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Review Article

Review of the IASB and FASB Joint Converged Framework

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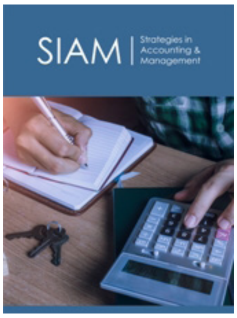
ISSN: 2770-6648



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Submission: February 09, 2023
Published: March 03, 2023

Volume 4 - Issue 1

How to cite this article: Yuansha Li and Zhang Weining. Review of the IASB and FASB Joint Converged Framework. Strategies Account Manag. 4(1). SIAM. 000577. 2023.
DOI: 10.31031/SIAM.2023.04.000577

Abstract

The International Accounting Standard Board (IASB) and the US Financial Accounting Standard Board (FASB) launched a collaborative and comprehensive project to develop a common Conceptual Framework (CF) in 2004. On July 6, 2006, both published their Discussion Paper Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information. However, amid the financial crisis in 2008, the IASB and FASB postponed and eventually terminated the convergence project. This study introduces the background and main content of the joint CF, focusing on a series of key issues. Should the IASB and FASB cease their cooperative research on the converged CF? Should it be exclusive for the IASB and FASB only to jointly develop a converged CF? Should the accountability concept be subordinate to decision-usefulness? Finally, the study suggests reactivating the converged CF project by involving other economies at different levels of development in the formulation process.

Keywords: Conceptual framework of financial reporting; Common conceptual framework; Objective of financial reporting; Qualitative characteristics of useful financial information

Introduction

Cooperation background of the joint framework

During the early period after the foundation of the International Accounting Standard Committee (IASC), the Financial Accounting Standard Board (FASB) had been “dismissive” of this newly established international accounting organization. The FASB has always believed that the accounting standards they set are of the highest quality in the world. Therefore, when the IASC completely modified the existing standards, made them core standards to improve comparability, and gained strong support from IOSCO, the FASB was still reluctant to cooperate with the IASC (reorganized as The International Accounting Standard Board [IASB] in 2001). Such cooperation seeks convergence with the core standards of the international accounting standards. By contrast, the FASB arrogantly warned the IASB of what constituted high-quality international accounting standards. In 1997, Arthur Levitt, then chairman of SEC, elucidated that high-quality accounting standards should “be able to lead to comparability and transparency and to improve the full disclosure of information.” These remarks mainly referred to the IASB. However, before and after the beginning of the new century, a series of major financial scandals broke out in the United States. Many countries or organizations began questioning the US Generally Accepted Accounting Principles (GAAP) rule-oriented standard formulation. The United States itself also began questioning the financial accounting standards. Thus, improving the quality of accounting standards has become a problem that the financial accounting standards committee must solve. Moreover, all major countries and organizations in the world, including Australia and the European Union, have issued statements in preparation to adopt (or intend to converge) the international accounting standards (now renamed International Financial Reporting Standards) [IFRS] issued by the IASB. When FASB’s reputation declined, the authority of IASB rose rapidly. Due to changes in the environment, ensuring the “charm” of the US capital market became the most concerned topic of Americans. After deep consideration, the US FASB was determined to begin full-scale involvement and cooperation with the IASB. With the US as a superpower, the FASB could maximize the fight for the control of the IASB. Moreover, the rapidly increasing authority of the IASB strengthened cooperation with the FASB for achieving great success. High-quality Conceptual Frameworks (CFs) of financial accounting could evaluate and revise the existing accounting standards, guide accounting standards setting bodies to develop new accounting standards and play a basic normative role in the absence of accounting standards (IASB, 2018). Given the important role of Conceptual Framework (CF) and certain important defects with the previous CF of the IASB and FASB, both decided to improve their existing CFs and work together to develop a complete, internally consistent and converged CF. They replaced their current CFs in October 2004.

