THE CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING AND A PEDAGOGICAL APPROACH THERETO

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INTRODUCTION

I don't think you should teach the standards. I think you should teach the conceptual framework and then discuss why certain standards have not followed the framework (Sir David Tweedie, Chairman IASB, 2011).

In line with these comments by the Chairman of the International Accounting Standards Board (IASB), principle-based IFRS education (figure 1), has been proposed by Barth (2008) and Coetzee and Schmulian (2011). The foundation of this pedagogical approach is that students ought to be taught the concepts as contained in the Framework for the Preparation and Presentation of Financial Statements (1989) (now replaced with the Conceptual Framework for Financial Reporting (2010)\(^1\)). A Conceptual Framework is the foundation on which Financial Reporting Standards are based. When students understand the foundational concepts contained within a Conceptual Framework, they will be able to apply judgment in accounting for economic events (Barth 2008). Further, given that a Conceptual Framework is not subject to as frequent revision as the Financial Reporting Standards which it underlies, the students are provided with a more enduring knowledge of financial reporting. This article considers the content of the Conceptual Framework for Financial Reporting, prior to proposing a pedagogical approach to the teaching thereof.

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**FIGURE 1**
Principle-based approach to IFRS education

Economic event

Conceptual considerations:
Framework

Standard setter’s reporting requirements

Practical and other considerations

Cost/benefit considerations

(Source: Coetzee & Schmulian, 2011)

\(^1\) This Conceptual Framework for Financial Reporting is part of a joint project between the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB).
THE CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

The Conceptual Framework for Financial Reporting documents the agreed upon concepts which underlie International Financial Reporting Standards (IFRS) and allows the standard setter, the IASB, to achieve consistency across financial reporting standards and over time, despite changes in the board members of the IASB. Further, the Conceptual Framework for Financial Reporting may be used, as required by IAS 8, Accounting Policies, Changes in Estimates and Errors, by preparers of financial statements to develop accounting policies for an economic event for which no financial reporting standard exists.

Conceptual Frameworks, including the Conceptual Framework for Financial Reporting, generally exhibit a generic structure. This structure is illustrated in Figure 2 and forms the outline for the discussion below.

**FIGURE 2**
Generic structure of a Conceptual Framework

- Definition of financial reporting
- Definition of the reporting entity
- Definition of users of accounts and their information needs
- Objective of financial statements
- Underlying assumptions
  - Qualitative characteristics of financial statements
  - Elements of financial statements
  - Recognition criteria
  - Measurement basis and techniques

(Source: Deegan, 2010)

**Underlying assumptions**

The underlying assumptions of the Conceptual Framework for Financial Reporting are the objective of financial reporting and the definitions of financial reporting, the reporting entity as well as the users and their information needs. Should a person reject the validity of these underlying assumptions then all the remaining concepts contained in the Conceptual Framework for Financial Reporting would also be rejected, as these all flow directly from the underlying assumptions.

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2 Financial reporting is a concept wider than financial statements and represents an interesting change in objective since that of the Framework for the Preparation and Presentation of Financial Statements.
The objective of financial reporting “is to provide financial information about the reporting entity\(^3\) that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity” (IASB 2010). The user group of ‘potential investors, lenders and other creditors’ refer to users who may provide resources to a reporting entity but are not in the position to demand information from the entity. In general, this user group requires information to support decisions of whether to buy, sell or hold their equity and/or debt instruments in the reporting entity. In addition, information is required by these users to ensure that efficient and effective use has been made of the resources provided to the reporting entity\(^4\).

**Qualitative Characteristics**

The fundamental qualitative characteristics of financial reporting, flowing from the objective, are relevance and faithful representation. Relevance implies the ability of the reported information to influence economic decisions through providing information to the users, relating to the amount and timing of cash flows for predictive and confirmatory purposes. A logical component of relevance is materiality which states that information is relevant and able to influence economic decisions should it be of sufficient importance in terms of value and/or nature. Faithful representation requires information to be presented that effectively ‘calls a spade a spade’. This concept requires that information be reported on: completely in words and amounts; free of any bias, whether conservative or otherwise (neutrality), and free from error. It is proposed that relevance enjoys the conceptual primacy of these two fundamental characteristics in that faithful representation of an event, no matter how well achieved, cannot make an event relevant to the decision making of the targeted user group.

