred to
<b>Income statement:</b>	
Composed by realized and unrealized values	Implicitly referred to

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As for the atomistic-reductionist vision of wealth, it is the foundation of the IASB measurement system. This latter aims to emphasize the firm's ability to generate cash and equivalents in a perspective of "cash flow" that is useful for users' economic decisions (mainly for investors). By so doing, all wealth items are considered as perfectly measurable on an individual basis. In Besta's time the "cash flow" perspective was not feasible: the typical manufacturing company was a small enterprise serving local markets, with few investors. It was often an extension of an individual proprietorship or a partnership. Nevertheless, the basic idea characterizing Besta's theory is that each wealth item can be observed and measured separately and independently from the others, so that it is possible to recognize the continuous changes in the whole set of wealth elements. In view of that, the firm's wealth is assumed as a mere sum of value-elements rather than an interconnected system of value-elements. The present study proceeds by considering the sharing of the theoretical foundations as the basic cause of the similarity between the two approaches.

The different historical moment is almost certainly the reason for the diverse objectives assigned to the financial statement. In IFRS case, the financial statement is the device to encourage the financial resources' efficient allocation, within an economic framework characterized by alternative investment opportunities. Instead, Besta considers the financial statement as the device to keep the firm's wealth under control. This latter was intended as a primary production factor within an economic framework mostly characterized by family firms, in which the attention was focused on the processes of wealth investment and growth. Notwithstanding the different purposes ascribed to the financial statement, in both approaches financial statement users are equity capital providers, although under different forms.

Moving to the IASB accounting tenets, their hierarchical order is not considered within Besta's theory, but many similarities are found with Besta's ideas. The main reference is to the accrual basis principle; both approaches distinguish between the moment of events verification and the one involving their realization through the exchange entitling the payment of a price. In Besta's thought every change in value in the wealth elements, even temporary, is considered a profit or a loss. Thus, the exchange against cash or a claim to cash or pay is not the reason for a profit or a loss; its function is to establish the actual measure of a profit or a loss. Therefore, the IASB rule to recognize transactions or other events at the moment they occur, instead of when money or its equivalent is paid or received, remains shareable. Differently from Besta's theory, the IASB model also refers to the matching principle (F.95) according to which in measuring net income for an accounting period, the expenses incurred in that period should be matched against the revenues generated in the same period. In this respect, it could be arguable that the matching principle reveals that the IASB model also

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contains some elements of another accounting paradigm named “revenue and expensive view” (Wüstermann and Kierzek, 2005)<sup>18</sup>.

An explicit reference to the going concern principle is missing in Besta’s theory. Nevertheless, he emphasizes the requirement to measure the firm’s wealth with different criteria depending on the determination of the accounting period income, or on the research of “the real value of a firm, or of its portions” for other different purposes (Besta, 1922: vol I, 262).

As for the qualitative characteristics determining the usefulness of accounting information, some of these features are also present in Besta’s idea. They are: the faithful presentation, the substance over form, the prudence and comparability. Of course, Besta can not refer to them as qualitative characteristics useful for economic decisions, but he simply considers them as general accounting principles for a “correct” financial statement preparation. The analysis reveals that according to the IASB model, information, in order to be reliable, must faithfully represent transactions and other events (F.33). This concept is not explicitly considered in Besta, but it can be inferred from the requirement of fairness he prescribes for business managers (Besta, 1922: vol II, 186). The correspondence concerning the substance over form principle derives from Besta’s opinion about the determination of the firm’s wealth. He argues it has to be performed considering the actual (*de facto*) conditions instead of the legal ones, in accordance with the IASB model (F.35). In other words, the substance of the firm’s wealth is not always consistent with what emerges from the legal form. In this respect, the substance over form principle is a natural consequence of the faithful representation of accounting information. Finally, for both approaches, the prudence principle is intended in an administrative rather than estimative sense: the behaviour of the person responsible for the financial statement preparation should be inspired by sound, honest and conscious management rules (so that assets or revenues are not overstated and liabilities or expenses are not understated), rather than by rigorous rules applied to evaluate each wealth item. In this perspective, the prudence principle is hierarchically subordinated to the accrual basis one whereas, under IFRS, it is also instrumental to the reliability of the financial statement information.