Main contents of the joint CF

Overall objectives and forms of the CF: The research of the FASB and IASB on the joint framework aimed to improve the quality of the CF for financial reporting and to eventually replace their existing CFs. Previously, the name proposed by the IASB in the concept statements of developing financial accounting was The Framework for Preparing Financial Statements. The FASB put forward "Objectives of Financial Reporting" in Concept Statement No. 1. However, the concept statements made afterward only solved the accounting elements and confirmed and measured issues related to financial statements. These statements were unrelated to the disclosure of footnotes to financial statements and other financial reporting issues. Financial reporting is based on financial statements and includes the statements of notes and other financial reporting. Therefore, the CF for financial reporting accommodates more information than the CF for financial statements. The actual development of financial accounting is also conformed. Thus, both parties agreed to regard the joint CF as the CF for financial reporting. Prior to 2006, the FASB released seven concept statements one after another, which constituted the CF. The IASB used a separate file to describe CF. A single file or multiple files is only a difference in forms. However, such differences are sometimes meaningful. A single file can convey clearly that the contents expressed in the file are a coherent whole. The FASB made concessions, agreeing that the future joint framework can take the form of a single file that is consistent internally. Furthermore, the IASB did not make concessions on the name. The reason is because the financial report was more relevant to the actual needs of the current financial accounting boundaries than the financial statements. Thus, given the assumptions of time, the joint CF can complete eight projects in eight phases: objectives and information qualitative characteristics, elements and confirmations, measurements, reporting entities, presentations and disclosures (including the boundaries of financial reporting), status and objectives of the CF at the level of accepted accounting principles, CF applications to non-profit organizations, and other issues. On July 6, 2006, the FASB and IASB jointly issued The Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Useful Financial Information (Preliminary Views).

Objectives of Preparing Financial Reporting

In SFAC No. 1, the objective of financial reporting is clearly positioned by "decision usefulness." The IASB framework positions the objective of the financial statements as "decision usefulness" and "commission responsibility view." The joint framework positions financial reporting as decision usefulness, but it notices that users of financial reporting also want to assess the administrative responsibilities performed by principal authorities and concerns about decisions on resource allocation. The required information in assessing administrative responsibilities performed by principal authorities is also the information needed for making decisions on resource allocation. Therefore, the joint framework believes that decision usefulness includes the commission responsibility view. Such belief implies that regarding the commissioned responsibility as the objective of financial reporting is unnecessary. Accordingly, the joint framework emphasizes that the general purpose of external financial reporting is to transfer information directly to a wide range of users (mainly including equity investors, creditors, suppliers, employees, customers, governments and their agencies and regulatory agencies, and the public) and not just to meet the needs of a single group. Therefore, financial reporting reflects subject views rather than proprietorship views which provide a conceptual basis for compiling consolidated financial statements from parent company theory to subject views.

Information Qualitative Characteristics

In this study, the FASB and IASB use four information qualitative characteristics as basic qualitative characteristics, which are correlation (including three sub-characteristics of predictive values, confirmatory, and betimes. Among them, confirmatory is consistent with the "feedback value" adopted by FASB), faithful representation (including three sub-characteristics of verifiability, neutrality, and integrity; According to the meaning of the joint framework, faithful representation also includes substance over form), comparability (including consistency, i.e., the comparability of horizontal and vertical accounting policies), and intelligibility. The study also imposes materiality and cost-benefit principles as constraints on financial reporting. Two things about the information qualitative characteristics should be noted [1]. Defining the logical sequence of the basic qualitative characteristics. A major criticism of SFAC No. 2 is that it does not provide a clear explanation of the relationship between correlation and reliability. Thus, the joint framework has made breakthroughs. It elucidates that, according to logical deduction, the priority order of these four information qualitative characteristics is as follows: correlation, faithful representation, comparability, and intelligibility. Relative to other information qualitative characteristics, correlation must first be considered because it determines which economic phenomena should be described in financial reporting. However, the joint framework emphasizes that considering correlation first and then faithful representation does not mean that the latter is inferior to the former. Correlation determines the information that should be described. If it cannot be faithfully represented, then correlation is useless or misleading in decision-making. Conversely, faithfully representing unrelated economic phenomena is not helpful for decision-making. As for comparability and intelligibility, their logical order is lower than that of correlation and faithful representation. They can improve the decision usefulness of financial reporting information that is already correlative and faithfully represented. However, if the information is not correlative and faithfully represented, then neither comparability nor intelligibility makes the information useful for decision-making. Various information qualitative characteristics complement one another in ensuring the decision usefulness of financial report information. The four concepts can be fully reflected to maximize the usefulness of financial reporting [2]. Faithful representation replaces reliability and does not specify substance over form. In previous concept frameworks, reliability and correlation are mentioned in information qualitative characteristics. However, the FASB clearly defines the two as the primary quality. This time, the joint CF has changed the formulation of reliability and replaced it with faithful representation. The reason is because the formulation of "reliability" is relatively abstract. Faithful representation of transactions and events that are intended to be represented (objective economic phenomena) represents the essence of reliability. Therefore, the joint framework states, "To make information conducive to investment, credit, and similar decisions of resource allocation, they must be made to faithfully represent real-world economic phenomena."

