

CONCEPTUAL FRAMEWORK COHERENCE: WHY AND HOW

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This paper proposes a basis for progress in the development of a conceptual framework as a basis for regulating GPFR. The broad socio-economic environment is explored to determine the primary purpose of GPFR and its regulation and, from this, to establish the high-level properties of a conceptual framework suitable for that purpose. Amongst the conclusions reached are that the coherence of the conceptual framework is a prerequisite for GPFR development. Coherence offers terseness in the conceptual framework and, thereby, the ability to arbitrate competing claims on GPFR. Identification of the primary purpose of GPFR and its regulation leads necessarily to adopting a specific view of the users, objectives, and qualities of GPFR. This specificity is not arbitrary but, instead, prioritizes satisfaction of the central drivers of conceptual framework development rather than every possible purpose of every possible claimant. The satisfaction of every GPFR user can only ever be incomplete and, thus, the general purpose of financial reporting would not be achieved by adopting a stakeholder theoretical view of the purpose of regulating GPFR. Consistent with the purposive approach we conclude in favour of the investor primacy principle, the proprietorship view of accounting, and the current value variant, fair value.

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Introduction

The development of conceptual frameworks (CFs) since the early twentieth century has occurred in the context of a discipline self-conscious of its history as an applied technology (Hendriksen, 1982). Theoretical nascence has informed the cautious steps made to distinguish General Purpose Financial Reporting (GPFR) specification from prevailing accounting practice (Staubus, 1999; Higson, 2003). Theoretical coherence requires the development of a complete, consistent set of principles (Hendriksen, 1982). Consistent with the motivation for normative accounting theories of the 1950s and 1960s, this paper argues for theoretical coherence as a basis to formalize and thus improve twenty first century GPFR. This paper therefore reviews twentieth century developments in CFs and GPFR and assesses the progress made in this field. A case is made that regulation of GPFR currently lacks a coherent basis. The argument does not entail that coherence will always or necessarily be tenable but instead, advances the case for a rebuttable presumption in favour of coherence by which departures require independent justification.

Coherence of the CF is a prerequisite for GPFR development. The failure of past CFs and GPFR resulted from the failure of standard setters overseeing ‘inventorial’ (of existing practice) approaches to accounting that were too descriptive of existing practice. This fact is noted by Gaffikin (2008), along with his observation that the distinction between *a priori* and *ex posteriori* theories of accounting and its regulation involve a false dichotomy. Coherence must start from the observation of important facts about the business reporting environment, and the CF developed deductively as a response to those facts. It must also introduce economy as a conduit to prescription if it is to avoid eclecticism. This approach is consistent with the (FASB/IASB) convergence project as it establishes the importance of a CF and GPFR that is standardised. Further, a basis for future GPFR developments is created by the prescriptions implicit in a purposive approach.

Section one briefly charts the history of CF development. The focus is primarily on the twentieth century and the US. The centrality of the US to the twentieth century global economy, the greater development of its financial markets, and the extent of the US influence on GPFR and its regulation all serve to justify this approach.

Section two defines theoretical coherence in relation to the development of CFs, GPFR and its regulation. CFs establish the principles guiding GPFR. They identify the users, explicitly define the objectives of financial reporting, its qualities, elements, and rules for recognition and measurement.

In this regard CFs play an important role in determining the nature and evolution of the rules of financial reporting. Contrary to the view of researchers such as Deane and Clark (2003, p.279) that the social and business environment provides all the guidance necessary for the development of GPFR and its regulation, the inductive empirical period to the mid 1950s showed this was not the case. Vexed questions about who the users are, what the purpose of financial reporting is, or which qualities are important suggest that CF development remains a challenge. The position of this paper recognizes Miller's (1985) concern that political constraints in the accounting standards setting environment may lead to inconsistent standards, although following the CF. The key point is that nothing about a poor CF improves this situation yet a well-formed CF has some prospect of doing so.

This paper argues that stakeholder theory along with other confounding influences, such as the use of stewardship as a conduit to historical cost based on the identification of investors as only those contributing capital at a company's initial listing, has constrained the development of a coherent CF. Opponents of investor GPFR user primacy have conflated the general purpose of GPFR with a diffuse set of specific purposes promoted by stakeholder theory. The central element of the case presented here is that the general purpose of financial reports is society's purpose and society *in toto* is primarily interested in the service GPFR can provide in terms of wider financial market stability and efficiency. Moreover, our focus is *financial* reporting, which restricts the focus of GPFR to strictly economic information and thus de-emphasises the recent focus on social, environmental reporting and, more generally, on sustainability outside of explicitly financial sustainability. This does not entail a rejection of the importance of these issues but raises doubts about the suitability of GPFR to address them.

Section three makes a case for the theoretical coherence in GPFR of accounting and provides recommendations for formalizing the basis for the regulation of GPFR.

Historical Background: the development of modern GPFR

Accounting evolved as an atheoretical technology for recording financial transactions. From its historical foundations GPFR has become central to the development of socialized capital, bridging the information gap between owners and managers of capital. GPFR as a monitoring system for this agency relationship was generally unquestioned until the 1960s (Arai, 1970) with GPFR targeting equity investors and creditors (Gray, Owen and Maunders, 1987). The development of stakeholder theory, from the 1960s, has been a source of pressure for the progressive extension of the range of users and of the information considered in the development of GPFR. This influence has played an

important role in preventing the development of a coherent theory of regulated external financial reporting.