Several similarities can also be found within the definitions of the financial statement elements. Although the IASB model considers the financial statement items in a perspective of cash generating ability, assets are defined as resources controlled by the enterprise and

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<sup>18</sup> Under this approach, the objective of financial statements is to provide information on the firm’s performance by means of periodic net income resulting from the proper matching of revenues and expenses; the latter are directly defined in terms of accomplishment and effort relating to the firm’s business activity (Paton and Littleton, 1955), whereas assets and liabilities are the “store” residuals arising from the matching and allocation process (Schmalenbach, 1919). The “revenue and expensive view” was developed by different authors in different periods. Nevertheless, the main contributions came from Schmalenbach in the early 20<sup>th</sup> century, followed by Paton and Littleton in the 1950s.

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liabilities as obligations, that is, they are positive and negative items of the firm's wealth respectively. It could be likely that the principle of substance over form also within Besta's theory may have as a consequence that an asset can be recognized only if it corresponds to a resource controlled by a firm. The definitions of revenues and expenses are identical with regard to the strict relation to the assets and liabilities concepts; this correspondence derives from the common "patrimonial" accounting approach. Actually, Besta refers to gross profits and losses in place of revenues and expenses, but these represent for all practical purposes the firm's net worth increases or decreases.

The recognition criteria of the financial statement elements are quite alike in terms of the reliable measurement of their value. In Besta's thought, this is verifiable with reference to the need to use the "effective cost" criterion each time the market does not allow plausible measurements. Instead, any reference to the probable economic benefits flowing in or out of an enterprise with the recognition of a financial statement element is missing. This latter requirement remains a direct consequence of the purpose assigned to the IASB financial statement.

A notable similarity also emerges with respect to the measurement criteria. In fact, in Besta's opinion the value of wealth and, consequently, of its constituents is an "actual value" consisting, in principle, in the replacement cost. When the financial statement elements are frequently exchanged on a monetary basis, it is possible to assume that their "actual value" is the "common or normal" price, corresponding to the average between the minimum and the maximum market price. These concepts reveal a similarity to the fair values measurement criterion introduced in the IASB model. Furthermore, the two approaches consider the use of the historical cost measurement criterion in addition to current values. In particular, Besta refers to the "effective cost" corresponding to the historical cost including all the availability fees.

Finally, the described features of both models lead to the recognition of an accounting period income composed by unrealized and realized values. Under the IASB model, income might encompass elements such as gains and losses resulting from changes in value of assets and liabilities (F.76 and 80) (e.g. IAS 39, 40 and 41), apart from revenues and expenses arising from the recognition or derecognition of assets and liabilities. Actually, not all the revaluation or restatement of assets and liabilities are included in the income statement, some of them are included in equity as capital maintenance adjustments or revaluation reserves under the concept of capital maintenance (e.g. IAS 16 and IAS 38). Considering Besta's idea, he does not really refer explicitly to unrealized values. However, his considerations about the accrual basis and the requirement of the "actual value" measurement criterion allow the presumption that the recognition of unrealized values for income determination is present in his thought.



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*Measurement criteria of some balance sheet items.* The analysis proceeds through the comparison between the measurement criteria of some balance sheet items that arise from the two theoretical frameworks (Table 3). As expected, in Besta's time, relatively few kinds of equipment were used in production whereas goods were produced for a limited market area. In such a condition, the balance sheet showed a wealth situation composed by elements that differ from the contemporary ones for quali-quantitative characteristics. Accordingly, non-perfectly homogenous balance sheet items categories have been identified for the comparative analysis; in this respect, a comparison is partially possible and in reference to only some items. For instance, categories such as Intangible Assets and Financial Instruments include a wider range of wealth elements, some of which did not exist in Besta's time; a similar remark also holds for instruments such as consolidated accounts.

