CONCEPTUAL FINANCIAL REPORTING FRAMEWORK - CATALYST OF FINANCIAL REPORTING INFORMATION RELEVANTS

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Abstract

The research area of the article is the presentation of the elements of the Financial Reporting Conceptual Framework developed by the IASB and refined because of the convergence process, taking into consideration the correction of the Framework deficit in the assessment methods through changes in 2018 evaluation for specific accounting standards. The study analyzes the fair value as an assessment method capable of insuring the fulfillment of the fundamental objective of financial reporting and highlights the systematic and progressive process of implementation of this concept by the IASB.

Keywords: Financial Reporting Conceptual Framework, IASB, IFRS, relevance, fair value, convergence.

Codes JEL: M-41

1. Introduction

A conceptual reporting framework is a logical system of interrelation objectives and fundamental concepts that describe the nature, functionality and treatment of financial indicators, with the purpose of providing financial reporting guidelines, whether the accounting system used is based on rules or principles. (Gornik-Tomaszewski and Choi, 2018) [1]. Even if the same standards applied and the discrepancies would be even greater in the context of using different accounting standards, the research proposes a theoretical approach, correlated with interpretive, comparative, and critical elements on financial reporting systems. Having a deductive architecture, the approach studies the existing

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concepts and theories, investigating both the arguments favorable to the issue addressed and the controversies it generates. Analyzing the current state of the financial reporting field, the study advocates for the development of reporting systems, as well as for achieving the highest degree of convergence in this field. The investigative approach is based on consulting the information sources in the literature relevant to the field of financial reporting, as well as regulations, official documents, and press releases of international standardizers and various analyzes and studies related to the research area. The study aims to highlight the inter-conditionality relations between those who report, the stakeholders with whom they interact, as well as the influence of standardization bodies and national or international authorities.

2. Literature review

Following the use of International Financial Reporting Standards by an increasing number of countries, it is a sufficient argument, in the opinion of some researchers, to confer on the International Accounting Standards Board, in its capacity as the entity that elaborates them, the status of model of transnational standardization body (Büthe şi Mattli, 2008; Lloyd et al., 2007) [2]. In 166 countries (IFRS Foundation, 2018) the application of IFRS has been formally adopted.

In the context of globalization and overstepping national borders, there is an inherent need for widespread use of transnational accounting standards, with researchers questioning how these mechanisms could work, or how to apply them on a regulatory basis or by encouraging their empirical use. (Held şi Koenig-Archibugi, 2005) [3]. The acceptance or rejection of all or part of the standards developed by the IASB depends on differences in the legitimacy of the various accounting concepts and principles with which they operate. Therefore, the construction of legitimacy, including the establishment of common views on accounting concepts and principles, is the main concern of the IASB as a transnational standardization body. (Black, 2008) [4]. The need to adopt procedural rules within the IASB and the acquisition of full procedural legitimacy reflects on one hand, the desire to adopt and apply IFRS without modification, gaining recognition from government and capital markets (Barbu and Baker, 2010) [5], and on the other hand, the limitation of the use of alternative mechanisms developed by other bodies. The adoption of measures designed to increase stakeholder confidence in the viability of decisions and solutions adopted and transferred into the standards developed by this body reflects the IASB's constant concern for the construction and strengthening of its procedural legitimacy. As a result, the IASB is one of the strongest transnational standardization bodies, undoubtedly fulfilling the conditions of sociological legitimacy.

However, the IASB is facing the problem of the lack of an external regulatory surveillance forum with regulatory levers, which is becoming increasingly acute in the macroeconomic context of a trend of public regulation of financial markets. The influence of technological progress and the globalization of the financial market are the main determinants of convergence towards common values and beliefs, as well as similar organizational systems. (Smith, 1973) [6], but the evolution towards these objectives depends on the cultural, social and institutional differences specific to each society (Gerschenkron, 1977) [7]. In accounting, convergence is approached from this broad perspective, which takes into account the similarity of objectives, the existence of immutable economic laws and principles, interdependence between states, and the involvement of national and international institutions in the convergence process and the actions of economic entities as direct beneficiaries of this approach. The magnitude of the phenomenon of globalization, which characterizes the contemporary world economy, has brought to the attention of the main standardizers of the moment, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) the need to use a common business language with coherent results, which facilitate the correct substantiation of transnational decisions. In a narrow sense, convergence involves the joint development of a single set of standards by the two bodies, while the broader meaning of the concept is to reduce the various differences between the standards issued by each body. (Carmona and Trombeta, 2010) [8].

The determination of the IASB and the FASB to achieve comparability and compatibility of the two benchmarks has led to significant progress, but the convergence process has proved to be complex and difficult. The work agenda changing constantly and adding new projects. The IASB and FASB launched a new joint project on designing a conceptual reporting framework by combining their, so six long-term projects reached the expected level of convergence, with revised standards or draft standards being developed (Raport de progres 2012). The progress report on the convergence process presented by the two standardization bodies on April 5, 2012, revealed the existence of four long-term priority projects, which are in full swing, and the debates will lead to a common point of view.