Catalysts for past developments in CF and GPFR developments

Watershed developments in GPFR and its regulation have been and are responsive to the prevailing socio-economic environment (Salvary, 1979, p. 5; Dean and Clarke, 2003, p.282). History provides illustrations of regulation for GPFR being shaped by changes in the reporting environment (Cain and Hughes, 2006; Fogel, 1970). Subsequent to its nineteenth century origins in the UK, key developments in GPFR regulation have tended to occur in the US, as that nation came to assume dominant economic status. In the 1930s, early attempts to develop a coherent theory of GPFR were made in response to the 1929 stock market collapse and subsequent Great Depression (May and Sundem, 1976; Gaffikin, 2008). The Great Depression led to an increasing recognition of the need to augment then current Balance Sheet reporting requirements with an Income Statement (Hendriksen, 1982). The Great Depression also lent impetus to the project for the development of a CF for regulation of GPFR. The global social dislocation of this period established a key foundation for society's interest in financial reporting.

More recently, a succession of socioeconomic events have caused questions to be raised about the usefulness of historical cost accounting measurement. The Penn Central collapse in 1970 sharpened the focus on the limitations of existing historical cost accounting, particularly its reliance on transactions-based recognition which allowed the manipulation of financial reports by selective recognition of losses and gains via disposals (Salvary, 1979). This manipulation could aggravate firm financial fragility due to the progressive preponderance of poorly performing assets in firms' portfolios, as managers had incentives to retain assets that had decreased in value while selling those on which they could 'book' a profit. The high inflation of the 1970s and early 80s also challenged established financial reporting practice. The perception of progressively declining relevance of historical cost accounting caused growing support for competing accounting measurement bases (Mattessich, 1995). However, when inflation receded in the early 1980s the immediate threat to historical cost accounting measurement dissipated. Nevertheless, variants of current cost accounting had established themselves as alternative measurement bases and when the Savings and Loan crisis of the 1980s renewed the threat to historical cost, the progression towards fair value accounting measurement gained momentum.

In the wake of the 1929 US (and global) stock market crash the US government moved to increase financial markets' regulation. The 1933 Securities Act supported a preference for investor-

focused financial reporting (Beaver, 1981; Bush, 2005, pp. 13-15). The 1934 Securities Exchange Commission Act established the SEC with responsibility for financial market oversight (Bush, 2005, pp. 11-18; Giroux, 1999; Beaver, 1981). It was in this context that the demand for a deductive theory of accounting arose (Most, 1982). No longer was existing Generally Accepted Accounting Practice considered adequate, as it was implicated in the economic malaise of the time. The widespread economic and social harm caused by the market breakdown demonstrated the ability of financial market turmoil to spread across society as a whole, causing high levels of unemployment and related social costs (Carcello, 2007; May and Sundem, 1976; Sunder, 2007). This environment led the American Accounting Association (AAA), formerly the American Association of University Instructors in Accounting, to issue *A Tentative Statement of Accounting Principles Underlying Corporate Financial Statements* (1936). This is the earliest authoritative promotion of a deductive approach to accounting theory, supporting the post-1933 shift in regulatory focus to investors and creditors (as distinct from management) and the information focus of GPFR (Bush, 2005, pp. 28-29; Watts and Zimmerman, 1979). Revisions followed in 1941, 1948 and 1957 (Zeff, 1979).

The transition from the inductive-empirical period to an (implicitly) deductive approach to CFs and GPFR

These early developments were advanced sporadically in the years prior to the establishment of the Financial Accounting Standards Board (FASB) in 1973. Under delegation from the Securities Exchange Commission (SEC), from 1939 until 1959, regulation of GPFR fell to the Committee on Accounting Procedures (CAP) and, from 1959 until the establishment of the FASB in 1973, to the Accounting Principles Board (APB) (Burton, 1978). The American Institute of Accountants (AIA) (later, the American Institute of Certified Public Accountants or AICPA), under urging from the SEC, had established the CAP which, during its incumbency, produced fifty-one research bulletins. Despite this, the CAP failed to develop a coherent accounting structure, causing it to be replaced by the APB in 1959 (Weinstein, 1987). The APB was tasked to develop a CF for accounting.

However, the APB's approach to the development of a CF lacked resolution (Burton, 1978), formalizing existing practice without an explicit theoretical basis. This occurred despite the fact that the motivation underlying the APB formation as successor to the CAP had been the unsatisfactory nature of existing practice. When Moonitz (1961) and Sprouse and Moonitz (1962) produced AICPA accounting research papers no. 1 and no. 3 on accounting postulates and principles the APB rejected them as "too radically different [from existing practice] for acceptance at this time" (APB, cited in, Zeff, 1979, p. 212). Consequently, the 1965 issue of AICPA Research Study No. 7 *Inventory of*

Generally Accepted Accounting Practice for Business Enterprises (Grady, 1965), took a more conservative approach than the 1961 and 1962 research studies, affirming existing practice. Subsequently, the AAA monograph *A Statement of Basic Accounting Theory* (ASOBAT) (AAA, 1966) adopted the more radical stance of Sprouse and Moonitz (1962), and advocated current cost accounting (Lewis and Pendrill, 2004).

The 1966 ASOBAT was an important turning point (Young, 2006). It rejected past approaches, including The Grady Report (1965) which had aimed to justify existing practice, on the assumption of its value. The Grady Report challenged the approach of Paton and Littleton (1940) in which an early attempt to establish the postulates of accounting was made. In their monograph, Paton and Littleton (1940) had employed a substantially deductive approach (Mattesich, 1995). The 1966 ASOBAT viewed accounting as a financial information reporting system. The aim of the system was to provide economic information to allow informed judgments and decisions by information users (Stamp, 1984). The case ASOBAT (1966) made for current cost was its relevance to users. It also held that while there were many users, their needs were similar (Trueblood Report, 1973; Young, 2006). This device gained currency from that point, muting the implication of diverse information needs across different users.

