FASB's Statements on Objectives and Elements of Financial Accounting: A Review

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ABSTRACT: This paper provides a critical review of the FASB's Statement on Objectives and of its Exposure Draft on the elements of financial accounting. First, the FASB's statements are compared with those of the previous authoritative bodies. Little that is new and little that can be expected to aid in the resolution of accounting issues can be found in the FASB's Statements. If the previous authoritative statements on objectives (and conceptual framework) can be adjudged failures, there is reason to believe that the present effort will have a similar future. Second, the reasons for such failure are considered and it is found that objectives of financial accounting do not have an unambiguous interpretation. Several explanations as to why accountants continue to seek an authoritative definition of objectives (and conceptual framework) are offered and some modest proposals for the "objectives of the FASB" are discussed at the end of the paper.

We thus have cause to feel grateful to the drafters of recommendations; and this review should on no account be construed as an attack on them. Obviously, they have devoted much time and care to their task, and have been prompted by a high sense of public service. If harm should in the end come from their work, the blame should attach more to disciples who have accepted their teaching too eagerly, and have invested it with an ex cathedra quality that could not perhaps have been foreseen. [Baxter, 1962, pp. 419-20].

The Financial Accounting Standards Board (FASB) issued an exposure draft of the proposed statement on Objectives of Financial Reporting and Elements of Financial Statements of Business Enterprises on December 29, 1977. The first part of the Exposure Draft, dealing with the objectives of financial reporting, was issued in revised form a year later as the Statement of Financial Accounting Concepts No. 1 (SFAC 1) [FASB, 1978]. A final statement on the elements of financial statements has not yet been issued. In this paper we review the FASB's statement on objectives (as contained in SFAC 1) and on elements (as contained in the Exposure Draft). Though many of our comments could also be applied to other aspects of the project on the conceptual framework.

We have benefited from many helpful comments in particular those by Professors Raymond J. Chambers, William W. Cooper, Sidney Davidson, Rashad Abdelkhalik, William R. Scott, Stephen A. Zeff, and the anonymous reviewers.

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undertaken by the FASB, we shall limit our discussion to the two documents mentioned above.¹

Few general criteria, other than internal consistency, have been proposed for evaluating conceptual frameworks. The approach taken in the reviews by Littleton [1962; 1963] of the Moonitz [1961] and the Sprouse and Moonitz [1962] monographs; by Ijiri [1971] of the APB Statement No. 4 [AICPA, 1970]; by a subcommittee of the American Accounting Association (AAA) to respond to the FASB's Discussion Memorandum of the Conceptual Framework [AAA, 1977b]; by Sterling [1967] of the AAA’s A Statement of Basic Accounting Theory [1966]; by Vatter [1963], Hanson [1940], and Kester [1940] of Paton and Littleton [1940]; and by Deinzer [1964] of various statements sponsored by the AAA [1936; 1941; 1948; 1957; 1964a; 1964b] seem too diverse to provide common criteria for evaluating a conceptual framework. We decided, therefore, to use two criteria in our review: (1) To what extent do these statements differ from previous attempts of this nature; and, regardless of the answer to (1), (2) to what extent will these statements, if adopted, yield the benefits expected by the FASB? Since we arrive at pessimistic answers to both questions, we are led to consider two further questions: (a) What are the fundamental difficulties in developing a set of objectives of financial accounting, and (b) why do authoritative bodies persist in trying to develop a conceptual framework? The final section of the paper contains the summary and concluding remarks.

1. COMPARISON WITH PREVIOUS ATTEMPTS TO DEVELOP A FRAMEWORK

Objectives

The SFAC 1 is divided into two parts:

Introduction and Background, followed by Objectives of Financial Reporting. The introductory section includes subsections on: (a) financial statements and financial reporting, (b) the environmental context of objectives, (c) the characteristics and limitations of information provided, (d) potential users and their interests, and (e) general-purpose external financial reporting. Financial statements are defined to be a subset of financial reporting, but no limits are provided on the number of elements of financial reporting that one may include in financial statements. The discussion of the environmental context of accounting bears a resemblance to the discussion by Moonitz [1961, Chapter 2] and by the Accounting Principles Board in Statement No. 4 (APBS 4) [AICPA, 1970, Chapter 3]. A discussion of the major characteristics of the U.S. economy in the statement of objectives would be justified if it were accompanied by a theory which linked the characteristics of various economies to alternative financial accounting systems. Since no such theory is provided, it is not clear how a vague description of the U.S. economy is useful for determining or understanding objectives.²

In the sections on potential users and general-purpose financial reporting it is stated that the specific objectives here refer to the general-purpose financial reports that serve the informational needs of external users who lack the authority to prescribe the financial information they want from an enterprise, a

¹ These documents were preceded by two Discussion Memoranda [FASB 1974; 1976a]; the latter was accompanied by a statement of tentative conclusions on objectives of financial statements [FASB, 1976b].

² For example, paragraph 13 refers to efficient allocations of resources within a market economy, but there are several definitions of allocation efficiency which might be employed. In the absence of an agreed-upon definition, inefficiencies cannot be identified.
statement very similar to Objective No. 2 of the Trueblood Report [AICPA, 1973]. The FASB relies considerably on the Trueblood Report when it states that financial reporting "should provide information to help present and potential investors and creditors, and other users in assessing the amounts, timing, and uncertainty of prospective net cash receipts. . . ." [FASB, 1978, para. 37]. The need for information on cash flows leads to the need for information on "the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events, and circumstances that change resources and claims to those resources" (para. 40).

After more discussion, the Board arrives at the conclusion that the primary focus of financial reporting is information about an enterprise's performance provided by measures of earnings and its components. . . . Information about enterprise earnings and its components measured by accrual accounting generally provides a better indication of enterprise performance than information about current cash receipts and payments [FASB, 1978, para. 43-44].

This last statement is not an objective, but means to an objective.

Although these paragraphs encompass many of the specific objectives of the Trueblood Report, the emphasis and order of presentation are different. Other departures from the Report are an omission of any reference to providing financial forecasts and to non-profit and social accounting (Objectives 10, 11, and 12, respectively, of the Trueblood Report).

