<u>Business Accounting II</u>

<u>Coursework</u>

<u>The role of a conceptual framework</u>

"If the IASB's movement towards the worldwide adoption of IFRSs is to be successful, the establishment of a more coherent international conceptual framework is necessary."

<u>Introduction</u>

The IASB which stands for the International Accounting Standards Boards was formed due to a number of different reasons. These reasons which be discussed later on in this essay. When the IASB was formed it still used the conceptual framework that was mentioned by the IASC (International Accounting Standards Committee) in 1989, the Framework for the Preparation and Presentation of Financial Statements and this will be explained including why we use the conceptual framework and who uses it. Also I will identify an accounting standard and will analyse what the framework says about it and the link between the framework and the standard. Also the advantages and disadvantages will be mentioned along with a conclusion.

<u>Brief History</u>

Before the International Accounting Standards Board (IASB) was introduced many different countries had different accounting requirements. Therefore when it came to producing accounts people got confused and this ***"….. creates problems ………",*** (Bendrey, M., Hussey, R. and West, C. (2004), Essentials of Financial Accounting in Business, Thomas Learning, London, pg.303). An example of this problem is when a person or companies are trying to attract people from other countries to invest in the business. Due to this people/ business producing accounts in that country must comply with the Accounting Standards set in that country in order to attract the investors. From this it can be seen that complying with the Accounting Standards set in other countries maybe easy to follow since the way it is set out is easy to follow and implement. However the problem is that the outcomes of the accounts will be totally different from one country to another. This was one of the reasons why the International Accounting Standards Board was set up along with other reasons such as ***"Taxation Systems differ in many countries depending on the political policies of the country and the trading traditions and objectives",*** (Bendrey, M., Hussey, R. and West, C. (2004), Essentials of Financial Accounting in Business, Thomas Learning, London, pg .303). Another reason for the setting up of the International Accounting Standards Board is because in certain countries the accounting professional has a real impact on what businesses producing. For example the ***"…UK has a very strong accounting profession that has been active in promoting better accounting practices"*** (Bendrey, M., Hussey, R. and West, C. (2004), Essentials of Financial Accounting in Business, Thomas Learning, London, pg.303).

The IASB – International Accounting Standards Board

In 1973 the International Accounting Standards Committee (IASC) was established and in the 1989 the IASC issued ***"the 1989 Framework for the Preparation and Presentation of Financial Statements..",*** (Bence, D. and Fry, N. (2004) Financial Reporting, Conceptual framework - Which way forward?, Vol.134, Iss. 1335; pg. 88**).** About 17 years later the IASC was reorganised into the IASB which is known has the International Accounting Standards Board in order ***"… to take over the responsibility for standards setting",*** (Scott, R. W. (2002) An international comparison and evolution of financial accounting concepts statements, Vol.1, Iss. 2; pg.163, 22pgs). The preparation and presentation of financial statements ***"is referred to as its conceptual framework.",*** (http://www.accountingweb.co.uk/cgi-bin/item.cgi?id=140805&d=101&dateformat=%o-%B [accessed 29th November 2005]).
It is said that the ***"IASB conceptual framework was prepared under the International Accounting Standards Committee..",*** (Scott, R. W. (2002) An international comparison and evolution of financial accounting concepts statements, Vol.1, Iss. 2; pg.163, 22pgs).

The conceptual framework – purposes

The IASB (International Accounting Standards Board) conceptual framework is a document which is used by many people and companies because this allows them to analyse what their financial objectives are and how to achieve these objectives. The documents also provide guidelines about the presentation of financial documents, how should they be recognised, measured and summarized. So the purpose of the conceptual framework according to (Thomas, A. (2002), Introduction to Financial Accounting, Fourth Edition, McGraw – Hill, Maidenhead, pg.498) , ***"…is to provide guidance to accountancies in their day to day work for various transactions and items",*** and to ***"..give an underlying theoretical basis for tackling accounting problems",*** (Higson, A. (1995) Is stewardship merely a comfort blanket?, Vol. 116, Iss 1227; pg.104, 1 pgs).The purpose which was mentioned earlier is correct because it does provide guidance to accountants. However, it also provides information to a number of different people like the managers, customers, investors, suppliers, government and public who are interested in the business. These people are know has Users and will be talked about in more detail later on in this essay. The Users come up with different conclusion depending on what information they are looking for. As well as the users using the conceptual framework the IASB also use it. The users look for certain information whereas the IASB use it from a different point of view. The IASB would look at the framework and ask them self whether the framework is easy to understand and implement, from the point of view of preparing the financial statements. If the IASB believe that it is easy to understand and implement then I believe that the framework will stay the same. On the other hand if it is not clear to understand and implement then the IASB would need to ***"….review ……….existing accounting standards...",*** (Thomas, A. (2002), Introduction to Financial Accounting, Fourth Edition, McGraw – Hill, Maidenhead, pg.494) or even ***"develop……….future accounting standards",*** (Thomas, A. (2002), Introduction to Financial Accounting, Fourth Edition, McGraw – Hill, Maidenhead, pg.494)
Another purpose of the conceptual framework is that it provides information to people

who are interested in the work of the IASB in terms of how standards are produced , what process the standards goes in order to make it part of the conceptual framework, how does voting take place about this act , if any voting occurs etc. The framework also used **"**
In promoting the harmonisation of regulations, accounting standards and procedures relating presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permit ted by international standards.", (http://www.accountingweb.co.uk/cgi-bin/item.cgi?id=140805&d=101&dateformat=%o-%B [accessed 29th November 2005]).