In 1970, after five years of study and a succession of drafts, the APB produced Statement No. 4 *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises* (Accounting Principles Board, 1970). The APB acknowledged its statement was largely descriptive of existing practice and not, as had been sought, prescriptive (Beaver, 1981; Zeff, 1979). The difficulty with this report was that its focus on existing accounting practice highlighted the inconsistencies therein. These inconsistencies meant that it was not very useful as a tool in setting standards (Johnson, 2004; Zeff, 1979). However, Statement no. 4 did formally articulate the move to elevate the information perspective over that of stewardship in accounting standards (Beaver, 1981; Storey and Storey, 1998; Coy, Fischer, and Gordon, 2001). Failure to develop a CF, compounded by the controversies over accounting for the investment tax credit and oil and gas accounting, led to growing criticism of the APB from within and beyond the accounting profession (Zeff, 1979; Weinstein, 1987). This led the AICPA to commission two major studies. These were to become synonymous with their authors, former SEC Commissioner Francis Wheat (The Wheat Committee Report, 1972) and the Trueblood Committee Report (1973), led by former Institute President, Robert Trueblood (Zeff, 1979).

The 1972 Wheat Committee Report recommended replacing the APB with the FASB and the 1973 Trueblood Committee Report provided the postulates giving direction to the (subsequent) FASB CF project. The Wheat Committee recommended the creation of a seven-man, full-time FASB to replace the volunteer-staffed APB. The Trueblood Report advanced arguments for decision-useful, relevant, investor-focused GPFR (Smith, 1996). It was proposed that the FASB would be established under the auspices of the Financial Accounting Foundation (FAF), composed of representatives of the AICPA, FEI (Financial Executives International), AAA and NAA (National Accounting Association). The Financial Accounting Standards Advisory Committee (FASAC) was also established, to provide questions of interest to the FASB (Schroeder, et al, 1991). Initially the FAF was to have a budget of between two and a half and three million dollars, composed of contributions from the preparer community. The APB terminated itself on the thirtieth of June 1973 to be replaced by the FASB on the first of July (Zeff, 1979).

The SEC gave formal support to the FASB when, in December 1973, it issued ASR No. 150, declaring that the, “standards and practices promulgated by the FASB in its statements and interpretations will be considered by the Commission as having substantial authoritative support and those contrary to such FASB promulgations will be considered to have no such support” (SEC, quoted in Zeff, 1979, p. 219). From this time the FASB began work on the development of a CF, based substantially on the recommendations of the Trueblood Committee. Progressively from this date the CF showed an increasing focus on prospective and decision-useful information that, while conceding multiple users, increasingly prioritized investors and creditors as the target of GPFR (Parker, 1982; Giroux, 1999). Trueblood’s focus on prospective information entailed a challenge to historical cost and its auxiliary assumption of matching (Flegm, 2000; Hawkins, 1973). These developments were reflected in the post-Trueblood era in the 1976 *Conceptual Framework for Financial Accounting and Reporting* issued by the FASB were confirmed in the following year by a committee of the AAA’s issue of *Statement on Accounting Theory and Acceptance* (Zeff, 1979; Shillinglaw, 1979).

From 1974 to 1985 the FASB developed SFACs 1-5 (the CF). The emphasis on prospective information gave implicit support for investors and creditors as the key users. This was a significant signal for future trends in standards and the emergence of coherence. Explicit reference to users as “*investors, creditors and others making economic decisions*” (SFAC, no. 1), combined with the investor user primacy principle (FASB, 1978, paragraph 34) affirmed the narrowing of the set of GPFR users (Stanton, 1997, p. 684). Although SFAC No. 1 identified 24 user groups it identified common information needs, consistent with those of sophisticated investors. SFAC-2 (1980)

Qualitative Characteristics specified the objective of GPFR to serve the public interest by providing financial information that enables the efficient allocation of resources (Flegm, 2000). SAC-3 also explicitly elevated relevance and prospective information, identifying a predictive and confirmatory function of such information (Schipper and Vincent, 2003).

Fair value as a result of the evolving CF project

From the late 1980s the FASB pushed for greater use of fair value accounting standards. The US CF was mirrored in developments in the international accounting standards issued by the IASC. The 1989 IASC Framework for the Preparation and Presentation of Financial Statements affirmed decision-useful, investor-focused information. This found further support in the Jenkins (1994) Committee Report which made the case for market efficiency and fair values. Progressively, the FASB and IASB (post-2000, as successor to the IASC) have moved to reflect common values and accounting treatments. To the current period a progressive narrowing of GPFR user definitions has been observed, reflected in 2008 in the FASB characterization of primary users as being investors and creditors and, in the IASB pronouncements, as current and prospective investors (Whittington, 2008, pp. 143-145). Lenders are still explicitly identified as users, as are creditors. In the 2010 IASB/FASB release of Chapter 3 of the developing joint CF, relevance and faithful representation have become the fundamental qualitative characteristic of financial information. The term faithful representation has replaced the term reliability to make clearer what was meant by reliability in the CF. Verifiability, the other common meaning of reliability, has been included in the CF as an enhancing qualitative characteristic.