In wording and substance, little is new or different in SFAC 1. Had the FASB pointed out the parts of the existing reports, such as APBS 4 and the Trueblood Report, that it agreed with and emphasized its disagreements, its contribution would have been easier to discern. Without such aid, we are hard-pressed to discern the FASB's net contribution to these earlier efforts. Given that previous authoritative efforts to write objectives are generally considered inadequate in helping to resolve accounting issues, a basic test of the FASB's contribution is the extent to which SFAC 1 may succeed where others have failed. We shall apply such a test after discussing the elements of financial statements and characteristics of financial information as provided in the FASB's Exposure Draft [FASB, 1977].

**Elements of Financial Statements**

The second major section of the Exposure Draft [FASB, 1977], paragraphs 36 through 66, deals mainly with definitions of the main categories of accounts appearing in financial statements: assets, liabilities, owners' equity, revenues, expenses, gains, and losses. Supplementing these definitions are subsections containing discussions of the bases for definitions, the matching of efforts and accomplishments, and the need to provide financial statements which articulate with one another. The elements of financial statements are integrated—revenues and gains result in, or from, increases in assets, decreases in liabilities or combinations of the two; expenses and losses result in, or from, decreases in assets, increases in liabilities, etc.

A noteworthy feature of the FASB's definitions is their dependence on un-
specified "accounting rules and conventions" [FASB, 1977, p. 19], again in the tradition of the definitions provided by two previous authoritative bodies, the American Institute of [Certified Public] Accountants' Committee on Terminology and Accounting Principles Board. This qualification appears to be inconsistent with the claim that conceptual frameworks can lead to the selection of appropriate principles and rules of measurement and recognition. How can a conceptual framework guide choices from among alternative principles and rules if the elements of the framework are defined in these very same terms?

The dependence of the FASB's definitions on unspecified rules and conventions leaves little basis on which to evaluate them, since a specific evaluation of these definitions would be speculative as long as we do not know what conventions will be adopted by the FASB at the subsequent stages of its project.

A second feature of the FASB's definitions is that they provide only the necessary conditions for a resource or obligation to be included in the asset or liability categories, respectively, rather than both the necessary and sufficient conditions. For example, a resource other than cash needs to have three characteristics to qualify as an asset:

(a) the resource must ... contribute directly or indirectly to future cash inflows (or to obviating future cash outflows), (b) the enterprise must be able to obtain the benefit from it, and (c) the transaction or event giving rise to the enterprise's right to interest in the benefit must already have occurred [FASB, 1977; para. 47].

Similarly, three characteristics are also necessary for an obligation to qualify as a liability:

(a) the obligation must involve future sacrifice of resources—a future transfer (or a fore-going of a future receipt) of cash, goods, or services, (b) it must be an obligation of the enterprise, and (c) the transaction or event giving rise to the enterprise's obligation must already have occurred [FASB, 1977, para. 49].

Since these are only necessary characteristics, their presence does not imply that an obligation will qualify as a liability or that a resource will qualify as an asset. All of these conditions may be satisfied and an obligation still may not qualify as an asset or, alternatively, as a liability. In the absence of sufficient conditions, these definitions will be of limited use to accountants.

The definitions of revenues and expenses given by the FASB follow the traditional practice of defining these as increases and decreases in assets or decreases and increases in liabilities, respectively, provided that the changes in assets and liabilities relate to the earning activities of the enterprise (broadly defined). Gains and losses are defined as increases and decreases in net assets, other than revenues and expenses or investments and withdrawals by owners.

The definitions of revenue and expense in APB Statement No. 4 [AICPA, 1970] are similar to the above except that the definitions there do not explicitly distinguish between revenues and gains nor between expenses and losses. A distinction between revenues and gains is also made by Sprouse and Moonitz [1962, p. 50] and by Paton and Littleton [1940, p.]

* For example, the Committee on Terminology defined assets in Accounting Terminology Bulletin No. 1 [AICPA, 1953] as follows:

"Something represented by a debit balance that is or would be properly carried forward upon a closing of books of account according to the rules or principles of accounting ... on the basis that it represents either a property right ... or is properly applicable to the future" (para. 26, emphasis added).

The APB in its Statement No. 4 defined assets as:

"economic resources of an enterprise that are recognized and measured in conformity with generally accepted accounting principles ... " [AICPA, 1970, para. 12] (emphasis added).
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60]. But while a distinction between expense and loss is made by Sprouse and Moonitz, Paton and Littleton do not do so. Indeed, they do not even provide an explicit definition of expense, which is consistent with their emphasis on cost rather than on the asset-expense distinction. It is not until their discussion of income that Paton and Littleton stress a distinction between costs matched against revenues (expenses) and those deferred to future periods (assets) [1940, Ch. V).

On the whole, the differences between the FASB and the APB definitions are small and seem unimportant. An explicit discussion of the main sources of disagreement would have been more fruitful than a "new" set of definitions. Circular as they are, the conflict on definitions seems to us to be only a proxy debate whose principal, to which we return later, is the debate about the accounting rules themselves.

*Characteristics and Limitations of Financial Information*

A part of the last major section of the Exposure Draft has been included in the introductory section of SFAC 1. There we find statements about: (a) the reliance of accounting on monetary transactions, (b) the emphasis of financial reports on individual enterprises and not on individual consumers or on society as a whole, (c) the role of estimation in accounting, (d) the fact that much of financial information reflects past events, (e) the coexistence of other sources of financial information, and (f) the costs of financial reporting.

The more well-known desirable "qualities" of accounting information, such as relevance, freedom from bias, comparability, consistency, understandability, verifiability, etc., are also referenced in the Exposure Draft, but are excluded from SFAC 1. The FASB acknowledges that trade-offs among these qualities are not easily accomplished in practice. The objectives and definitions of the elements of financial statements are expected to guide the Board in future phases of the conceptual framework project when these trade-off issues arise in more concrete form.

The characteristics and desirable "qualities" of accounting information discussed in the Exposure Draft are familiar to accountants and appear as "qualitative" objectives in APB Statement No. 4 and as components of accounting concepts or as postulates in other conceptual frameworks.