Notwithstanding these limitations, the comparative analysis can help to understand the role played by the measurement systems (historical-cost and fair values) within the two approaches. Table 3 shows that the fair values model is often proposed by IFRS as an alternative to the historical-cost one (e.g. Property, Plant and Equipment, Intangible Assets), the latter potentially remaining the reference assessment criterion. Fair values are used as benchmark treatment only for Investment Property, Biological Asset and Financial Instruments available for sale.

**Table 3.** Balance sheet elements measurement criteria: comparison between IFRS and Besta's theory

CATEGORY	IFRS	BESTA'S THEORY	Similarity level
<b>Inventories</b>	The lowest between cost and net realisable value.	Exchange value. Effective cost is recommended in the absence of an active market, provided that it is lower than the selling price.	Null
<b>Property, Plant and Equipment</b>	Initially, cost. Subsequently: <ul style="list-style-type: none"> <li>▪ cost, or</li> <li>▪ revalued amount (fair value).</li> </ul>	Exchange value. Effective cost is recommended in the absence of an active market.	Low
<b>Loans and Receivables</b>	Initially, fair value. Subsequently, amortised cost using the effective interest method.	Present value.	Low
<b>Equities and Bonds</b>	Initially, fair value. Subsequently: <ul style="list-style-type: none"> <li>▪ amortised cost using the effective interest method (held-to-maturity);</li> <li>▪ fair value (available-for-sale).</li> </ul>	Exchange value.	Low
<b>Investment in Subsidiaries and Associates</b>	Investment in subsidiaries: <ul style="list-style-type: none"> <li>▪ consolidated financial statements;</li> <li>▪ separate financial statements: cost or fair value in accordance with IAS 39.</li> </ul> Investment in associates: equity method.	Equity method. Alternatively, the exchange value is applicable.	Low
<b>Intangible Assets</b>	Initially, cost. Subsequently: <ul style="list-style-type: none"> <li>▪ cost, or</li> <li>▪ revalued amount (fair value).</li> </ul>	Effective cost.	High
<b>Investment Property</b>	Initially cost. Subsequently: <ul style="list-style-type: none"> <li>▪ fair value, or</li> <li>▪ cost.</li> </ul>	Exchange value. Effective cost is recommended if the exchange value calculation is uneconomical.	High
<b>Biological Assets and Agricultural Produce</b>	<ul style="list-style-type: none"> <li>▪ Biological assets: fair value;</li> <li>▪ Agricultural produce harvested from an entity's biological assets: fair value.</li> </ul>	Exchange value.	High

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Instead, in Besta's thought the basic criterion is the "actual value"; only the uncertainty in its calculation can justify the application of the "effective cost". An example highlighting this uncertainty is the measurement of Intangible Assets. In this case, Besta directly refers to the "effective cost". It is worth assuming that he proposed this criterion because it was difficult to presume the existence of an active market for these assets.

In conclusion, the above analysis overall reveals a moderate level of similarity. This is fairly surprising because of the common focus on the firm's wealth. In fact, for Besta, the accounting information system has to satisfy the information needs of the principal owner who has supplied both capital and entrepreneurial skills, thus, it should provide the most current wealth value through a current value accounting. For the IASB model, the measurement at fair values should directly follow from the objective of the "asset and liability view" to provide information on the firm's wealth, as reflected in its cash flows streaming in and out provided that they are measured with reliability.

## 5. Concluding remarks

This paper focuses on a past accounting theory developed by the Italian scholar, Fabio Besta, in the 1880s. The aim is to discuss its topicality in the age of IFRS by stressing on the importance of resorting to previous accounting solutions to understand better and evaluate more efficaciously current accounting scenarios. Since the IASB model uses an accounting approach based on wealth, this study addresses its attention to the "patrimonial" accounting approach developed by Fabio Besta. It was in use in Italy until the 1970s, after which the approach of another scholar, Gino Zappa, has been followed.