In a further advance in CF coherence, one arguably inextricably linked to the growing momentum of fair value measurement, the trend towards representational faithfulness as a primary quality of financial reporting began as early as the late 1980s (Hendriksen and Van Breda, 1992). The significance of the CF substitution of representational faithfulness for reliability as a primary qualitative characteristic (OC 2-14; BC 2.13-BC 2.24, FASB, 2008; FASB, 2010), and in IASB discussion paper and ED, was that it muted the mutual exclusivity of relevance and reliability (IASB, 2005). This is consistent with the IASB's prioritization of relevance in its qualitative characteristic hierarchy (Whittington, 2008, p.146). Faithful representation includes the elements: completeness, neutrality and freedom from error (FASB Framework, 2010). Verifiability helps users to assure that information faithfully represents the economic phenomena it purports to represent and means that "... *different knowledgeable observers would reach the same general consensus, although not necessarily complete agreement...*". (IASB Framework, 1989, QC 23).

The ‘separation’ of reliability into faithful representation and verifiability was an important move by standards setters in the trend towards the coherence of singular measurement. It is not unreasonable to infer that this was an element of standards setters’ attempts to undercut historical cost (Whittington, 2008, pp. 143-6).

The broad trends described in CF development involve the fundamental precepts informing GPFR development. These include: the objectives of stewardship counter-posed with decision-usefulness; the qualitative characteristics of relevance and reliability; reconciliation of the aims and qualities of GPFR; and evolving definitions of these elements to facilitate reconciliation. These issues were central to the relevance/reliability debate. One manifestation of this conceptual-level debate is the valuation debate between fair value and historical cost. In broad terms the debate has been between those in favour of traditional accounting, entailing the priority of stewardship, reliability and historical cost, and the ascendant decision-usefulness, relevance and fair value. The described trends broadly reflect an implicit trend towards the coherence made explicit in this paper.

The essential elements of a coherent CF and the implications of this for GPFR

Table 1. A summary of the proposed approach to CF and GPFR theoretical development and previous approaches

Approach	Coherence	Inventorial (of existing practice)
1. Level of abstraction	Macro-level deductive-empiricism	Micro-level inductive-empiricism
2. Principle basis	Purposive-the general purpose of GPFR	Purposes-of all stakeholders
3. Extent of domain	Parsimonious, defining a narrow domain; prescriptive <ul style="list-style-type: none"> • Entity type: profit • Entity view: proprietorship • Information users: investors 	Extensive, defining a broad domain; descriptive <ul style="list-style-type: none"> • Entity type: profit/non-profit • Entity/accountability view: stakeholder • Information users: all stakeholders
4. Assumptions	1. Aim for GPFR regulation that has a hierarchy of purposes 2. The primary purpose should inform all subsequent developments in the regulation of accounting 3. Cost-benefit is a constraint 4. Progress must target steps <i>towards optimisation</i> 5. Resolving all conflict instantaneously is unrealistic	1. Offers no hierarchy of priorities 2. Each stakeholder's needs should be accommodated 3. Cost-benefit indifferent 4. Progress must be <i>to optimisation</i> 5. All conflicts must be resolved instantaneously

5. Implications	<p>1. High quality financial standards that support society's demand for stable financial markets, through efficient capital allocation are the aim</p> <p>2. Investor primacy narrows users and their needs</p> <p>3. Relevance & decision-usefulness are prioritized</p> <p>4. Relevance & reliability are complementary</p> <p>5. Decision-usefulness and stewardship are reconciled</p> <p>6. Fair value is indicated</p>	<p>1. Market stability and efficiency is subordinated to the partial satisfaction of all stakeholder needs.</p> <p>Subordination of the general purpose to many specific purposes</p> <p>2. Exhaustive range of financial and non-financial information is required for diverse users</p> <p>3. Reliability & stewardship are typically preferred but without clear conceptual grounds</p> <p>4. Relevance and reliability are mutually exclusive</p> <p>5. Decision-usefulness & stewardship are mutually exclusive</p> <p>6. Historical cost is typically preferred, based on the stewardship and reliability preferences</p>
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Theoretical coherence

There are a number of important attributes of a coherent theory of accounting. These are identified in table two above as deductions from the purposive approach to accounting regulation. An accounting CF is best pursued by reducing internal conflict among the objectives and qualities of accounting information and this undertaking can be advanced by setting coherence as a primary feature of CF development. Standard setters' CF development has implicitly evolved to achieve such a consistent basis for the development of GPFR principles. This process has involved establishing a hierarchy of GPFR objectives and qualitative characteristics, and the reconciliation of different conceptual elements. The aim of this paper is to make explicit the largely implicit development of these foundations. Central to this process is the explication of the social welfare function presently missing from accounting research, as identified by Mozes (1992). The need for an explicit welfare function is due to the fact that a normative theory of accounting has wealth redistribution implications. In effect, coherence is the proposed solution to what has historically been a menu of potentially conflicting principles that have no mechanism to determine the hierarchy of those elements or to resolve conflicts. The proposal is advanced cognizant of the dissent and tension between users and between nations (Stolowy and Jeny-Cazavan, 2001, p. 494). This tension supports the view that CF coherence should provide a rebuttable starting point for GPFR development and that departures from this must be independently justified.