The above review of SFAC 1 and of certain parts of the Exposure Draft reveals little that is new on the objectives of financial reporting and definitions of the elements of financial statements. Lack of novelty, of course, does not imply worthlessness. It is quite possible that the FASB's effort may yet have the potential to yield some benefits. The FASB has suggested that the following benefits may manifest themselves as a result of achieving agreement on the conceptual framework [1976c, pp. 5–6]:

1. Guide the body responsible for establishing standards,
2. Provide a frame of reference for resolving accounting questions in the absence of a specific promulgated standard,
3. Determine bounds for judgment in preparing financial statements,
4. Increase financial statement users' understanding of and confidence in financial statements, and
5. Enhance comparability.

In reviewing this early part of the conceptual framework, it is probably fair to ask how reasonable it is to expect that the above-mentioned benefits will actually be realized. Of course, this evaluation
may have to be changed when all the pieces of the conceptual project are in place. However, the evaluation of this part of the project, tentative as it is, should not await completion of the project.

In the following section we examine the degree to which the first two benefits stated by the FASB, viz., guidance for establishing standards and resolution of accounting questions in the absence of standards, are likely to be attained on the basis of the given objectives and definitions. The effect of the project on users’ understanding of, and confidence in, the financial statements is an empirical question and is beyond the scope of this review paper. We are not sure what precisely is meant by (3), determination of the bounds of judgment in preparation of financial statements and by (5), enhancement of comparability. Since the empirical or analytical contents of these benefits are not clear, it is difficult to evaluate, beyond purely subjective opinion, whether and to what extent these benefits will be derived from the FASB’s objectives and definitions. We shall, therefore, confine ourselves to an evaluation of the first two benefits stated by the FASB.

2. RESOLUTION OF THREE ACCOUNTING ISSUES

As a means of evaluating the potential benefits the FASB’s objectives and definitions may provide in resolving accounting issues, we selected three which have been debated for some time and which have received much attention from accountants and others. The issues are: (1) deferred credits, (2) treatment of costs of exploration in the oil and gas industry, and (3) reports on current values of assets and liabilities.

Deferred Credits

The FASB defines liabilities as “financial representations of obligations of a particular enterprise to transfer economic resources to other entities in the future as a result of a past transaction or event affecting the enterprise” [FASB, 1977, para. 49]. No specific reference to deferred credits appears in this section, although reference is made to liabilities arising from the collection of cash or other resources before providing goods or services, or from selling products subject to warranty. It is also stated that “legal enforceability of a claim is not a prerequisite to representing it as a liability” if future transfer is probable.

The APB, in Statement No. 4, is more direct:

Liabilities—economic obligations of an enterprise that are recognized and measured in conformity with generally accepted accounting principles. Liabilities also include certain deferred credits that are not obligations but that are recognized and measured in conformity with generally accepted accounting principles [AICPA, 1970, Para. 132, emphasis added].

A footnote to the last sentence specifically singles out deferred taxes as an example of liabilities which are not obligations!

Neither Paton and Littleton [1940] nor Sprouse and Moonitz [1962] refer to deferred credits arising from differences between financial and tax reporting, with both concentrating on the obligations of enterprises to convey assets or to perform services in the future.6

The FASB’s definition of liabilities is so general that at this stage we cannot predict the Board’s position on deferred taxes. However, those who favor the recognition of deferred taxes can adopt a somewhat broad interpretation of the FASB’s definition of liabilities to justify the inclusion of deferred taxes as an ele-

5 The FASB may wish to commission such a study now, so that a preconceptual framework measure of confidence and understandability can be taken before this opportunity is lost.

6 The issue of deferred taxes did not appear in the accounting literature until about 1942. See AICPA [1942].
ment of financial statements, particularly at the individual asset level. In contrast, those who do not could take the FASB’s statements literally and just as easily argue against the inclusion of deferred taxes. Hence, these broad definitions will not help resolve the issue.

Accounting for Oil and Gas Exploration Costs

Bitter controversy still surrounds the issue of how to account for petroleum exploration costs. The issue surfaced in the petroleum industry some two decades ago when the full-cost method was introduced. But the essence of the issue has an earlier precedent.

Hatfield [1927, Chap. 2] considers the problem of whether the acquisition costs of successful experiments should be limited to the costs of the successful experiments themselves or whether they should also include the costs of unsuccessful experiments. Hence, the full-cost versus successful-efforts debate is part of a more general issue of what constitutes the costs of assets when the acquisition process is risky.

The issue reflects a difference of opinion regarding the level of aggregation at which the historical acquisition cost principle is applied to record assets for subsequent amortization. But there is no reference in the Exposure Draft to alternative levels of aggregation for asset recognition and measurement. The only explicit statement bearing on this problem is that “[i]nformation about enterprise earnings and its components measured by accrual accounting generally provides a better indication of enterprise performance than information about current cash receipts and payments” [FASB, 1978, para. 44]. However, both full-cost and successful-efforts accounting are forms of accrual accounting, so that proponents of the former (e.g., the Federal Trade Commission) have the same support for their position as do proponents of the latter (e.g., the FASB).

The fact that the framework supports two opposing principles of accounting is preliminary evidence that the framework is unlikely to be a useful guide in resolving this issue.

Selecting the Valuation Basis for Assets and Liabilities

Alternative theories of valuation and income were discussed in accounting texts published 50 years ago. For example, Hatfield [1927] states:

Having accepted the principle that the original valuation of assets is normally their cost price, and having noticed the practical and theoretical difficulty in determining the exact cost price, there remains the more important question as to subsequent revaluations of assets. . . . Shall the accountant base revaluation on (1) the original cost . . . (2) on the estimated present cost of acquiring a similar asset . . . or (3) on what the asset might be expected to bring if thrown upon the market in the process of liquidation [p. 73]?

Similar discussions appear even earlier in Paton [1922], in Hatfield [1909], and in a much more detailed fashion in Canning [1929].

