Accounting Standard Setting: Thoughts on Developing a Conceptual Framework

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Abstract. This paper explores how academics and regulators might approach the task of developing a conceptual framework for financial accounting policy. It does so against a backdrop of a short history of accounting thought that lays out approaches that have been taken in the past and evaluates their impact. With the lessons from history recognized, the paper then offers a number of suggestions to be considered as we go forward. Some of these suggestions come from research. Some come from taking a utilitarian perspective on accounting. Some come from observing accounting that voluntarily arises in markets without regulation. The discussion engages with many of the ideas offered in the Conceptual Framework project of the International Accounting Standards Board and the Financial Accounting standards Board, including issues of objectives, “qualitative characteristics,” recognition and measurement, and a balance sheet approach versus an income statement approach. But the paper is offered primarily to help academics engage in the important task of developing normative accounting policy.

Keywords: conceptual framework, accounting standards, accounting policy
Accounting is underappreciated in society. Market economies require firmly established property rights, along with independent courts to enforce those rights. But of equal importance are accounting systems of high integrity that track our rights and obligations to each other.

Accounting is critical for directing capital to firms that will use it most productively. Accounting is essential for the efficient functioning of capital markets where those firms are valued and where the peoples’ savings are at stake. The determination of what is “good” accounting versus “bad” accounting is of high importance.

The mantle of responsibility for developing accounting standards has fallen on the International Accounting Standards Board (IASB) and country-specific regulators like the Financial Accounting Standards Board (FASB) in the United States and the China Accounting Standards Committee in China. They take their charge seriously, and are searching for a framework to guide their endeavors. At present, the IASB and the FASB are involved in a Conceptual Framework project to provide a foundation on which future accounting standards can be built.\(^1\) They are finding the going tough. Some critics feel they are going in the wrong direction, along the road to “bad” accounting. For lack of acceptance (and presumably because of other priorities), the project has, unfortunately, taken a “back burner” status of late.

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\(^1\) The Exposure Draft for the first stage of the project was released in May, 2008. It covered the objectives of financial reporting and the “qualitative characteristics” to govern accounting standards. The Boards completed this stage in September, 2010 and have since published proposals on Elements and Recognition and the Reporting Entity Concept. Currently the Boards are conducting discussions on Measurement. See [www.ifrs.org](http://www.ifrs.org) and [www.fasb.org](http://www.fasb.org) on the Conceptual Framework pages.
Accounting academics are involved in a variety of activities, but one mission is primary: To improve the practice of accounting. They join accounting standard-setters in the task of distinguishing “good” accounting from “bad” accounting. At one time, the large accounting firms engaged in the mission, writing many thought pieces for journals, but now have largely surrendered the task to the regulators. Academia is one remaining institution outside the Boards to grapple with the issues. Academics view themselves as having a comparative advantage of thinking conceptually, so one would expect them to be at the forefront in developing a framework for accounting policy making. They also profess a stance of independence. Needless to say, academia has thus far not succeeded. Indeed, most academics are reticent about venturing into issues of accounting policy.

This paper offers some thoughts that may help both regulators and academics formulate a framework within which they feel comfortable to engage in normative accounting issues. The paper is in two parts. The first part sets the stage with a short history of accounting thought and an evaluation of how academic research to date has contributed to the development of accounting standards. The second part offers a number of points to be considered as we go forward. They are points that I have found quite helpful in struggling with normative policy issues in my own mind. They are offered with the hope that they might similarly be helpful to others in formulating a conceptual framework and will stimulate research on normative accounting issues.

1. A brief history of accounting thought

History teaches lessons that bear on the future. What have been the underlying ideas behind the development of accounting principles to date and how successful have they been? The quick history outlined here is largely confined to developments in English-speaking countries, with a
particular focus on the United States. Other countries have contributed significantly to accounting thought, particularly on the European continent. The bias here is largely due to the author’s limited exposure to writings in other languages.

1.1 Generally Accepted Accounting Principles

Up to about 1930, the legitimacy for accounting practice came from precedent: Accounting methods were justified on the grounds that they were “generally accepted.” Even today, this criterion can be applied if there is no specific regulation on an issue. For the main part, these generally accepted accounting principles were forged in markets without regulation, so they have bearing on today; while market failure must always be entertained, accounting methods developed on a voluntary basis between contracting parties is a “free-market” must bear on the conversation.