Walker (2003, p.340) summarized the essential elements of a CF, stating that its assumptions must be consistent with external user behaviours and practices, it must be expressed clearly, demonstrate an internal consistency and provide a comprehensive guide to financial reporting practice. A CF must hold a clear view of the objective of financial reporting from which logical, coherent standards can be developed. Walker argues that ideally a CF would cover all sectors but the diversity of users this would entail provides support for public benefit entity financial reporting to be separated from profit-orientated entity financial reporting (consistent with the views expressed by Sprouse and Moonitz, 1962). The descriptive characteristics of the framework should allow the use of induction (Walker, 2003, 3420; Miller and Redding, 1988; Mattesich, 1995), be of a general nature, and enable prediction.

The role of parsimony in coherent theoretical development

Following Beaver and Demski (1974) and Jensen (2001), theoretical coherence is most likely to be advanced by establishing the narrowest credible parameters to accounting's objectives and methodologies. Mattesich (1995) identifies the advantage of a theory as a logical, structured set of principles as being dependent on its economy. In the sense that these accounting researchers have identified terseness as a key virtue of any theory, the paper proceeds to define the most parsimonious plausible view of the determinative elements of a CF and its derivative, GPFR. This view is based on the purpose of regulation of GPFR.

Theoretical coherence requires a complete, consistent set of principles established to guide the development of concepts as the basis for rules and, where evolving issues extend beyond the rules developed, a deductive basis to infer the accounting treatments indicated (Hendriksen, 1982; Higson, 2003; Mattesich, 1995). In order to develop a coherent CF, following the concepts developed by Sprouse and Moonitz (1962), a definition of the environment in which accounting exists is required. Features of that environment include: the prevalence of the corporation; the separation of management and ownership of the modern corporation; predominantly market-based economies; and, voluntary labour (Sprouse and Moonitz, 1962). The relation of GPFR regulation to its environment must also be defined. This includes an assessment of the objectives of the regulation. These objectives have typically been drawn in terms of the mutual exclusivity of stewardship and decision-usefulness, thus adding complexity (Field, Lys, and Vincent, 2001).

The purposive approach as a conduit to coherence

Sprouse and Moonitz (1962) developed their broad principles from an explicit identification of key elements of the broad socio-economic environment. This paper follows in this inductive-

deductive tradition. The acceptance in this paper of certain accounting principles of Sprouse and Moonitz (1962) rests on their implicitly purposive approach and is the basis for the approach advocated in this paper. Spacek (1962) challenged the principles developed by Sprouse and Moonitz (1962) on the basis that they showed no necessary relationship to the fourteen postulates developed earlier by Moonitz (1961). The disconnection between the primitive variables of the earlier work and the principles ‘derived’ supports the re-assignment of the principles to the regulation of GPFR as opposed to accounting *simpliciter*. This entails starting at a higher level of abstraction in which *inter alia* companies already exist, they have a defined purpose, regulation is a fact in the world and it, similarly, has a purpose, and social construction creates conventional *objects*. Moonitz (1961) and Mattesich (1995) address their focus towards an appreciably more primitive ontology than is the case here, building from an atomistic analysis. The distinction in this paper is that we stipulate ontological elements that, in particular, Mattesich (1995) sought to establish. Mattesich’s approach is consistent with his objective of a theory of accounting, as opposed to the present objective of establishing a systematic basis for the CF and the application of this to GPFR.

The central theme underpinning the development of GPFR regulation is that it has been reactive to economic and financial market dysfunctions (Salvary, 1979, p. 5; Wells, 2003: Dean and Clarke, 2003, p.282). Deductively, the purpose is to ensure the production of company-specific financial information of a type and quality sufficient to ensure that accounting information deficiencies are not an independent cause of market failure. To this negatively defined aim of GPFR we can add the positive aim of the CF and regulation to support the efficient allocation of capital through the specification of GPFR. The argument is an objection to the suitability of GPFR to redress (negative) externalities and the greater relative suitability and agency of alternative, political mechanisms available in democracies. This, *inter alia*, means constraining financial reporting choices. This does not presuppose that GPFR developed consistent with such principles is sufficient to ensure the efficient allocation of capital, as was asserted by Trueblood (1973), but it is assumed as a necessary condition.

The description of the socio-economic environment identified by Sprouse and Moonitz (1962), informing GPFR, includes substantially private control of productive assets, free labour, and the market as the primary mechanism for the distribution of goods and services. We extend this descriptive approach to a description of the relationship of the publicly listed corporation to society. This is because the impact of GPFR specification is greatest in relation to publicly listed limited liability companies, allowing us to isolate the determinative features of GPFR as those unique to such entities, and therefore the central motivating imperative underlying GPFR. This, in turn, prioritizes

investors isolated from the management of their capital as the priority of the regulation of GPFR. This implication is reinforced by the typical causes of shifts in GPFR development; financial market dysfunction and its potential flow through to economic crises. The focus on investors derives from the residual nature of equity which leaves them in greatest jeopardy. Hence investors should be the priority of regulation. Implicit in this argument is the idea that accounting as a financial information system should seek to minimize information asymmetry between managers and investors to reduce this as a source of aggravation to any endogenous market instability.

The objective of eliminating financial reporting as a source of financial market instability or inefficiency supports the conceptual superiority of current values over historical cost, given the systematic homogeneity of current values. Nowhere could the argument be sustained that dated fair values constitute the best, most topical measurement base for informing market participants. This is qualified only to the extent that current market values are not available, creating the need to substitute estimates of current values for observable current values. In contrast, however, historical cost measurement is at best ‘proven’ temporally remote and heterogeneous fair value. The ongoing debate surrounding accounting measurement has focused on the current value proxy, fair value. Independent of the argument for current value accounting measurement, fair value has sufficient flexibility to enable on-going development. Objections to fair value typically relate to the excessive subjectivity introduced by levels two and three fair value. This is substantially a question of implementation and, thus, not systemic. This supports fair value as central to a coherent basis for specification of GPFR. This, in turn, supports the position of academics, such as Barth (1994) and Barth, Beaver, and Landsman (1996; 2001), for the extension of fair value accounting on the basis of its greater relevance to investors.