Liquidation values were generally ruled out in such discussions because they seemed inconsistent with the going-concern notion, and since discounted values had not yet achieved popularity then, the choice between alternative valuation bases was usually limited to historical or replacement costs.

With respect to these alternatives, it might be informative to quote some statements from Paton and Littleton [1940], who, some accountants believe, had no tolerance for valuation bases other than historical cost accounting. On pages 122–123, they state:

With the passing of time, however, the value of the particular productive factor—as reflected in the current cost or market price of like units—is subject to change in either direction, and when a change occurs it becomes clear that the actual cost of the unit still in
service or still attaching to operating activity is not fully acceptable as a measure of immediate economic significance.

Later, on page 123, they ask the question:

Would accounting meet more adequately the proper needs of the various parties concerned if, in the process of separating the charges to revenue from the unexpired balances, the estimated replacement costs or other evidence of current values were regularly substituted for recorded costs incurred? There seem to be no convincing reasons for an affirmative answer. Recorded costs are objectively determined data; estimated current values are largely matters of opinion and for some types of cost factors are conspicuously unreliable.

In the section on “Limitations of Estimated Replacement Cost,” they comment: “In the first place continuous appraisals at the best are costly, and can be used only if the benefits to be derived clearly justify the additional cost incurred” (p. 132). They then suggest that in periods of price stability and situations involving complex enterprises, such benefits are unlikely to exceed the costs of implementation. Finally,

The fair conclusion is that the cost standard of plant accounting holds up well, as compared with any alternative plan, when faced with typical business needs and conditions. At the same time it would be going too far to hold that under no circumstances can any useful purpose be served by introducing into the accounts and reports, by appropriate methods, data designed to supplement the figures of actual cost [Paton and Littleton, p. 134].

The latter statement led them to recommend that alternative valuations be limited to supplementary schedules.

The above are practical, not theoretical, arguments and are probably representative of the views of many accountants who have expressed a reluctance to accept current costs in published financial statements. No conceptual framework, however logically conceived, can counter practical issues regarding the reliability of estimates of, say, replacement costs. The “true” replacement costs of assets are not observed until those assets are actually replaced (nor are “true” exit prices observed unless the assets are sold). So the issue is not whether current costs are useful “in making economic decisions”; rather, the issue is what criteria may be used to alternative estimates of unknown parameters. Unfortunately, neither SFAC 1 nor the Exposure Draft addresses this problem of estimation.

On the basis of the above analysis, we conclude that the results of the FASB’s effort to write objectives and definitions are hardly different from previous attempts of this nature and, as such, are unlikely to help resolve major accounting issues or to set standards of financial reporting as the FASB had expected. Pessimistic as our conclusions are, they should not surprise those familiar with the standard-setting process during the past 30 years. The charge of the Trueblood Study Group was very similar to the first two benefits expected by the FASB:

The main purpose of the [Trueblood] study is to refine the objectives of financial statements. Refined objectives should facilitate establishment of guidelines and criteria for improving accounting and financial reporting [AICPA, 1973, p. 67].

Both the supporters and the critics expressed doubts that this purpose of the study would be met. Bedford [1974, p. 16], while largely supporting the report, said, “I refer to the extremely difficult task of logically deriving accounting standards from objectives—not that I think it can be done but because I fear some will think it is appropriate.” Miller [1974, p. 20], a critic of the report, stated, “The greatest short coming of the Trueblood Report is, it seems to me, that the
accept/reject criteria are not sufficiently precise. I wish Professor Sorter and his associates had been less subtle.” Sprouse stated, “I have no illusions about the use of such a document to prove that a particular accounting standard is ‘right’” [1974, p. 28]. These doubts about the accomplishments of the Trueblood Report are very similar to our reservations about the fruits of the FASB’s labors.

Since our conclusion about the potential value and effect of the FASB’s objectives and definitions is pessimistic, we are led to inquire into the very nature of objectives of financial accounting and the fundamental difficulty of defining them in a social setting. The inability of different authoritative drafts of objectives produced in the last decade to achieve general acceptance on a conceptual framework is hardly due to the lack of diligence on the part of their authors; it may stem from addressing the wrong problem.

3. The Nature of Objectives of Financial Accounting

An objective is something toward which effort is directed, an aim or end of action, a goal [FASB, 1974, p. 13].

Financial accounting is a social or multiperson activity. Members of society engage in financial accounting or in other social activities when they are motivated by their individual goals and objectives. We shall assume that the meaning of the terms “goal” and “objective,” as they apply to individuals or homogeneous groups of individuals, is self-evident for the purpose of the present discussion. Given a clear definition of the objectives that motivate each individual to engage in an aspect of a social activity, what meaning can we assign to the term “objective” when it is applied not to individuals or groups, but to the activity itself? In what sense can a social activity be said to have an objective?

We suggest three different interpretations of the meaning of the objectives of a social activity: functional objectives, common objectives, and dominant group objectives. In this section we shall first explain the meaning and implications of each interpretation and then examine the nature of the objectives of financial accounting in light of these interpretations.

Functional Objectives

The union of individual objectives could be referred to as the objective of the social activity in a functional sense. A functional explanation of social phenomena assumes that the consequences of a social arrangement or behavior are essential elements of the causes of that behavior (see Stinchcombe [1968], esp. pp. 80–100). Objectives that motivate individuals to engage in an activity on a continuing basis must also be the consequences of the activity; otherwise the individuals will not continue to engage in it. Thus, the functional explanation implies that the union of individual objectives can be identified without probing into the motivations of individuals by simply observing the set of consequences of the social activity. These consequences themselves therefore can be regarded as the objectives of the social activity. Since the consequences are observable phenomena, they can be objectively determined. However, the set of consequences may be so large that a complex and lengthy description may be the result. Nevertheless, a statement of consequences is one possible interpretation of the objective of a social activity.

Common Objectives

A second possibility is to define the intersection of individual objectives, i.e., the subset of objectives common to all
individuals, as the objective of the social activity. By definition, common objectives are equal to or fewer in number than the functional objectives. If all individuals are motivated by an identical set of objectives, common objectives are the same as the functional objectives; if each individual is motivated by different objectives, the intersection is null and there are no common objectives.