By looking at the different purposes of the conceptual framework a conclusion can be made that the main purpose of the conceptual framework is ***"…..to provide a basis for the development and review of accounting standards, and to assist preparers, users and auditors or financial statements …….,"*** (Thomas, A. (2002), Introduction to Financial Accounting, Fourth Edition, McGraw – Hill, Maidenhead, pg.498).

Who uses the conceptual framework?

The conceptual framework is used by a wide range of different users who would be interested in different information because different users have different needs which have to be met.

Mangers also use the information provided in the conceptual framework because it allows them to predict future outcomes like budgeting, planning and forecasting. It also allows them to see where most money is spent on like things like machinery etc and are they being used effective or not.

Customers are referred to as a user of financial documents because the main thing that customers look for is whether or not that business will continue to trade or not in the near future. This is very important especially if a customer have ***"……a long term involvement with ……..the …",*** (Thomas, A. (2002), Introduction to Financial Accounting, Fourth Edition, McGraw – Hill, Maidenhead, pg.10) business. For example is a customer purchase an electrical product and it turns out to be faulty. Due to this the product will need to go back to the manufacturer for repair. However if the business where you purchased the product does not exist then it is a problem. The problem will be a lot for the customer who would need to all the running about in terms of sending the product back. Finding out what is going to happen etc. If the business continued to trade in the near future then the business will deal with everything like getting the product fixed or having a replacement sent to them etc.

A group of people who would also like to use the conceptual framework for getting information are the investors. The main thing that investors will be looking at is whether or not their assets are being looked after or not. This can be said to be the ***"……safekeeping of the entity's resources and for their proper, efficient and profitable use.",*** (Thomas, A. (2002), Introduction to Financial Accounting, Fourth Edition, McGraw – Hill, Maidenhead, pg.10). Due to this the investors would carefully assess the management to find out if it is effective at achieving this or not. The conceptual framework allow the investors to check for this because is the profits are higher then last year, the conclusion will be that the asset/s are being used effectively. Alternatively if the profits have declined from last year then you can say something is wrong, like assets are not being used at all or are being used for a limited time only or even the economy maybe slowing down, or the nature of the business or consumer confidence The main thing investors will be looking for is ***"...the risk and return on investment.",*** (Blake, J. and Lunt, H. (2001), Accounting Standards, Seventh Edition, Pearson Education Limited, Harlow, pg.267). So from this investors will decide to invest in this business or not.

The lenders are also interested in the information provided in the conceptual framework because the lenders would like to know if the business will be able to pay them back or not plus any interest added on as well. An example here would like paying your mortgage by making payments of certain amounts every month. So let just say you have got a mortgage of about £90,000 to set up a business and the monthly amount you have to pay is about £500 plus any interest added. By looking at business accounts the lenders will be able to see that the business can either pay this amount or not. If the business can then it is good because if a business carry on paying it off then when the business wants to borrow more money they can. They can borrow money since the lenders past records have shown that the business always pay the monthly off every month.

Just like the lenders the suppliers would like to know if the business can make ***"the payments of the sum due",*** (Blake, J. and Lunt, H. (2001), Accounting Standards, Seventh Edition, Pearson Education Limited, Harlow, pg.267). Also just like the lenders mentioned above if the business carries on paying the supplier then it is excellent. However if for what ever reason it fails to pay the supplier then the supplier could withdraw the supply and would reconsider to supply to them again in the near future. Suppliers would use the information in the conceptual framework in order to help ***"….. them decide whether to sell to the entity and to assess the likelihood that amounts owing to them will be paid when due",*** (Thomas, A. (2002), Introduction to Financial Accounting, McGraw – Hill, Maidenhead, pg.10) etc

Employees are also users of the conceptual framework because they want to know if they have got a stable job which will last at least for the year in order to feed children and pay the bills on time. Other question the employees would have when identifying certain aspects of the conceptual framework is ***"Does the business make sufficient profit and have enough cash available to make necessary payments to the employees? Will the business continue……………….an employee has secure employment?",*** (Alexander, D. and Nobes, C. (2004), Financial Accounting An International Accounting, Second Edition, Pearson Education Limited, Harlow, pg.138).