Assessing the implicit coherence of extant CFs

The case has been made that, to this point, CF development has loosely progressed as a search for coherence. Formalizing this process will consolidate standard setters’ progress towards coherence. Furthermore, it provides direction for future progress towards GPFR coherence. The foundation for the basis presented in this paper is the shift from consideration of the causes for regulation to that of the optimal response to those causes.

The purposive approach to regulation has a number of implications for the specification of that regulation. As market failures and scandals have been central to the development of GPFR, especially where those failures have had wider implications for society, the identifiable public good associated with accounting regulation is the minimization of such failures. This allows the deductive

inference of theoretical coherence of (regulated) GPFR for reduction or elimination of information asymmetries between management and investors. Equally, it addresses the ‘redistributional effects’ problem identified by Demski (1973, pp. 721-2) that dictates the need for an explicit accounting theoretical social welfare function by subordinating it to broader societal concerns. Demski’s (1973) (wealth) redistributional implications of a normative theory of accounting are a matter of interest to broader societal process; through, for example, taxation, other fiscal policies, and regulations. Accounting rules focus on company specific financial information and must prioritize societal welfare (their general purpose) through the fullest possible contribution to market efficiency and stability. This is the most GPFR can look to as its contribution to market efficiency, supporting the conclusion that the general purpose of GPFR is to support the efficient operation of markets. The priority for efficient allocation of capital allows the predication of GPFR users as investors, creditors, and lenders (as depicted in table 1).

Yet stakeholder theory has constrained the development of coherent GPFR by making the case for a wide range of GPFR users. The argument implies that the general purpose of GPFR is the purpose of every potential claimant to a stake in the company. Stakeholders and their information demands are typically loosely specified, finding definition in any group that influences or is influenced by the company (Schon, 1971; Roberts and Mahoney, 2004). On this basis the general purpose of GPFR is asserted as the specific purposes of myriad stakeholders (Laughlin, 1977). Practical cost-benefit constraints exist with the consequence that stakeholder theory effectively supports satisfying some of the information needs of all of the stakeholders. This, arguably, fails to satisfy any specific purpose. Moreover, the general or societal purpose of GPFR is compromised by the conflation of the general purpose with multiple specific purposes. Henderson and Pierson (1983) also describe the role of high-minded stakeholder theory in confounding the development of a consistent basis to GPFR.

GPFR is a public good which, if left to the market, would lead to underproduction of company-specific financial information. It is, however, a special case. The public good is fully delivered when the interests of the marginal contributors of capital are satisfied. In essence the public interest is in financial stability and GPFR’s contribution to the provision of investors with the information necessary to make capital allocation decisions (Staubus, 1999). In this sense the public interest is distinct from the investor and creditor interests but achieved incidental to the satisfaction of these specific interests. The public are effectively free-riders on a system that serves, and aims to serve investors. In fact, on the basis of research such as Lee and Tweedie (1980), and Bartlett and

Chandler (1997), many investors do not directly use GPFR and, thus, similarly free-ride on the effects of regulation of GPFR.

The function of the sparest plausible conception of the users of GPFR is central to a theoretically coherent CF. Beaver and Demski (1974), and Benston, et al (2006) suggest suppressing user heterogeneity to assist in the formulation of a coherent theory of GPFR. The FASB (2002, pp. 2-3) implies support for this view, stating that "*much of the detail and complexity in accounting standards is demand-driven*". This, arguably, hints at the coherence-confounding complexity born of a stakeholder conception of GPFR's purview. From this base regulation has the singular objective of establishing rules which produce GPFR that minimizes information asymmetries between management and investors (as shown in table one). This provides important foundations for choice of the type of information to provide to investors for decision making. Arguably, this undermines support for accounting conservatism, while supporting current values as a central implication of a coherent theory for GPFR.

Views confounding CF and GPFR coherence

A range of arguments for accounting conservatism and historical cost measurement claim support from the stewardship function of GPFR. These arguments often involve the fabrication of rigid conditions of static investment. That is 'investment' is defined as an occurrence at initial listing whereby subsequent secondary market transactions are exclusively conducted by traders (Bush, 2005). Further, it appears to be an implicit assumption that capital raising on secondary markets seldom occurs after the initial listing (Bush, 2005, pp. 2-3). These conditions are implicit in the stewardship priority where stewardship is inferred as accountability for the original capital invested, and this is used as the basis for an argument for historical cost accounting. This is, at the least, a very peculiar interpretation of stewardship. As historical costs are a matter of record, identifiable from a succession of annual reports, it is unclear how these costs are a deductively inferred implication of stewardship (Crowther, 2002). Relaxing the assumption of the self-containment of individual financial reports would reduce the dichotomy between stewardship and decision usefulness (Gerboth, 1973; Beaver, 1981; Crowther, 2002). Logically, stewardship and decision-usefulness move sympathetically, forming around current values. This view is advanced by the FASB (2007) and IASB (2006).