Dominant Group Objectives

A third possible interpretation of the objectives of a social activity is the objectives of an individual or subset of all individuals in the society who are able, through whatever mechanism, to impose their will on all others involved in the activity. In the presence of such a dominant group, the objectives of individuals not included in the group become irrelevant, since the dominant group objectives become the objectives of the social activity. Obviously, this interpretation cannot be used if the dominant group does not have the power to impose its will on the society.

Accounting as a Social Activity

Accounting is a social activity engaged in by (1) corporate managers who perform in activities that are recorded by the accounting system; (2) corporate accountants who gather the data and compile the reports; (3) auditors who scrutinize and attest to the fairness of the reports; (4) outside government and private agencies, investors, employees, customers, etc., who read these reports; and (5) college and university personnel who train their students in accounting. Each group of individuals engaged in financial accounting possesses its own private motives or objectives leading to this involvement. In the light of the three possible interpretations of the objectives of a social activity discussed above, what meaning can we assign to the objectives of financial accounting?

Functional Interpretation of Accounting Objectives

Since all consequences of accounting are included in the functional interpretation of objectives, consider the following sample of objectives that would qualify under this interpretation:

1. Increase employment of accountants, auditors, and teachers of accounting;
2. Help companies market their securities to creditors and investors;
3. Help outsiders monitor the performance of management;
4. Maximize the wealth of the present owners of the company;
5. Minimize income tax burdens of companies;
6. Aid in controlling inflation;
7. Disclose the impact of enterprise operations on the quality of the environment;
8. Help management avoid hostile takeover attempts;
9. Systematically record, classify, and report data on the business transactions of the enterprise;
10. Aid in enforcing anti-trust laws.

Each of the objectives listed above could be viewed as legitimate by one or more sets of individuals involved in financial accounting. Note that a complete description of the consequences of financial accounting will include not only "facts" but what is regarded as "fiction" by specific individuals. For example, a manager may regard the avoidance of hostile takeover attempts as a valid objective of financial statements while a shareholder may believe that the effect of financial accounting practices on avoidance of hostile takeovers is non-existent. In order to be included in
the set, it is sufficient that someone involved in financial accounting believe in that consequence or use it as a personal objective. Note also that this set includes contradictory objectives and consequences. For example, management may believe that one accounting method for inventory accounting will help market the firm's securities, whereas shareholders may believe that an alternative inventory method is more revealing of management's competence. Similarly, the objective of accountants to increase the demand for their services may be in conflict with the objective of corporate managers to maximize their own or the shareholders' wealth.

Although probably not intended as such, the objectives stated by the FASB may be viewed as functional objectives. For example, the first objective given by the FASB is:

Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence [FASB, 1978, para. 34].

If "should" is removed from each sentence, this objective is reduced to a mere statement of an empirically verified and a widely accepted consequence of financial accounting. Financial accounting does, indeed, provide information useful to investors and creditors, and it is comprehensible to those willing to study the reports with reasonable diligence. But, being purely descriptive, functional objectives themselves cannot serve as normative goals to guide policy making. Nevertheless, if they are reasonably complete, they can serve to improve the understanding of the role of financial accounting in society.

There is reason to believe that the FASB did not intend to offer its statement as one of functional objectives. First, the statement is far from complete, concentrating on a few facts and a few unverified theories about the consequences of financial accounting, without any effort to present, for example, the motivations behind the supply side of financial accounting services. And the normative tone of the statement precludes the possibility that the FASB has attempted to provide a statement of the union of individual objectives of all persons involved in financial accounting.

**Common-Objectives Interpretation of Accounting Objectives**

A second possible interpretation of the objectives of accounting is the subset of individual objectives which are common to all individuals involved in accounting. Cyert and Ijiri's [1974] model of heterogeneous interests can be modified to apply to the objectives. Cyert and Ijiri use a Venn diagram to illustrate their point. The elements of the sets considered by them are pieces of information which various interest groups—users, managers, and auditors—may be willing to use, provide, or attest, and the intersection of the three sets is the actual information provided by the financial statements. The choice problem posed by Cyert and Ijiri could be moved to a higher level of abstraction by considering the sets of accounting principles that each group would prefer to be used in the preparation of financial statements. A still higher level of abstraction would involve specific sets of objectives that each group would seek to fulfill through its involvement in financial accounting.

It is conceivable that the intersection of the three sets will become progressively smaller as we move to higher levels of abstraction from pieces of information.
to accounting principles to objectives, in which case the Venn diagrams at the three levels of abstraction might appear as in Figure 1.

We do not know whether the intersection of the sets grows larger or smaller as we move from items of information to principles to objectives and vice versa. Generally, agreement on principles and objectives will be easier to obtain if such statements are sufficiently vague so as to allow room for various interest groups to adopt their own interpretations. But vagueness, while necessary to obtain initial agreement, will reduce the usefulness of a statement of objectives in setting accounting standards. The proposition is borne out by the statements of objectives we have seen thus far. The vagueness of statements of this nature is consistent with the level of generality at which agreement is sought. It allows enough room for each interested party to maneuver to protect its own interest when actual accounting standards and rules are written.

Some empirical evidence is available on the non-overlapping nature of accounting objectives. In 1976, when the FASB carried out a survey to determine how many people involved in various aspects of financial accounting agreed with the Trueblood objectives, the Board was surprised to learn that only 37 percent of the respondents believed that providing information useful for making economic decisions was an objective of financial accounting:

Let me point this up for you. In our first discussion memorandum on the conceptual framework of accounting, we sought an expression of opinion from respondents on the following as a basic objective of financial statements: it is taken directly from the Trueblood Report:

The basic objective of financial statements is to provide information useful for making economic decisions.

Could there be disagreement with a statement such as this? I am sure you will be astounded to learn that only 37 percent of our respondents were able to recommend the adoption of this objective. Twenty-two percent recommended that it be rejected out of hand; and 10 percent insisted that it needed further study. It is difficult to believe that only 37 percent can agree that the basic objective of financial statements is to provide information useful for making economic decisions. I think this

7 The question is subject to debate; see, for example, the analysis of responses of various parties to the FASB's pronouncements by Coe and Sorter [1977–78] and Watts and Zimmerman [1978].
suggests the problem quite clearly [Armstrong, 1977, p. 77].