The usefulness of the information presented in financial statements can be further improved by a number of enhancing qualitative characteristics namely: comparability, verifiability, timeliness and understandability. Comparability implies that events which are alike are reported on in a similar manner, whilst events that differ are reported differently. Comparability should not be confused with uniformity (i.e. making all events appear the same). Verifiability requires that differing people with the same set of facts should draw similar conclusions, whilst understandability requires that information is to be presented in such a manner that a user with a reasonable level of sophistication will be able to make sense thereof. Finally, timeliness implies that information is made available at an appropriate time, relevant to the decision for which it is required.

The attainment of these characteristics in financial reporting is subject to necessary pervasive constraints. The benefit gained from achieving these characteristics should not exceed the cost necessary to realize that benefit.

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\(^3\) The concept of reporting entity has not been defined by the IASB in the *Conceptual Framework for Financial Reporting* yet.

\(^4\) The efficient and effective use of resources is commonly referred to as the stewardship concept.
Recognition and measurement of the elements of financial statements

Rooted in the concept of accrual accounting, rather than matching, the recognition of the elements of financial statements (asset, liability, equity, income and expense) is dependent on the ability of the element to be reliably measured and the probability that the element will lead to an in- or outflow of economic resources. Assuming that an element may be recognized in terms of the Conceptual Framework for Financial Reporting, the measurement thereof is problematic. The Conceptual Framework for Financial Reporting is particularly weak in providing a conceptual basis for the measurement of the elements of financial statements. Currently the Conceptual Framework for Financial Reporting provides little more than a list of measurement basis, resulting in the inconsistent measurements of the elements across the various Financial Reporting Standards.

TEACHING THE CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

Given the importance of the Conceptual Framework for Financial Reporting to the standard setter and other users, it appears reasonable that similar importance should be attached to the teaching thereof. The question that arises is how the concepts contained therein should be taught. This article seeks to provide an illustrative case of an approach adopted in the teaching of the Conceptual Framework for Financial Reporting.

Context

The teaching approach outlined in this paper was adopted in an introductory course to IFRS. Students enrolled for this course have completed a ‘bookkeeping’ course but have limited, if any, exposure to Financial Reporting Standards. The introductory course to IFRS is presented to groups of approximately 200 students each. These students all intend qualifying as professional accountants. The course adopts a mixed methods pedagogical approach in that both principle-based and rule-based IFRS education occur using student-centered and teacher-centered methods (Coetzee and Schmulian 2011).

Teaching method proposed

What is accounting?

To introduce the topic, the students are required to ‘go back to basics’ and define what they understand accounting to be. The lecturer leads the discussion towards the following generally accepted definition of accounting:

“Accounting is the system of recording and summarizing business and financial transactions, and analyzing, verifying, and reporting the results.”

What is financial reporting?

The discussion is then focused on the reporting component of accounting and the students’ definition thereof. During this discussion it becomes evident that the students have
varying views on financial reporting, what it involves, who is responsible for the reporting, to whom they are responsible and how they provide financial information. This discussion serves as the starting point to illustrate the role of a standard setter in formalizing and regulating financial reporting.

The students are then introduced to the IASB. A short video interview on CATV⁵ (a broadcast venture of the Institute of Chartered Accountants of Scotland) with Sir David Tweedie, chairperson of the IASB, is shown to the students. This video clip provides inter alia background on the development of the IASB, the convergence between the FASB and IASB and the role of IFRS in the economic crisis. Of particular interest in the interview is the advice that is provided to current accounting students on their future careers and what it means to be a professional accountant.

**Developing a Framework for Financial Reporting**

Once information about the IASB and its role has been considered, the students are encouraged to discuss which of the accounting concepts, with which they are already familiar⁶, are important and would they encourage the IASB to consider when developing an IFRS. This discussion serves as a basis for informing the students of the due process in standard setting, followed by the IASB. To develop the discussion it is useful to ask leading questions such as what criteria would be important to ensuring financial information is useful and of high quality. Some element of role-play, whereby the students play the role of various stakeholders, may add value, although for the discussion used in this course the role was limited to that of investor. As aid to guiding the discussion the lecturer may wish to keep a generic Framework for financial reporting in mind (see Figure 2 above). At the conclusion of this discussion the students are informed that they have in essence partially followed the due process in developing their own ‘Framework’ of concepts and inherently their own view of the world. The students are then referred to an IASB document⁷ entitled “How we Consult” which details the due process followed by the IASB to develop an IFRS (and the Conceptual Framework for Financial Reporting).