Termination of the Joint Framework Cooperation

After the outbreak of the financial crisis in 2008, the IASB and FASB shifted their focus to the emergency revision of specific standards. In 2010, the FASB and IASB decided to postpone further actions on the joint CF. They agreed to discontinue the effort to work on their frameworks on a joint basis. After the FASB and IASB discontinued the cooperation on the joint CF, they started revising their respective CFs. After extensive consultation, IASB decided to restart the CF revision project and issued A Review of the Conceptual Framework for Financial Reporting (Discussion Paper) (DP) in July, 2013 and Conceptual Framework for Financial Reporting (Exposure Draft) (ED) in May, 2015. In 2018, the IASB officially issued the revised Conceptual Framework for Financial Reporting and made immediately effective for the IASB and IFRS Interpretations Committee. The accounting entity is effective after 1 January 2020. In January 2014, the FASB reactivated its CF project, focusing on concepts for presentation and measurement. Among them, the presentation issue is a problem that has not been solved by FASB's previously published CF. On August 11, 2016, the FASB and IASB jointly issued the Proposed Statement of Financial Accounting Concepts No. 8 Conceptual Framework for Financial Reporting Chapter 7: Presentation. However, the FASB has not yet given a formal revision of Conceptual Framework for Financial Reporting to ban the previously released Concept Statement No. 7. Evidently, IASB's progress in revising the CF for financial reporting is faster than the FASB.

Restarted Joint Concept Framework and Representative Development Process

Should the joint CF be stopped?

The objective of the IASB is to build a set of high quality IFRS and apply them globally. Over the past decade, IASB's IFRS has been recognized and adopted by different countries or regions. Several studies have corroborated that implementing IFRS has significantly improved the quality of accounting information and has achieved significantly positive economic consequences (e.g., decreased capital costs, increased market liquidity of stocks, increased attraction of foreign investment, increased accounting earnings, and stock price informativeness) [3-9], especially in certain advanced economic entities. However, certain important economies still formulate their own accounting standards without directly adopting IFRS. For instance, the United States insists on formulating its own accounting standards. Moreover, unlike other important economies such as China, which still maintains its own accounting standards, the United States has not publicly claimed to achieve the convergence of the US GAAP and IFRS.

The reason is because the United States has long believed that the quality of GAAP in the country is the highest in the world. However, as the global influence of the IFRS continues to increase, the United States has also been hesitant about dealing with the IFRS. For instance, FASB's recognition of the IFRS is reflected in many aspects, such as the joint CF developed in 2004; the cooperation in many fields after the financial crisis, such as fair value, revenue recognition, and lease accounting; and the US SEC allowing non-US companies listed in the United States to adopt the IFRS to produce financial statements. However, the two sides ended cooperation in the joint concept framework in 2010. The US SEC also gave up its original intention to require US listed companies to implement the IFRS in 2014, which, in turn, showed that the US distrusted the IFRS. With the global influence of the IFRS further improved, the United States can possibly re-approach the IFRS. High-quality CFs of financial accounting can evaluate and revise the existing accounting standards, guide accounting standards setting bodies to develop new accounting standards and play a basic normative role in the absence of accounting standards [10]. The convergence of CFs provides a solid foundation for the future development of accounting standards and are critical for the IASB to achieve global and high-quality accounting standards. The CF plays an important role in assessing the quality of specific standards and guiding the development of new ones. However, such framework is not a specific accounting standard. Specifying accounting treatment for specific economic operations is unnecessary. Therefore, the resistance in deciding to cooperate in the research of the CF is smaller than specific standards. We believe that the IASB and FASB should fully and contingently continue to cooperate in the research of CFs.

Is it appropriate to develop CFs only by the FASB and IASB?