We are puzzled at the Board's puzzlement. Why should we believe all groups of interested parties would adopt the provision of information useful for making economic decisions as their motivation for being involved in the financial reporting process? For example, we should not be surprised if auditors, like everyone else, seek to maximize their own wealth through participation in the accounting process. If the provision of economically useful information implies greater exposure to the risk of being sued without corresponding benefits of higher compensation, they will not see the provision of economically useful information (however defined) as their objective of the financial accounting process. Similar arguments could be made about any other interested party who might have been surveyed by the FASB. The members of each group probably stated what they believed were their objectives for being involved in the process.

At present, we do not have data to determine which, if any, objectives are actually common to all participants in accounting. Consequently we cannot yet determine whether the common-objectives approach is a feasible interpretation of the objectives of accounting.

**Dominant Group Interpretation of Accounting Objectives**

Unlike the Trueblood Study Group, the FASB has not stated explicitly how it selected its subset of objectives from a much larger set of potential objectives. But from the objectives which the FASB did select, we can infer that it has followed the Trueblood Study Group in relying on the notion of user-primacy in financial accounting. This notion represents the dominant-group approach to defining the objective of a social activity that we identified above.

Most of the discussion appearing in the literature on the objectives of financial accounting during the past ten years tends to rely on the notion of user-primacy. Beaver and Demski [1974], for example, concentrated their attention on the problems generated by the heterogeneity of tastes among the users of financial statements, on the assumption that this group would be the primary group whose interests would be reflected in the objectives of financial statements officially adopted by the authoritative agencies:

There seems to be a consensus that the primary purpose of financial reporting is to provide information to financial statement users. Yet, the basic, fundamental role of objectives within this utilitarian, user-primacy framework remains obscure—largely we speculate because the problem of heterogeneous users has not been forcefully addressed. . . . A basic purpose of this summary and synthesis, then, is to offer a view of the nature and role of financial accounting objectives that explicitly rests on heterogeneous users [p. 170].

Cyert and Ijiri [1974] considered the heterogeneity of preferences for information sets among three diverse groups (assuming that the intragroup heterogeneity is unimportant) and analyzed the problem of determining accounting standards under the assumption that the user interest is primary. Referring to 1(a) of our Figure 1, they stated:

This is a logical, if not a unique approach since in many user-corporate relationships the corporation is accountable to the users for

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6 "While mindful of the importance of the audit function, the Study Group has been primarily concerned with the nature of information and not its attestability." [AICPA, 1973, p. 10.] The Trueblood Study Group left the problem of estimation and the interests of the management to "implementation" and did not consider these interests worthy of consideration within the set of objectives of financial reporting.
its activities. If the users are in a position to demand information from the corporation based on a contractual or statutory relationship between them, it makes sense to define what Circle U is and then attempt to move Circle C toward it. Furthermore, in the interaction of the three groups, the profession’s purpose is to help keep a smooth flow of information from the corporation to the users. Hence, Circle P is clearly subordinate to Circles C and U. Thus, it is perhaps the most practical way to state as objectives the need to move Circles C and P toward the goal of a newly defined Circle U [p. 32].

If the user group had the power to enforce its preferences at no cost to itself, the objectives of this group could be called the objectives of financial accounting. This would simplify the problem of setting objectives. Indeed, if the user group were homogeneous, the problem would be trivial. However, there is little evidence that the user group has the power to impose its preferences on financial accounting.

A considerable amount of confusion about the objectives of financial accounting has been generated by comparing them to the objectives of the firm. For example, Bedford [1974] notes, "‘The basic objective of financial statements is to provide information useful for making economic decisions.’ This statement is as direct as the statement that ‘the basic objective of private enterprise is to make a profit and it is equally operational’ [p. 15; emphasis is added]. Few would dispute that, as stated, the profit-maximizing objective of the firm is merely a shorthand way of stating the objectives of the shareholders of the firm under the assumption of homogeneous shareholder preferences; it does not represent the specific objectives of the managers, employees; creditors or of any other parties inside or outside the firm. Besides, profit is a net concept in the sense that it is the difference between revenues and expenses, and its use as an objective implies that additional revenue should not be generated beyond the point at which the additional cost exceeds it. Provision of information for decision making, unlike profit, is a gross concept and cannot provide guidelines as to how far the firm should go in providing information for economic decisions.

The analogy to the theory of the firm is more apparent than real. In that theory, if the objective is to maximize the owners’ wealth, production-investment variables can be chosen in view of the cost and revenue functions which serve as the environmental variables. What is the FASB (or any other agency entrusted with the task of writing accounting standards) supposed to maximize or optimize? When the FASB recommends that the objective of financial statements is to provide information useful for making rational credit and investment decisions, should we understand that the provision of such information should be maximized without regard to the cost and other consequences of making such information available? What are the variables over which to optimize, and what is the trade-off among these variables? Unless these trade-offs are defined, a statement of objectives that will be useful in arriving at the most satisfying accounting standards cannot be said to have been laid down, nor can there be a way of determining if the recommended objectives have been achieved by a given accounting standard.

The extraordinary emphasis of the recent pronouncements regarding objectives of financial accounting on user primacy can probably be traced to inappropriate applications of single-person decision theory in a multi-person context. In single-person decision theory, the generation of information is regarded as a more-or-less mechanical process which remains unaffected by its ultimate
uses. The person making the choice of an information system out of the available alternatives calculates the expected present value of the benefits to be derived from the use of information produced by each system and makes the choice on the basis of the excess of these benefits over the respective costs. The same underlying event-generating mechanism is assumed to be common to all information systems, and it remains unaffected by the choice of information system made. This model, developed by the physical scientists and engineers for the control of mechanical or inanimate systems, is inappropriate for social systems, where the object of control is not an unchanging chemical process but a human being with learning capabilities. In control systems where human beings stand at both the sending and receiving end of the information channel, the flow of information affects behavior at both ends. We cannot choose an information system which is best suited to the needs of persons at one end of the information line on the assumption of a constant behavior pattern of the persons at the other end. Indeed, the two-way effect of the information makes the designation of one party as user and the other as sender somewhat ambiguous. A user-primacy notion in the selection of objectives of financial accounting which ignores how firm managers are likely to adjust their behavior to the new information system (and how this adjustment in management behavior will affect the interests of the so-called users) represents a very short-sighted view of the whole problem. As such, solutions derived from this simplified approach will not work. A similar argument could be offered regarding the exclusion of the auditors from the “primary” groups whose interests must be explicitly considered in any realistic set of objectives of financial accounting.