In making his case for historical cost and stewardship, the basic normative question of what accounting should be was attacked by Ijiri (1975). Ijiri isolated the novelty of accounting processes which defines the limits of accounting as a financial information system. He asserted the priority of

stewardship and historical cost measurement as essential elements of accounting on the basis of (then) current practice and his companion assumption that bias minimization or reliability are the primary features of information provided by GPFR. This position identified three parties central to the accounting process: the accountant, the accountor, and the accountee. Ijiri's view was that the primacy of stewardship is necessary to explain the role of each of the parties. This general position was reiterated in the AAA (1993) call for the re-assertion of the stewardship priority in accounting regulation and that a tension exists between stewardship and decision usefulness.

Ijiri's preference for accounting regulation motivated by stewardship was based on inductive empiricism. This is distinguished from deductive theories such as Chamber's Cocoa. The distinction is not as well defined as the competing theoretical bases imply (Gaffikin, 2008). Ijiri's empiricism asserts an approximation to the argument from conservatism; that what has been, has been for good cause. The empiricism applied in this paper simply isolates a different level of empirical foundation as the basis for deduction; that what has preceded in the way of regulation has been for a purpose and that purpose should be the primary aim of GPFR. Implicit in this position is that regulation should not look first to the methods of those producing GPFR to determine what financial reporting should aim to achieve, but rather to its purpose.

Ijiri's (1975) central concern was to minimize potential bias in accounting information. This directed him to conclude in favour of reliability (in the sense of verifiability) as the prime quality of accounting, leading him to his support for historical cost measurement and the inherent verifiability that records of past transactions entail. This argument is suspect in two regards. The perennial property of accounting, that it is a 'true and fair' account of a company's state, is not clearly a function of circumscribing demands on accountants' judgment. Arguably it is an injunction on preparer judgment and ethics. This supports sanctions for the failure to discharge professional responsibilities adequately rather than the simple avoidance of positive misstatements explicit in historical cost measurement. Secondly, historical cost measurement as a derivation from the accountability function is not free from bias, as realization determines recognition. 'Pure' historical cost measurement, under which downward impairments apply, does little to alleviate this. Impairment under historical cost is asymmetric and is achieved only at the cost of the principal virtue of historical cost measurement; that it is reliable as it is the result of a verifiable transaction. The failure of historical cost accounting to present a true and fair view through periods of elevated inflation and due to selective realization depicts a system that is biased.

Fair value as an implication of CF theoretical coherence

In contrast to the case for historical cost measurement, and allowing that the earlier description of fair value subjectivity as a subsidiary issue is possibly too thin, the position advanced in this paper makes the case for fair value measurement. There is no doubt that the subjectivity of levels two and three fair value measurement poses a serious impediment to the implementation of fair value as current value. The earlier description of excessive fair value subjectivity as a non-systemic issue or an issue of operationalization is based on the assumption of credible control mechanisms. These include any combination of: exclusive use of external valuers for ‘hard to value’ assets and liabilities; disclosure of the assumptions underpinning levels two and three valuations (Ryan, 2008, p. 1608); and, a more severely punitive legal framework for culpable misrepresentations (Chorafas, 2006). Each control mechanism presents certain problems but, arguably, none is greater than the systematic irrelevance of accounting information implied in litigation and contracting risk management asserted of historical cost and conservatism.

Importantly, and in relation to the extended view of accountability argued for in this paper, the distinction between current and prospective investors is rejected. As was described, investors can participate in secondary markets and buying equities in such markets does not definitionally entail trading as opposed to investment. Thus investors are potentially always interested users whether in their decision to buy, hold, or sell. Investment without review implies a stasis in the individual investor’s circumstances as a normalized condition and it presupposes that markets are perfectly efficient. Moreover, it assumes that the risk profile of a company and investors is static. The questionable nature of the assumptions about investors as original (from public issue) equity capital providers who hold indefinitely has the implication that current investors and potential investors are type identical.

In addition to fair value measurement, demand for prospective information in GPFR is also an implication of this paper. The singular implication of stewardship and (investors’) decision-usefulness arises at two comparative points. Those two points are any selected historical point since the inception of the company and the present. This consideration is distinguished from certain arguments for initial providers of equity as investors, against those who buy on secondary markets, characterized as traders. The latter point may be extended into the future as pertains to forecast information. Both the stewardship/accountability and the relevance/decision-useful motivations behind GPFR may be satisfied by this additional information. This position is an entailment of the temporal extension of the account function into the future. Clearly, managers can be called to account for current forecasts in the future. This extends accountability rather than ‘trading it off’ in

favour of relevance. The view of the compatibility of the two broad functions of GPFR contrasts to the charge that standard setters have subsumed stewardship into decision usefulness. The objection to standard setters' assumption that information relevant to investors will satisfy the demands of stewardship assumes the substantial mutual exclusivity of these objectives. This, in turn, draws support from the previously described narrow and abstruse definition of stewardship. It is unclear that such a definition is sustainable.

The importance of theoretical coherence for CFs, GPFR, and accounting

Theoretical coherence is essential to an applied technology (such as accounting) if it is to have a referent as the basis to formalize its structure (Inanga and Schneider, 2005; Zeff, 1971; Loftus, 2003, p. 298). Without coherence, debate becomes intractable, essentially degenerating into squabbles between different camps without an umpire to direct progress. The relevance/reliability debate has frequently taken this form. The assumed mutual exclusivity of each of these properties is used by the respective protagonists to argue that the other is making a case for irrelevant or unreliable GPFR. Mattesich (1995) describes the greater degree of logical precision that comes with theoretical formalization. At the broadest level GPFR as a system of rules needs to identify its purpose. Financial reporting has a government mandate, and that mandate exists for a purpose. However in the context of a progressively competitive market for financial information the position argued for here is that financial accounting should not rely on its regulated monopoly but instead strive to maintain it as a distinct competitive advantage. The specific technical competencies of accounting in the competitive financial information market can usefully inform the specification of accounting regulation but they should be seen in light of the signal advantage accounting holds as a regulated domain.