**Content of the Conceptual Framework for Financial Reporting**

The students are assigned the task of preparing a ‘mind map’ of the IASB’s Frameworks: both the 1989 Framework for the Preparation and Presentation of Financial Statements and the 2010 Conceptual Framework for Financial Reporting. The students are instructed to consider similarities and differences between the two Frameworks and possible reasons therefore (reference to the Basis of Conclusion supporting the Conceptual Framework for Financial Reporting is particularly useful in this regard). The objective of this assignment is to encourage the students to engage with the contents of these Frameworks prior to the lecture thereon.

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⁵ Available at https://www.icas.org.uk/icascatv/cat16/issue19.
⁶ The students are exposed to many concepts at secondary school level and the undergraduate bookkeeping course. However, they may not have a complete ‘toolbox’ of concepts at their disposal yet. The exercise may also serve as a valuable indicator of the students’ existing understanding and ability to distinguish between concepts, principles and rules.
⁷ Available at http://www.ifrs.org/NR/rdonlyres/A9708702-32FA-49A9-B469-FC6BAF6136E9/0/HOWWECONSULTFINALvb.PDF.
The actual content of the *Conceptual Framework for Financial Reporting* is facilitated through using the appropriate sections of an IASB webcast and supporting slides entitled “Framework-based teaching of principle-based standards”. In this webcast Professor Mary Barth, academic advisor to the IASB, discusses in detail the *Conceptual Framework for Financial Reporting* and common misunderstandings related thereto. To consolidate the students’ knowledge of the *Conceptual Framework for Financial Reporting* a short presentation providing an overview thereof was recorded by the lecturers and posted on the IFRS Rookies channel on YouTube and Facebook.

Given that the objective of the course remains preparing the students for a professional qualifying examination (which currently consists exclusively of various single-answer, fictitious scenarios) the topic is concluded by exposing the students to typical exam-type questions. In an ideal environment this time may be better spent in exercising the students’ judgment, based on the concepts, in various practical case studies.

**CONCLUDING REMARKS**

The lectures on the *Framework for the Preparation and Presentation of Financial Statements (1989)* (now replaced with the *Conceptual Framework for Financial Reporting (2010)*) have traditionally been based on the lecturer standing in front of the class imparting knowledge of the concepts to the students, of whom little more is expected than to passively absorb the knowledge. Once these lectures concluded, the *Conceptual Framework for Financial Reporting* was considered dealt with and to the relief of both the students and lecturers one could now begin with the more ‘important’ and ‘interesting’ IFRS rules.

Such an approach is however contrary to current developments in IFRS education (Barth, 2008 and Coetzee and Schmulian, 2011). Further the authors are not prepared to accept similar emotions to those of Marcel Achard (French Playwright, 1899-1974) who stated:

“When I give a lecture, I accept that people look at their watches, but what I do not tolerate is when they look at it and raise it to their ear to find out if it stopped”.

Accordingly a revised approach to the pedagogy employed when teaching the *Conceptual Framework for Financial Reporting* is advocated. This approach incorporates a diversity of activities including webcasts and videos. Emphasis is placed on the students to take responsibility for their learning through requiring them to work through the relevant Frameworks prior to the lectures thereof. Furthermore, the lectures have been expanded to not only focus on the content of the Frameworks but to place significant emphasis on its purpose within the financial reporting environment. While it is hoped that this revised approach will create a more conducive learning environment it should not be forgotten that the students are only beginning to understand these concepts and that the development of a thorough understanding of these concepts takes place through the integration of the concepts with the principles of financial reporting for each economic event subsequently considered (Coetzee and Schmulian, 2011).

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8 Available at http://www.ifrs.org/News/Announcements+and+Speeches/webcast+framework+based+teaching.htm.