To summarize, we have examined three possible interpretations of objectives of social activities in general and financial accounting in particular. We have concluded that the union of individual objectives, being too diverse and contradictory, cannot serve to guide policy; intersection of individual objectives may be null; the dominant-group objectives, assuming user primacy, do not reflect the economic reality of the power of suppliers in the accounting marketplace and are, therefore, unworkable. Fundamental to an understanding of the nature of financial accounting as they are, these difficulties in interpreting the objectives of financial accounting have received little attention in the literature. This lack of attention stands in sharp contrast to the repeated efforts to prepare a statement of objectives and definitions and leads us to examine the possible reasons that may stand behind the efforts to prepare an authoritative statement of objectives and definitions.

4. Why Search for a Conceptual Framework?

In the first section of the paper, we compared the SFAC 1 and the Exposure Draft to the previous attempts of this nature and found little substantive difference. In the second section, we examined whether the first two of the five benefits claimed by the FASB may reasonably be expected to flow from these statements and reached a negative conclusion. Then we probed the very meaning of the term “objectives” as applied to financial accounting and found that term too ill-defined. These conclusions led us to inquire into reasons why authoritative bodies have continued to search for objectives and a conceptual framework of accounting. We consider several of these.

The first reason could be that our
negative conclusions in section two regarding the usefulness of these statements in resolving accounting issues and standard-setting problems are wrong. If so, it should be easy for someone to illustrate, possibly using issues other than the three we selected, that these objectives and definitions will indeed help resolve the accounting issues. We are not aware of any such illustrations.

A second reason for the search for conceptual frameworks could be provided in terms of the three potential benefits claimed by the FASB and not examined in this paper. It may turn out that the issuance of the conceptual framework increases the users' confidence in, and understanding of, financial statements. Someone may also give workable definitions of "bounds for judgment" and comparability and show that the issuance of conceptual frameworks may have desirable consequences in these respects. Again, neither the theoretical arguments nor the empirical evidence that bears on these issues is available.

Two further reasons are possible: One lies in the form in which accounting problems are brought to the authoritative bodies, while the second lies in the attempts of the accounting profession to keep the rule-making power in its own hands.

Repeated efforts of authoritative bodies to define the conceptual framework of accounting in general and the elements of financial statements in particular may arise from the genuine belief that a determination of precise definitions of certain terms will somehow help resolve accounting controversies. Such belief is reinforced each time an accounting controversy surfaces and the proponents of alternative methods present their arguments in the established terminology of accounting so as to convince the policy makers that the weight of tradition, so highly prized in accounting, is on their side. Given a strong motivation to have an accounting standard accepted which is favorable to one's interests, it is not difficult to devise an argument as to why a given transaction should be recorded in a certain way under the currently accepted definitions of accounting terms.10 Since the views of various parties are presented to the policy-making bodies not in the form of conflicting private interests, but in the form of conflicting interpretations of accounting definitions, it may appear that a clearer definition of each accounting term will solve the problem. A frank discussion of the private interests of various contending groups may be tactically disadvantageous in open public discourse.11 Hence, the overblown emphasis on authoritative definitions. However, definitions, no matter how carefully worded, cannot bear the burden of the struggle for economic advantage between various interest groups. Legal definitions survive in a similar environment only because their interpretations by the courts are backed by the power of the state to enforce them, a power not available to the FASB.

The conceptual framework-seeking behavior of the FASB and its predecessors can also be explained in terms of a self-interest perceived by the public accounting profession. The profession has long argued that its interests are best served if it can maintain control over prescri-

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9 See Zeff (1978, pp. 57–58) for a typology of the arguments offered in accounting controversies.
10 See Kitchen (1954) for a stimulating discussion of the problems of definition in accounting.
11 Since everybody is assumed to be serving the interests of the information user, proponents of all accounting methods argue their case because it will benefit such user. Recall that in the heyday of the LIFO controversy, a major argument for LIFO was that it yields a better measure of income. Watts and Zimmerman (1979) have attempted to explain the existence of some normative theories in financial accounting, using a parallel argument.
tion of accounting standards. This is revealed in its protests against any hint that the control of the profession over the standard-setting process may be weakened. Fear of governmental intervention has long been, and continues to be, the major reason for calls for action in the profession. Consider, for example, the following:

If the practitioners, after sufficient time has elapsed, have not come to some substantial agreement as to what are or should be considered accepted accounting principles and practices, we may well expect the Commission's [SEC's] staff accountants to prepare, and the Commission to publish what it shall demand in the way of such practices... [Smith, 1935, p. 327].

Appropriate as it is today, note that the above statement appeared in an article published almost 45 years ago. Disagreements centering on diverse accounting standards continue to attract much of the criticism leveled at the accounting profession and are the source of the greatest threat to the profession's control over the standard-setting process. The presence of diverse accounting practices hurts the credibility of the standard-setting bodies in two ways. First, the existence of alternative accounting methods is taken as prima facie evidence that the accounting standard-setting body is not doing its work properly and is simply allowing firms to record transactions in an arbitrary fashion. Second, whenever the standard-setting body prescribes the use of all but one of the alternative accounting methods, the advocates of the methods were no longer permitted to criticize the agency for being arbitrary in not protecting their interests. No matter what it does, a body like the FASB can expect to find itself criticized by powerful interest groups. A good example is provided by the debate on accounting for oil and gas exploration costs. The FASB was instructed to develop a uniform accounting standard for the oil and gas industry or face the threat of having such a standard written by a government agency. When the FASB chose the successful efforts over the full-cost method, it found, aligned against it, a powerful industry group as well as some government departments and agencies. Being largely an offspring of the accounting profession, the FASB has (as did the APB) little defense against the criticism that it does not have legitimate authority to make decisions which affect wealth transfers among members of society.