1.2 A priori analysis: Accounting theory, 1930-1970

The Great Crash of 1929 was a watershed, for it saw the beginning of stronger regulation—most notably with the establishment of the Securities and Exchange Commission (SEC) in the U.S. Two points stand out. First, there was wide criticism of the practice of writing up assets to values above cost, an accepted accounting practice during the boom times of the 1920s. Under the rallying cry of “no more water in the balance sheet,” the SEC became firmly committed to conservative, historical cost accounting, a stance that continued until the move to fair value accounting recently. Second, with regulation, the question changed. No longer was it a question of what are the accounting principles used in practice but rather a question of what the accounting principles should be.
That normative question gave rise to the phenomenon of the accounting academic to supply the answer; rather than teaching generally accepted accounting principles, academics engaged in the question of what those principles should be. An important contribution came with the monograph by Paton and Littleton (1940). This monograph rationalized the prevailing historical cost accounting by formulating it in terms of the underlying principles and concepts that drive it: Revenue recognition and matching in the income statement, with the balance sheet transitioning between successive income statements by reporting costs not yet matched to revenues, along with other accruals necessary for income statement matching.

With the historical cost accounting of practice understood, the era of “accounting theory” began. This involved a priori modeling of alternative accounting systems to historical cost. Although there was some inductive and deductive reasoning, the modeling was not on the level of the rigorous economic theory of today. Indeed, the positions taken were often sharply opinionated. The names of Baxter, Sprouse, Moonitz, Goldberg, Chambers, Staubus, Revsine, Edwards and Bell, Ijiri, and Sterling come to mind. Their reasoning produced proposals for price-level adjusted accounting, replacement cost accounting, exit value accounting, deprival value accounting, common cash equivalent accounting, and more.

This theorizing resulted in a proliferation of proposals but with no means of sorting them out other than appealing to aesthetics. It had little impact on practice, still firmly based on conservative, historical cost accounting.\(^2\) Theory is, of course, at the core of academic endeavor, but it became to be appreciated that “accounting theory” was not grounded in foundational disciplines—economics and the other behavioral sciences. Further, the various accounting

\(^2\) An exception in the U.S. was replacement cost accounting. FASB Statement No. 33 required replacement cost financial statements as supplementary information to the primary historical cost presentation. The requirement was suspended after a few years.
theories came with little empirical testing. That led to the modern era, beginning in the mid-1960s. This era follows the scientific method: Prescriptions are derived in a rigorous way from clear assumptions, with empirical analysis of the data brought to bear on the evaluation of prescriptions.

1.3 The modern era: Economic theory

Modern accounting theory rests on the foundations of neo-classical economics. The assumptions are those of the rational, wealth maximizing, risk averse individual. These are the same foundations on which modern finance theory has been built. Finance theory has lead to many innovations, including asset pricing models, the Black-Scholes model, and a variety of other financial engineering models. On the economics of disclosure, agency theory, valuation theory, and management accounting, modern accounting theory has also made progress, though not to the extent of the product development in finance. However, disappointingly, theory has not contributed much to the prescription of principles for financial reporting. For the most part, the financial accounting theory has dealt with information primitives (in the manner of information economics), but rarely introduces information variables that bear resemblance to accounting.

One branch of economic theory, positive accounting theory, does focus on accounting numbers. This theory, laid out in Watts and Zimmerman (1985), sees accounting and its institutions as an outcome of a political process. Accounting standards emerge from individuals pursuing their self-interest; regulators reach conclusions based on the demands of constituents who lobby in their own interest (and accounting boards add their own self-interest in making decisions). This perspective may help to understand how accounting principles are determined, as a descriptive matter, but provides little insight into the normative questions about accounting.
Indeed, the approach is quite cynical: Accounting principles are just the outcome of politics. Nevertheless, at its core, positive accounting theory recognizes that accounting principles are the result of human interaction. Thus, while one might be cynical about accounting standards that come from regulation, one can also envision principles that might arise voluntary between freely contracting individuals without regulation. Such principles might then be compared with those that arise under regulation.