The quality of the IFRSs is closely related to the quality of the joint framework. Moreover, how representative the joint framework is and whether comprehensive considerations can be made to consider the basic conditions of countries in the world also affect the representativeness of future IFRSs. The future standards mainly reflect the developed countries, especially the needs of the United States. Such standards reflecting the needs of developed and developing countries may be related to the joint framework. If the IASB selects a country to jointly formulate the CF, then the United States is undoubtedly the first choice. However, should the IASB cooperate with other countries to develop and increase the representation of the CF? The United States is currently the only superpower in the world, which is reflected in many aspects such as politics, military affairs, economy, and culture. Capital market and financial accounting, which plays an important role in the capital market, are the most developed in the United States. For instance, the funding for developing accounting standards by the

United States far exceeds the input of many other countries or organizations in the world. In terms of the numbers and details of standards, many other countries or organizations cannot reach the SFAC of the FASB. Therefore, an inevitable contradiction occurs to the IASB to expand its international influence in the development process. On the one hand, actively seeking the support and cooperation of the United States in promoting IFRS helps improve its quality and the reputation of the IASB. In the last century, the United States basically adopted a "cold attitude" toward international accounting standards. Therefore, although the IASC was developed, its development was limited. Since this century and especially after 2001, the United States has actively intervened in the work of the IASB and has reached many cooperation intentions, which is clearly one step closer to IASB's objective of seeking global convergence standards. On the other hand, the excessive reliance on the United States must be prevented. If international organizations rely too much on a certain country, then their ability to represent the interests of all countries in the world must be met with skepticism [11,12].

In IASC's reorganization process, the United States actively intervened and occupied the Trustees of IASC Foundation and the IASB Trustees leadership position[1] . One is the strong US FASB, and the other is the IASB, which is dominated by the United States. Whether the CF developed jointly by the two can take good care of the needs of developing countries and other developed countries can inevitably cause doubts. What is certain is that this CF certainly has a strong "American color." Its objectives of initial consensus and the qualitative characteristics of accounting information show such color. Absorbing the advantages of US SFACs and fully reflecting US intentions and interests are two different things. We believe that the IASB developing its own CF is appropriate to seek acceptance by all countries. Jointly developing a CF with developed and developing countries instead of formulating a framework with one single superpower is also appropriate. Given that the IASB only cooperates with the US FASB, can the joint framework developed comprehensively reflect the needs of developed and developing countries? To be impartial and to strive for fairness, the joint framework should take care of the common needs of developed and developing countries. The IASB should consider this matter.

Joint framework (preliminary view) makes the commissioned responsibility become the subject to decision usefulness. Is it appropriate?

The commissioned responsibility includes broad and narrow commissioned responsibilities (narrowly defined). The commissioned responsibility view requires the existence of a clear principal–agent relationship. Thereafter, the principal decides whether to continue the appointment or dismissal of the administrative authorities based on the financial report provided by the agent. When the capital market develops into a situation in which the equity is fragmented, many small shareholders are unwilling to supervise the administrative authorities of the company because of the cost–benefit principle. Thus, the clear principal–agent relationship gradually blurs, and investors begin to adopt a "vote-by-foot" approach to companies that they believe are poorly managed. Consequently, the decision usefulness gradually evolves and develops. However, holding or selling stocks of companies through the stock market in a decision usefulness view can also be considered as a commissioned responsibility decision. Thus, investors must select companies' current administrative authority or another administrative authority as the trustee. Such situation manifests the indirect exercise of the entrusted person's rights in the commissioned responsibility relationship. Thus, the broad evaluation of commissioned responsibility includes decision usefulness.

In general, the commissioned responsibility put forward in the CF for financial reporting refers to the narrowly defined commissioned responsibility. Given the varying degrees of the development of capital markets in various countries, the co-existence of commissioned responsibility and decision usefulness has emerged. The information joint framework required by the evaluation of commissioned responsibility believes that it is basically within the scope of the resource configuration required information under the view of decision usefulness. Certain differences exist between the two in terms of information quality requirements. Information evaluating the performance of commissioned responsibility should emphasize faithful representation. Moreover, information on decision usefulness should focus on correlation. Therefore, many countries now still regard the decision usefulness and commissioned responsibility views as two objectives, such as China and the United Kingdom. In the discussion of the joint framework, two members of the IASB disagreed to make the commissioned responsibility as the subject to decision usefulness. They affirmed that the decision usefulness view focuses on predicting the quantity, timing, and uncertainty of future cash flows. Predicting future cash flows is also related to evaluating the commissioned responsibility. However, evaluating the commissioned responsibility requires attention to stakeholders' trading information. Past transactions and events must also be emphasized. Whether the results can lead to the preservation and appreciation of assets should also be clarified. After all, cash flow from future transactions and events is not the only matter involved. Therefore, commissioned responsibility and decision usefulness should be two parallel, non-conflicting but differently focused objectives. Both deserve a certain amount of attention and serve as two required objectives.

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