Thus, a body like the FASB needs a conceptual framework simply to boost its public standing. A conceptual framework provides the basis for arguing that: (1) the objective of its activities is to serve the users of the financial statements (it is easier to use the public-interest argument for the user group than for any other group), and (2) it selects among accounting alternatives on the basis of broadly accepted objectives and not because of pressures applied by various interest groups seeking a favorable ruling from the Board. The ability, intelligence, ethical character, and past services, etc., of the members of the FASB are not sufficient to convince the parties adversely affected by its rulings that it makes social choices through an impartial consideration of conflicting interests in society. Rather, a conceptual framework is needed to provide the rationalization for its choices.

If a more representative body were to take over the function of setting account-

12 Of course, the auditors' fear of government intervention is asymmetric. Consistent with their self-interests, they do want the government to continue to require an audit of certain business firms to ensure demand for their services but want to keep the standard-setting process free of government control.

13 A discussion of this public-interest argument appears in AAA(1977b).
ing standards, perhaps there would be less of a need for a conceptual framework. Indeed, the demand to develop a conceptual framework may be inversely related to the power of enforcement which the standard-setting agency can command. For example, the Securities and Exchange Commission, which has the legal power to enforce its Accounting Series Releases, has not been hampered by the fact that it has not yet enunciated a conceptual framework of accounting.

5. CONCLUDING REMARKS

There is little evidence that official statements of objectives of financial accounting have had any direct effect on the determination of financial accounting standards. Whenever the APB or the FASB has had to consider a financial accounting standard, various interest groups presented arguments to support the methods that each perceived to be in its own best interests. The standards issued had to be compromises among the contending interests. Whether the standard-setting process stays in the private sector or is transferred to some public agency, this feature is unlikely to change. What, then, will likely be the effect of the FASB's Conceptual Framework Project on the development of financial accounting standards in the future?

Our initial guess is that the objectives selected by the Board will be ignored in future rule-making activities, just as were those from previous authoritative attempts. Following the publication of these objectives, the Board will probably feel obliged to pay lip service to them in its future pronouncements, but these pronouncements will not be affected in any substantive way by what is contained in the present documents.

It might have been a more fruitful exercise for the FASB to develop a set of objectives for itself and not for the entire social activity called financial reporting. A few examples of such objectives are provided for consideration:

First, the Board could explicitly recognize the nature of financial accounting as a social activity which affects a varied set of interests, both of those who actively participate and those who do not. As the interests of each group are affected by the actions of the Board, it must expect to hear arguments in support of, and against, its decisions. The representations made by these parties could be viewed in the context of their own private interests. In the past, accountants in public practice (i.e., auditors) have tended to be more vocal in their reactions to the Board's actions than have other parties. But perhaps accountants in public practice should have less direct influence on the rule-making process in the future. In its statement of objectives, the Board could define mechanisms for arriving at a compromise ruling after a hearing has been given to all affected groups in society. The Board's primary objective would simply be to arrive at a compromise ruling after considering various points of view on each issue.

A second objective for the FASB might be to limit the detail and specificity of its accounting standards. The pressure to write increasingly detailed and specific accounting standards is great and, in recent years, the resistance of the Board to such pressures seems to be weakening. In this connection, we might note that one of the three conditions laid down by the Council of the Institute of Chartered Accountants in England and Wales for approving recommendations on account-

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14 See, for example, Horngren (1973, p. 61). “My hypothesis is that the setting of accounting standards is as much a product of political action as of flawless logic or empirical findings.”

15 An explicit objective along these lines was also proposed in AAA (1977b, pp. 10-11).
ing principles to its members was simply that the document be reasonably concise in form (see Zeff [1972, p. 11]).

Judging from the length and detail of some of its recent pronouncements (e.g., those dealing with leases and oil and gas exploration costs), the FASB seems to have abandoned an attempt to keep its Statements of Financial Accounting Standards concise.

A third objective of the Board could be to abstain from issuing an accounting standard unless the pronouncement could command a substantial majority. The recent move to lower the minimum voting requirement for issuing an FASB recommendation to a simple majority of seven members will probably increase the frequency of FASB pronouncements which are widely opposed by large segments of interested parties and therefore undermine the basis of its support.

In short, the FASB could assume that various functions of financial statements are well established and known generally by those who produce, audit, and use accounting information. Its task would be essentially one of trying to appease conflicting interests in the presence of disagreements over accounting rules, measurements, disclosures, etc. But once this role were recognized, what would be the advantages and disadvantages of allowing a private board like the FASB to make compromise decisions? Is this not a function essentially similar to that performed by the courts, and, if so, are we now back to the proposal for an accounting court?²

These questions appear to offer fruitful areas of research, more so than trying to deduce the objectives of financial accounting. Perhaps we can achieve more progress by developing and testing theories regarding why a major part of the responsibility for standard setting continues to lie with a private agency, and why members of the profession and corporate managers continue to contribute time and money to the process of developing a conceptual framework. It is unlikely that a general fear of government regulation alone can account for the latter. And, finally, to conclude with Baxter [1962, p. 427]:

Recommendations by authority on matters of accounting theory may in the short run seem unmixed blessings. In the end, however, they will probably do harm. They are likely to yield little fresh knowledge... They are likely to weaken the education of accountants: the conversion of the subject into cut-and-dried rules, approved by authority and not to be lightly questioned, threatens to reduce its value as a subject of liberal education almost to nil. They are likely to narrow the scope for individual thought and judgment; and a group of men who resign their hard problems to others must eventually give up all claim to be a learned profession.

¹ Of course, there is no government agency in the UK which serves an enforcement role like that of the SEC in this country. This factor may allow broader statements in the UK.

² First proposed by Littleton [1935].

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