1.4 The modern era: The empirical revolution

At about the same time as theory moved to the same foundations as neo-classical economics, we saw the advent of empirical accounting research that has so dominated the last 50 years of research. The seminal papers were Ball and Brown (1968) and Beaver (1968). These papers took the following position: Rather than theorizing about desirable accounting principles, let us take accounting to the data and let the data speak. For financial accounting, the accounting data were aligned with stock prices (and later bond prices) to answer the question: What do market prices tell us about accounting? The subsequent 50 years of so-called “capital markets research” pursued this question, along with the complementary analysis that documents the empirical properties of accounting numbers—their time-series and cross-sectional relationships, their forecasting ability, the issue of earnings quality, their effect on incentives, and the question of whether accounting information is quickly impounded in stock prices (to name a few). This endeavor has produced a tremendous amount of descriptive results that has added to our stock of knowledge. It has provided insights into financial statement analysis, contracting, corporate governance, and has promoted investment strategies based on accounting information. However, on the core mission of the academic endeavor, it has failed; empirical research has produced few normative prescriptions on accounting principles. Perhaps this is to be expected: Correlations
observed in the data cannot provide policy conclusions without further structure. Beaver’s *Revolution* treatise (Beaver, 1997) sees the empirical revolution as an “information perspective” on accounting, not a measurement perspective, but it is measurement principles that the IASB and FASB are pursuing in their framework project and it is the perspective that is badly needed.

2. **Some considerations in formulating a conceptual framework**

With history behind us, what is the path ahead? In this section, I offer some points that I hope will help in closing in on the problem. The points come largely from my own engagement with the issues. Some of the points draw from research, particularly that in financial economics. Many are lessons learnt from the experience in grappling with normative issues in our Center for Excellence in Accounting and Security Analysis (CEASA) at Columbia University and from the effort in writing the conceptual framework of the American Accounting Association Financial Accounting Standards Committee (2010). Not all points will be agreed upon, and in no way represent a comprehensive survey of current thought in the academic community. They are simply morsels to put on the table, issues that I believe we should consider in prescribing accounting principles. Where relevant, the points will be contrasted with the (tentative) positions that the IASB and FASB have taken in their Conceptual Framework project. Indeed, some of them are a reaction against the approach taken by the Boards.

2.1 **Accounting is utilitarian**

One’s thinking is very much helped by keeping the goal of the endeavor in mind, the eye on the prize. That gives direction. Much of science is a study of natural phenomena; scientific endeavor is directed to discovering how the natural order works. Not so accounting. Accounting is utilitarian. Accounting is not something to be discovered, as if it exists in nature, but rather
something to be designed, a product to be perfected to serve customers. While accounting researchers must be grounded in the foundational disciplines—economics and the other behavioral sciences—their role is more akin to medical research. With a firm knowledge of physiology and biochemistry, medicine attempts to develop products that heal people. Similarly, with a sound knowledge of economics, the accounting researcher forges into product development. Those products may be the costing systems and performance metrics of managerial accounting, financial statement analysis techniques, earnings quality diagnostics, or accounting standards for the financial reporting “product.” Like the medical drug, the researcher evaluates the product for its benefits and for possible negative side effects. The focus is on the user. It is a focus that has driven modern finance to deliver an array of products that are routinely applied in investing, corporate capital structure, dividend policy, financial engineering, and investment performance evaluation.

This may appear to be a fairly obvious point, but is sometimes lost in the variety of activities that we conduct as accounting researchers. It is a point that has given me focus as a researcher and one that inspires to engage in normative thinking on accounting policy. Not all research leads immediately to products, but that orientation is essential for the success of the academic endeavor. The point is elaborated upon in the Penman (2008) paper in the China Accounting Review. It may be relevant in the decision to adopt IFRS in China where the socio-political environment frames the user differently, though I have no insight into the issue.

2.2 Objectives

The IASB and FASB Conceptual Framework project starts with a statement of objectives. This is most important, for one cannot develop a product without understanding who the customer is.
The Boards’ state objective is to provide information “about the amount, timing, and uncertainty of future cash flows” to investors. However, while focusing on users, it is not specific enough. Accounting that reports to shareholders necessarily differs from accounting that reports to debt investors: For the former, interest is an expense in the income statement, but for the latter, interest is a distribution (income to them). Stakeholder accounting (that sees employees also sharing in the value of the firm) must differ from shareholder accounting, for then wages are not an expense, but rather a distribution of value to employee stakeholders. The Boards see themselves as providing general-purpose financial reporting. That is just not feasible. One must designate the user before a crisp design—that determines the treatment of interest expense, for example—can be implemented.