The public will not be interested in the conceptual framework in my opinion because they don't care whether the business is make a profit or loss but some people may be interested. However, to the public it is relative to know what the impact of the business is like on the community, environment, economy, etc.

An Accounting Standard

IAS 1 is an accounting standard which deals with ***"…basis for presentation of general purpose financial statements…",*** (Deloitte, IAS PLUS, at http://www.iasplus.com/standard/ias01.htm [accessed: 29th November]). Here the standard is concern with the way the financial documents are presented to do other people like the users who use different information from it to fulfil their own needs. Also the financial documents would need to be able to be compared with other financial documents from the business past records and from the other businesses. This needs to be done because it allows the users and other people to see that the presentations are the same for the different businesses and from the past records of the financial documents. The IAS 1 also shows how the financial statements should be lay out and what each financial documents should include, ***" IAS 1 sets out the overall framework and responsibilities for the presentation of financial statements, guidelines for their structure and minimum requirements for the content of the financial statements."*** (Deloitte, IAS PLUS, at http://www.iasplus.com/standard/ias01.htm [accessed: 29th November]).

A problem about the IAS 1 occurs because of the words ***"..'true and fair view' ,"*** (Evans, L., (2004) Financial Reporting, Fair Presentation – Problems with fairness, Vol.134, Iss. 1334; pg. 81) because it created problem within some of the EU countries since they argued that it conflict the legal requirements especially the tax law. However, the IASB introduced a new IAS 1 which state that ***"the meaning of 'fair presentation' is explained: 'fair presentation requires the faithful representation' of effects of transactions in accordance with definitions and recognition criteria set out in the Framework……..",*** (Evans, L. (2004) Financial Reporting, Fair Presentation – Problems with fairness, Vol.134, Iss. 1334; pg. 81).

In my opinion every part of the conceptual framework links with this standard because for example in order for the users to collect the information they need, the information must be set in a way which make it easy for the users to find this. Due to this the "IAS 1, Presentation of Financial Statements", must be implemented. When the accountant or someone else get the information which is required to produce the financial documents they must make sure the information is reliable, relevant etc. To do this they can use the IAS 1 because it gives information what should be in and sometimes it mentioned how old it should be.

From the latest Accountancy magazine from the period November 2005 the IAS 1 has been amended. The following are the amendments: ***"***

- ***All entity's objectives, polices and processes for managing capital;***
- ***Quantitative data about what the entity regards as capital;***
- ***Whether the entity has complied with any capital requirements; and***
- ***If it has not complied, the consequences of such non - compliance.",*** (2005, Accountancy, Institute of Chartered Accountants in England and Wales, London, Vol 136, No 1347, Iss NOV, pg. 94).

The above are important since they allow users to discover more information about the business before coming to a conclusion.

Advantages and Disadvantages

So overall the conceptual framework can be seen as a good thing because if businesses have a conceptual framework then it is easy to follow since the **"*issues can be ranked*",** (Williamson, D. Objectives of accounting, at http://www.duncanwil.co.uk/objacc.html [accessed 29th November 2005]). From this it can be seen that the conceptual framework is like a ladder because there are a number of guidelines which need to match before proceeding on to the next stage. For example if the users of the financial statements are not known, how can the objectives be outlined since different users require different information to satisfy their needs. All that businesses would need to do is slowly start to climb the ladder after one stage is done then continue up the ladder and continue to the next stage and so on. Another advantage the conceptual framework provides to businesses is that when new laws or a change in the conceptual framework occur this conceptual framework can be used to clarify the problem/s. Also ***"…with a framework, rational debate cannot occur because positions about the appropriate accounting treatment for a given transaction can neither be defended nor refuted…",*** (Williamson, D. Objectives of accounting, at http://www.duncanwil.co.uk/objacc.html [accessed 29th November 2005]). The main advantage that I believe is of the conceptual framework is that businesses would need to refer to just one framework rather than following different frameworks because the framework which I have discussed above is the one everyone agrees on (globalisation).

The disadvantage of the conceptual framework is that it takes time to produce because first of all you have make sure the information you have gather is correct and up to date then compare the conceptual framework to your accounts before releasing them to the public. This can take up to 3 months which is a long time therefore information gather in the first month could be misplaced which could have a big impacted on the overall figure in the documents.

Alternative to conceptual framework

If the conceptual framework didn't exist then many companies would either use the USA GAAP or would use the International Financial Reporting Standards. Due to this I believe that if companies used one of the above mentioned then no one would understand the financial statements especially the users of the financial documents. So if this happens then I believe that there is point be of producing accounts since no one understand them.

Conclusion

Overall the conceptual framework is an excellent piece of work which in my opinion should be adopted by all businesses. If the conceptual framework had more rules rather than having guidelines then this would prove to be very effective because certain information would be allowed to be shown in the conceptual framework and other information won't be shown. The rules are good thing to have because everyone financial documents would be identical from the layout of it to the wording of it.