Although the convergence process is currently in a period of stagnation, nobody declared the projects abandoned. At the financial reporting conference at Baruch College New York (May 2, 2019), FASB President Russell Golden talked about the progress and challenges of the IASB-FASB bilateral convergence, as well as how the two bodies will cooperate in the future. Golden acknowledged that achieving full convergence remains an ideal for the time being, but that the IASB-FASB collaboration will continue to insure the highest possible degree of compatibility between the two standards.

3. Research metodology

Placed in the general area of financial reporting research, this study conducts an investigation of the IFRS reporting system developed by the IASB. The research finds itself in the positivist current, correlated with interpretative, comparative, and critical elements on the object of research. It is a predominantly quantitative research.

In a deductive way, the approach starts from the existing concepts and theories, from the analysis of both the arguments favorable to the approached issue and the criticisms brought to it and pleads for achieving the highest degree of convergence in the field of financial reporting. Ensuring the organization and explanation of information by deepening the literature, quantitative research has contributed to shaping the current state and a clear perspective on the General Conceptual Framework of Financial Reporting. The study of the literature focused on the three types of sources of information identified by Saunders et al. (2009) [10]. The primary sources include the first raw work initiatives, which may be reports, manuscripts in the process of being published or any other type of study in the early stages. Secondary sources have a much wider scope, they are usually accessible to the public and subject to review by it, and include books, publications, and scientific journals. Synthesis documents such as bibliographies, encyclopedias, dictionaries represent the group of tertiary sources, consulted to complete the other categories of resources. An essential component of the research process, the deepening and revision of the literature allowed to achieve a comprehensive perspective on the issues investigated are still insufficiently explored, both in terms of knowledge and research trends in the field, and the main questions that need further answers or revealing some aspects.

4. The conceptual framework of financial reporting: determinant of the strategic nature of financial information

The Conceptual Financial Reporting Framework adopted in 2018, the basis for drawing and presenting financial statements, replaces the old General Framework and allows the facilitation of the development of logical and consistent standards applicable to the financial reporting of profit-oriented companies.

The existence of the Conceptual Framework facilitates the process of elaborating IFRS by harmonizing the proposals of the individual members of the IASB and achieving their consensus on solid and equivocal regulations for all categories of users. However, the conceptual framework is not only addressed to international and national standardization bodies, it also responds to the needs of reporting companies in addressing issues that are not subject to a specific accounting standard. In addition, it provides the necessary reference elements for users to interpret the information presented in financial reporting or auditors in formulating the opinion regarding the IFRS compliance of the investigated financial statements. The conceptual framework finalized in 2018 brings changes and clarifications to the concepts with which the financial-accounting field operates. In addition, introduces new chapters on issues previously not addressed in the reporting framework.

The main concepts presented in the Conceptual Framework derive from the fundamental objective of general financial statements. Namely they provide "financial information on the reporting entity that is useful to existing and potential investors, lenders and other creditors in the decisions they make regarding the resources they offer to the entity" (IFRS Foundation, General Conceptual Framework for Financial Reporting, 1.2, 2018:8) [11]. If the old Framework mentions that the respective decisions involve operations regarding the equity instruments, debts, and the different forms of crediting, the 2018 version introduces the decisions regarding the exercise of the rights to influence the management actions with impact on the resource management (stewardship). The preparation of general financial statements based on the concepts defined by the Conceptual Framework primarily satisfies the information needs of users who cannot directly request the reporting company to provide financial information. In order to provide a theoretical basis for the preparation of complex financial statements, the Conceptual Framework explains the qualitative characteristics of financial information, defines the elements that make up financial statements and outlines the rules for recognizing and assessing them in the context of accrual accounting and continuity of activity. The specification of the qualitative characteristics of the information presented in the financial reports facilitates the identification of the most important elements that we need to know and analyze in the process of forming a true image of the reporting company, as well as in the elaboration of the investment decision. The conceptual framework highlights the fundamental nature of the relevance and accurate representation of information, emphasizing the cognitive superiority of these qualitative characteristics without neglecting the nuances of the amplifying characteristics (comparability, verifiability, timeliness and intelligibility).

The secondary qualitative characteristics that amplify the information provided influence the correct rationale for decisions using financial statements. Comparability allows the study of the evolution over time of different company-specific elements, as well as the identification of similarities and differences between different companies. The usefulness of financial information is enhanced if "different independent and knowledgeable observers could reach a consensus, but not a full agreement, that a certain description is an accurate representation (IFRS Foundation, Conceptual Framework for Financial Reporting, 2.30, 2018:18) [11], this way the criterion of verifiability is met. Opportunity must characterize the information provided, meaning we must know before the moment the users of the financial statements substantiate the decision. In addition, must be intelligible, a character conferred by the "clear and concise classification, characterization and presentation of information" (IFRS Foundation, Conceptual Framework for Financial Reporting, 2.34, 2018) [11], so that it can be understood and capitalized on by users with a sufficient degree of knowledge of economic activities.