With a sharp definition of the user, I have found that a number of issues in accounting resolve easily. The accounting for interest on debt is clear once one sees the shareholder or equity investor as the user: Interest is an expense. The accounting boards have long wrestled with the issue of debt versus equity, going back to the FASB (1990) discussion paper on the issue. With a so-called proprietary view of accounting—reporting to the shareholders, the owners—the difference is clear: Equity is the claim of the shareholders (the common equity), and all other claims (including preferred equity) are those to be settled by the common shareholders, so are debt. The treatment of contingent equity claims—convertible bonds, convertible preferred stock, warrants, stock options, and the like—flows immediately, as described in the CEASA (2005) White Paper No. 1. GAAP and IFRS confuse on this point, applying grant date accounting to stock options under IFRS Statement No. 2 and FASB Statement No. 123R, crediting shareholder’s equity rather than a liability, and failing to settle up against equity when the claim is settled with a loss to shareholders.
In their Conceptual Framework, the IASB and FASB seem to be taking an entity view of accounting—that is, focusing on accounting for the firm rather than for the claims of investors. That a clarifying statement of objective. But, in doing so, it must be recognized that no user is specified and the objective of “faithfully reporting to shareholders” is deemphasized. The result is a muddling of debt and equity claims in the financial statements (as in IFRS 2 and FASB 123R). And it produces contradictions. An entity view means interest and indeed wages are a distribution of entity value, not an expense in generating that value, yet income statements treat them as expenses in contradiction with the entity view. Clearly, without a sharp specification of the user, the accounting gets very messy and messy accounting is not want any user needs, whether that be a shareholder or a debt holder. The entity is not the user, the customer. Rather it is the investors who invest in the entity.

2.3 Qualitative characteristics must be discriminating

The first stage of the Boards’ Conceptual Framework lays down a number of “qualitative characteristics” that financial reports are supposed to exhibit. They include the concepts of “relevance,” “neutrality,” “faithful representation,” and “comparability.” A statement of these concepts has a product focus: The accounting product should exhibit these attributes. They are noble concepts, hardly ones with which to disagree—apple pie and ice cream, as it is said in the U.S. But they are too broad to cut through to a solution on a particular accounting issue like the capitalization of research and development (R&D), the accounting for off-balance-sheet vehicles (for example), or even the important issues of fair value accounting versus historical cost accounting (relevance versus reliability?). They also introduce conflict: Will relevance be sacrificed because different treatments will violate the cause of comparability or reliability?
Most importantly, the concepts do not connect in any concrete way to what users look for in financial reports. Jiang and Penman (2013) explore what the accounting would look like under the characteristics that fundamental analysts look for in accounting information. They allude to the analysts’ demand to separate speculation from hard information and then show how this demand can direct principles for Recognition and Measurement. Those principles result in a non-speculative balance sheet on which an analyst can anchor a valuation. It results in an income statement that provides a firm basis for forecasting future income, that is, an income statement that grounds the analyst in speculation about the future. This has implications for an income statement approach versus a balance sheet approach to accounting and for historical cost accounting versus fair value accounting. Rather than the “soft” principles in the FASB-IASB framework, this approach has “bite,” leading to prescriptions about the accounting. For more on these points, see the American Accounting Association Financial Accounting Standards Committee (2010) conceptual framework document.

2.4 Definitions are not the foundation for a framework

In moving to the Recognition stage of their project, the IASB/FASB specify a set definitions of assets and liabilities to which accounting must conform; an item is “recognized” as an asset or liability if it meets the definition. I do not think this is the way to go. It promotes a legalistic approach that ties accounting to those definitions while entrapping preparers in a cobweb of accounting minutiae over interpretation of definitions. It inevitably results in specifying accounting that is inconsistent with a prescribed definition because other issues surface. For example, an asset is defined as something with future economic benefits, yet investments in research are not booked as assets. Does the definition imply that all speculative intangible assets should be added to the balance sheet—investments in employees, distribution systems, supply
chains? Probably this will not happen, so the definition is violated in the execution; one is left with accounting that is supposed to be driven by definitions but is inconsistent with those definitions. One has a conceptual framework that does not operate.

The alternative is to focus on what the user needs. An analyst is probably not interested in legal conformity to definitions but in using accounting to gain insight into valuation. Again, product features are to the point, not legalistic conformity. That, of course, frames the research agenda: How do I use accounting information to value a firm? What accounting is useful for assessing the stewardship of management in protecting and enhancing my interest in the firm? Much work has to be done on this, but my recent book, Accounting for Value (Penman 2011, now forthcoming in Chinese) has made a stab at it.