A comparative analysis between Besta's model and the IASB model is performed to underline the key common assumptions and differences between the two, whilst bearing in mind the different historical periods in which the two models were developed. In particular, it takes into account the theoretical foundations, the principles for the preparation of the financial statement and the measurement criteria of some elements of the financial statement.

Despite some important differences (e.g. the financial statement objectives), the analysis reveals various similarities. The two approaches seem to share the same theoretical foundations; namely the "patrimonial" accounting perspective ("assets and liabilities view" in IFRS setting) and the atomistic-reductionist view of the firm's wealth. Under the "patrimonial" view, the objective of the accounting system is to provide information on the firm's wealth as reflected in its assets and liabilities; income comprises all changes in those assets and liabilities, even those in value, and indicates the increase or decrease in the firm's wealth during the accounting period. Nevertheless, viewed from a "patrimonial" perspective, the IASB model raises some controversial issues. Firstly, while in Besta's thought the wealth basic measurement criterion is the "actual value" (the present market value), for IFRS the fair values measurement is often presented as an alternative to the historical cost one, which seems to remain the first reference measurement criterion. This is fairly surprising since the

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measurement at fair values at the end of each accounting period should follow from the objective of the “assets and liabilities view” to provide information on the firm’s wealth. Secondly, according to some IFRS not all changes in the fair values are included in the income statement, though they meet the definition of revenues and expenses. Some of them are instead included in equity as capital maintenance adjustments or revaluation reserves. In view of that, under IFRS, income is not properly equivalent to the firm’s wealth increase or decrease and consequently the reference concept of capital maintenance may remain unclear; that is, the entire set of IFRS seems to reference either to a financial or physical concept of capital maintenance. Thirdly, within these theoretical perspectives, both approaches reject recognition criteria of transactions or other events based on the realization principle (when cash or its equivalent is received or paid). This occurs in favour of criteria which allow the recognition of revenues and expenses as a result of changes in assets and liabilities and in their fair values (e.g. IAS 39, 40 and 41). Nevertheless, the IASB model also refers to the matching principle according to which expenses are recognized when they can be matched with the associated revenues. This is the case, for instance, of the recognition of the construct contracts (IAS 11) and the government grants (IAS 20). In this respect, it could be arguable that the matching principle reveals that the IASB Framework as well as specific IFRS also contain elements of another accounting paradigm named “revenues and expenses view”. In brief, under this paradigm, the focus is on the firm’s performance as depicted by its periodic income resulting from the proper matching of revenues and expenses of the period. As in Wüstermann and Kierzek (2005), it follows that the entire set of IFRS may not be classified as a consistent accounting system and that some contradictory accounting treatments coexist. In particular, a clear objective of IFRS financial statements may not be identified.

In summary, this research reveals the topicality of Fabio Besta’s thought in the period of IFRS, which was no longer in use because it was followed by Gino Zappa’s innovative ideas on accounting. By retrieving some similarities between Besta’s ideas and the IASB model this study has detected some possible ambiguity about the currently existing IASB model. The main problems encountered throughout the research concern the different historical periods regarding the two compared approaches. Besta’s theory was developed in the second half of the 19<sup>th</sup> century, when the economic activity was ruled by family owned firms. In his thought, the financial statement was a tool to keep the firm’s wealth under control. Whereas, the IASB model refers to an age of globalization of economic activities in which the financial statement is a device to encourage the efficient allocation of financial resources. Moreover, the IASB model emphasizes a “cash flow” perspective useful for economic decision making which could not have existed in Besta’s days.

In spite of its limits, the research reveals anyhow the role played by accounting history in understanding and enabling a more efficacious evaluation of current accounting practices, such as those related to the recent adoption of IFRS in Europe. This study could help

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contemporary accounting scholars in the current debate on the development of a proper set of accounting standards that have been taking place in the new international scenario.

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