Coherence is consistent with the aim of the International Accounting Standards Committee Foundation constitution (IASCF) (2009), para. 2(a), "to develop, in the public interest, a single set of high quality, understandable and enforceable accounting standards." Coherence entails the singularity sought by the IASB's oversight body (the IASCF). This necessarily entails a spare territorial demarcation. Central to this, and the endeavor of this paper, is that dissimilar domains cannot be grouped. Beyond the proposed narrowness of users, objectives and qualities of GPFR, an implication of this is that investor primacy explicitly excludes public sector accounting from the IASB project. Moreover, inclusion of GPFR qualities and objectives, beyond the qualities most important to the primary users requires conclusive independent argument. Without this terseness debate surrounding CF development becomes intractable and regulation becomes little more than an inventory of placations of vested interests. These placations have been responsible for much of the

complexity and mixed-attribute nature of current accounting. They are also responsible for the retreat from fair value measurement during the Global Financial Crisis.

A complete CF should provide questions of interest for accounting research. In particular, researchers could address the causes of regulation and consider the optimal responses to such drivers. In this sense a coherent basis for regulation of GPFR as an applied technology is simply one that makes GPFR ‘fit for purpose’; where that purpose is defined, if not directly by regulators, then by the causes of regulation. Mattesich (1995) identifies the purposive approach as essential to an axiomatic theory of accounting, acknowledging the history of purpose-orientated accounting has manifested in the diversification of the discipline.

The process of developing a coherent theory of an applied technology is essentially a question of creating a basis for the optimization of the technology. It can be achieved by various methods of enquiry. Positivism as it is currently practiced can contribute to identifying the optimal form of regulation. For this purpose it need only deduce the purpose of regulation and then proceed to investigate the effectiveness of particular regulations. Such research can incorporate the existing focus on the behavior of managers and accountants in terms of accounting choices. The caveat to this is that such research will typically or necessarily, start with a regulation, proposed regulation, or theorized regulation as the basis for determining the interest of the questions it asks.

A role for positive accounting research within a normative framework

Employing positivism is important to the development of a coherent CF and GPFR. This idea follows the consistency of a normative theory supported by empirical methods asserted by Mattesich (1995). Positivists Watts and Zimmerman (1990) allow that positive theory can have normative implications once objectives are determined. The argument of this paper is that there is a value to asserting an analytical basis to empirical-statistical research. This is not retrograde as that positivist research is not rejected; it must, however, look outside itself to determine its focus. The standard objections of positivists to normative theories, that they are unscientific, are not relevant. By asserting a normative theory of accounting regulation and explicitly identifying that theory’s generative assumptions, the theory lays itself bare for assessment. As a starting point for empirical research the key issues determining the worth of normative accounting regulation theory are:

- Are the causes and motivations for the regulation of GPFR correctly identified?
- Can we establish the achievement of those objectives of GPFR by following the implications of the theory?

Assuming the answer to these questions is yes the theory constitutes a coherent basis for the regulation of GPFR.

Gaffikin (2008) identifies the distinction between deductive and inductive or *a priori* and *ex postteriori* theories as a false dichotomy. The view articulated by Gaffikin forms an explicit part of the basis for the approach developed in this paper. The objectives of accounting regulation are a deductive and an empirical matter. The question of the theory's satisfaction of the identified goals of allocative efficiency and financial market stability are the substantive part of a well-found accounting regulation research agenda. This approach contrasts with CFs of the past by identifying the origins of regulation and determining its objective. This bypasses a problem alluded to by Gaffikin (2008) that CFs of the past tend to have been inventories of existing practice.

Against this view Dean and Clarke (2003, p.279) and Salvary (1979, p. 1) argue that such an approach makes accounting a simulacrum of the thing it purports to represent. Their view is that CFs disrupt faithful representation and that the CF project itself is fundamentally ill-conceived. Further, they argue that the existing social, cultural, political environment in which business operates provides the necessary concepts and constraints for veridical financial reporting. On this view CFs actually constrains coherent, useful financial accounting and reporting. Their position supports Mattessich's (1995) view that care must be taken not to impound systematic measurement, information selection, or representation bias into the nominated model. The model must provide us with a good sense of its subject.

Conclusion

The history of developments in CFs and their theoretical basis over the twentieth century has been broadly one of progress. Generally this progress towards GPFR coherence has been atheoretical, occurring independent of an explicit, well-defined set of postulates or without any necessary derivation from the identified postulates. Often incremental movements have been made to narrow the suite of factors considered in regulation for GPFR. This has been identified in the 'primary user' device, the condensation of decision usefulness and stewardship, and the clarification of reliability. This paper derives principles to support these CF developments. This approach is based on the value attended to CF by striving for coherence.

The principles outlined have implications for twenty-first century CF and GPFR development. These implications include the priority of the investor and, as an entailment, preference for the proprietorship view of accounting. From this, combined with the argued for ubiquitous status of the investor as 'potential investor', the preference for current value and prospective information arises.

The case presented in this paper provides support for fair value accounting, subject to the caveat that the identified ‘rehabilitation’ of fair value occurs to address its operational weaknesses. Beyond these implications the theory provides indications of productive research agendas. These include: value relevance research, investor decision model research, and equity valuation implications of investor use of accounting information as an independent source of evidence on the efficiency of markets.

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