2.5 Grounding in the underlying disciplines: Dividends and financing

We have said that products must honor the science of the underlying disciplines. An engineer building a bridge must do so in accordance with the laws of physics, otherwise the bridge collapses. Similarly, accounting must honor the “laws” of economics. Two basic ideas in financial economics come to mind.

The first, the Miller and Modigliani (1961) dividend irrelevance concept says that dividends are the distribution of value, not to be confused with the generation of value. Financial accounting practice gets this correct: Dividends are not an expense in the income statement to calculate earnings, but rather a distribution from book value in the balance sheet. Ohlson (1995) shows how this accounting leads to accounting-based valuation models that display the dividend-irrelevance property. This very desirable feature is simply an accounting property, a result of the accounting design for how dividends are treated.
The second underlying concept from financial economics is the Modigliani and Miller (1959) financing irrelevance notion: While operating activities add value, financing activities do not. While one can conjecture exceptions, issuing and redeeming bonds and issuing and repurchasing stock typically does not add value. Rather, the firm generates value from an entrepreneurial idea that results in customers, with value added if revenues from those customers exceed the value given up in serving the customers. The principle calls for a separation of operating activities from financing activities in financial statements. The IASB and FASB Financial Statement Presentation project makes a big move in this direction but, unfortunately, that also appears to be on the back burner, leaving us with the confusion between operating activities and financing activities in the current financial statements. For a critique of the current GAAP presentation, see the CEASA (2006) Occasional Paper by Nurnberg. For a re-design of financial statements that honors the principle, see the CEASA (2013) White Paper No. 4.

Students of financial economics recognize that the Modigliani and Miller propositions assume perfect capital markets. Many observers claim that Chinese capital markets are far from this ideal. However, I do not think that this observation changes the normative stance. It may be that firms can add value by trading in imperfect (and inefficient) capital markets—by repurchasing shares when the market undervalues them, for example—or are frustrated in raising capital in imperfect markets. But these are very different activities from trading with customers and suppliers, so requires the separation of operating activities from financing activities in the accounts. The Miller and Modigliani dividend irrelevance notion also depends on perfect capital markets so investors can generate their own dividend policy via “home-made dividends.” But even so, accounting should always separate the dividend from the activity of generating value from customers.
2.6 Grounding in the underlying disciplines: The economics of arbitrage

Shareholders invest in firms to add value to their investments. The economics of value added revolve around arbitrage: One adds value by arbitraging markets. This is often applied in the negative to financial markets where a presumption of no-arbitrage (market efficiency) is often stated. However, in real activity, it is recognized that value-added comes from arbitraging input and output markets—delivering products and services to customers (in output markets) at a price in excess of that paid (in input markets) for the materials and services required to make the product. In accounting, earnings is the value-added metric. Earnings focuses on revenues from customers relative to the expenses incurred to serve customers, the spread between operating in output markets and input markets.

The point impacts directly on the central issues raised in the IASB and FASB Conceptual Framework project—the choice between a balance sheet approach to accounting versus an income statement approach. In the former, the focus is on the balance sheet: Net assets are measured at their fair value, with earnings in the income statement then measured as the change in fair value in successive balance sheets. The income statement approach focuses on recognizing revenues (output prices) and a matching of expenses (input prices), with the balance sheet carrying accruals that effect the periodic matching.

The choice between a balance sheet approach and an income statement approach cuts to the issue of Measurement that is so much the focus of the Conceptual Framework. Designating a balance sheet approach and fair value as the measurement attributive fails to recognize the arbitrage principle. Fair value accounting lists assets and liabilities at their exit value, but the sum of fair values of individual assets is not the fair value of their sum. Businesses combine
assets together to generate value. That is the way they arbitrage: They combine assets in a unique way to produce a product such that the value of the assets (in using them jointly) is greater than the sum of their individual values. It is their joint use in the execution of a business plan that generates value, not their individual stand-alone value. To illustrate, the value of coal inventory for a steel producer is not what it can be sold for (its exit value) but the value in firing up a furnace to produce steel to sell for customers. And the value of a furnace is not its exit value, but the value from combing it with coal to produce steel for the output market. The steel producer is arbitraging the costs of coal and furnaces with the price of steel to exploit an arbitrage opportunity and (hopefully) add value from that arbitrage.

The system of income statements and balance sheets actually reports a number of value added from using assets jointly: earnings. Indeed, the earnings number includes earnings coming from assets not on the balance sheet at all, like brands, research and development, supply chains, and distribution systems. One might think of valuing a firm on the basis of its balance sheet, but that is impossible for most firms if it is the value from arbitrage that one is after. But valuation theory says that one can also value a firm on the basis of its earnings—flows rather than stocks—and earnings is the one summary number that the accounting system delivers. That points to an income statement approach, as laid out in Penman (2009).

Fair value accounting also has its roots in the economics of arbitrage. But the presumption in fair value is one of no-arbitrage rather than the arbitrage of prices: A fair value price is one where there is no arbitrage opportunity with respect to the available information. In the parlance of modern finance, fair value prices are efficient market prices (that cannot be arbitraged), thus they “fully reflect all information” about value. The presumption often follows that fair value accounting numbers will provide more information than historical cost numbers.
However, they are not relevant for an endeavor, like a business, that is involved in arbitrage. Fair values may be relevant for certain separable, stand-alone financial assets (traded in efficient markets) but not for assets employed under a business model. Indeed, if fair value accounting were substituted for accounting that reports the firms’ ability to arbitrage, then information would be lost such that the determination of the fair value of assets in aggregate would be frustrated and market prices would become less efficient. The fair value accounting issue is explored under the arbitrage principle in the CEASA White Paper No.2. That paper establishes conditions for when fair value accounting is appropriate and when it is not.

2.7 Generally Accepted Accounting Principles: Observations from practice

If accounting is a product, is must be tested to see that it actually works in practice, much like a medical researcher who puts a new drug into trials. That is a task for research, and academics might well focus on how to do this. Papers that examine “earnings quality” issues and the properties of incentive and performance measures are in this vein. With the lack of a laboratory, such testing is difficult to do in financial accounting. However, there is the laboratory of experience, where one can view the effectiveness of a given accounting practice and its side effects. In particular, practice that arises voluntarily and successfully in markets without regulation should guide the regulation. That point is made by positive accounting theory discussed above and, of course, was the modus operandi of accounting in the “generally accepted accounting principles” era prior to 1930.

A current practice guides the debate on fair values as a measurement attribute. Open-end hedge funds and mutual funds employ fair value accounting because, as they are not traded, they must report a net asset value (NAV) at which investors buy into the fund or redeem out of the
fund. That is, the accounting provides the price for trading the fund. However, when a fund is illiquid (which makes it difficult to measure fair values), hedge funds lock up or place the relevant assets in a side pocket (that cannot be traded), awaiting the realization of value that reveals the fair value. Business operations have similar assets—plant, equipment, inventories, and even bank mortgages—whose (joint) fair value is difficult to measure and will not be revealed until value is realized. The remedy for the hedge fund instructs the accounting for the business firm: Do not recognize the value in book value until the realized value is clear. Essentially, lock up until the value is clear. That, of course, points to the realization principle: Do not recognize value from assets until there is realization—customers actually willing to pay for the product produced by the assets.

Further examples from the laboratory of life raise concerns about fair value. As indicated earlier, conservative, historical cost accounting became entrenched in the U.S. in reaction to the accounting practice of “putting water in the balance sheet” in the 1920s, asset values that subsequently evaporated in the 1929 Great Crash. Fair value accounting revived in the booming 1990s, with the SEC granting Enron Corporation permission to fair value long-term energy contracts. At its core, Enron was a fair-value-accounting house of cards that collapsed. The write-up of available-for-sale mortgage assets of banks to fair value during the real estate bubble up to 2007 is now seen as doubtful in the light of the subsequent evaporation of those values and the collapse of banks’ balance sheets. We have difficulty testing accounting products in laboratories, so these real-life experiences must be given considerable weight.
3. Conclusions and Lack of Conclusions

These few ideas are offered with the hope that they might help academics and standard setters along the path to a conceptual framework for financial accounting. They fall far short of providing a comprehensive framework, though I believe one can take them further to make stronger statements, as in the conceptual framework offered by the American Accounting Association Financial Accounting Standards Committee (2010).

The discussion implies an income statement approach to standard setting rather than a balance sheet approach. This is the core issue in the IASB and FASB Conceptual Framework, with the Boards appearing to lean towards a balance sheet approach with fair value as the measurement attribute. However, the resolution of that issue raises further issues, namely those of revenue recognition and matching. The Boards are currently addressing the revenue recognition issue and the American Accounting Association Financial Accounting Standards Committee (2011) has also weighed in on this issue. While the analysis above points to earnings as the summary number to focus on in the financial statements, there remains many open questions as to the measurement of earnings.
References