The conceptual framework for financial reporting presents the elements of the financial statements grouped according to the type of information provided, delimiting the indicators that characterize the financial position (assets, liabilities, and equity) from those that reflect the company's performance (income and expenses). Moreover, provides reference definitions of these elements, starting from the observance of the business continuity principle and the accrual accounting principle, reflected in the provisions on the recognition of indicators. "Accrual accounting describes the effects of transactions or other circumstances and events on the economic resources of the reporting company and the claims on the reporting company in the periods in which they occur, even if the cash flows generated by them occur over a different period of time." (IFRS Foundation, Conceptual Framework for Financial Reporting, 1.17, 2018) [11].

The new Conceptual Framework addresses the recognition of elements in terms of their ability to provide relevant information useful in substantiating decisions. Thus, the recognition of an item is possible only if it complies with the definition of the concept as set out in the Conceptual Framework and if the recognition of that item, the income, expenses, or changes in equity it generates is likely to provide relevant and accurate information of that item.

According to the old Conceptual Framework, the recognition of an item and its presentation in a company's financial reporting focused on the analysis of two fundamental characteristics: the probability that any future economic benefit associated with that item enters or leaves the company, and the possibility of reliable quantification of the value or cost of that item. The concept of probability accentuated the degree of uncertainty of the generation of future economic benefits reflecting the characteristics of the environment in which the company operates. However, the conceptual framework did not stipulate a certain level of probability from which the recognition criterion is considered to be met, thus diminishing the consistency of the application of IFRS. The new Conceptual Framework addresses the recognition of elements in terms of their ability to provide relevant information useful in substantiating decisions. Thus, the recognition of an item is possible only if it complies with the definition of the concept as set out in the Conceptual Framework. And if the recognition of that item, the income, expenses or changes in equity it generates, will likely provide relevant information and faithful representation of that element (IFRS Foundation, Conceptual Framework for Financial Reporting, 5.7, 2018) [11]. In order to recognize and present them in the financial statements, the indicators are subject to the evaluation process, which determines their monetary value. The basis for the evaluation model lais on estimates, reasoning, models, and less on accurate estimates. (IFRS Foundation, Conceptual Framework for Financial Reporting, 1.11, 2018) [11]. However, in the opinion of some authors, the conceptual framework is deficient in the presentation of the evaluation concepts (Storey şi Storey, 1998; Lachmann et al., 2015) [12]. Lacking the specification of both the objective of the valuation and a complete and coherent conceptual set of definitions of accounting valuation, which would facilitate the choice of normalizers or users for a particular method of valuation. Given the fundamental importance of evaluation in the process of preparing financial statements, the lack of eloquence in the regulation of evaluation is a major impediment in the process of improving the financial reporting system. The conceptual framework mentions that in the financial statements we can use various evaluation bases, in various combinations and with different degrees of use, presenting a series of valuation methods used in standards (historical cost, current cost, attainable value and present value). The old Framework does not specify the criteria by which it can be determined whether the choice of a particular method is appropriate for a given situation (Baker şi Barbu, 2007) [5]. But this Conceptual Framework stipulates that the choice of the basis of assessment must take into account the nature of the information (IFRS Foundation, Conceptual Framework for Financial Reporting, 6.23, 2018) [11].

5. Information nuances of using fair value when evaluating the indicators present in financial statements

In the international framework, the new Conceptual Framework defines fair value as “the price that would have been collected for the sale of an asset or paid for the transfer of a debt in a regulated transaction between market participants at the valuation date.” (IFRS Foundation, Conceptual Framework for Financial Reporting, 6.12, 2018:53). IFRS 13 “Measurement at fair value”, IAS 16 “Property, plant and equipment”, IAS 19 “Employee benefits”, IAS 36 Impairment of Assets”, IAS 38 “Intangible Assets”, IAS 39 “Financial Instruments: Recognition and Measurement”, IAS 40 “Real Estate Investments”, IAS 41 “Agriculture” provide information on the criteria that has to be achieved when determining fair value as a basis for measurement. The concept assumes the existence of a hypothetical market and ideal conditions, the price obtained on a market with perfect competition is the fair value, following transactions between independent economic partners that perform within reason and that interact.

The orientation of financial reporting towards fair value indicators lies in the need to provide users of financial statements with useful information in the decision-making process, a paradigm that has become a fundamental objective of accounting standardization with the launch of the draft of the conceptual financial reporting framework. Therefore, while the evaluation model based on historical cost can be justified through several arguments (Holthausen şi Watts, 2001; Power, 2010) [13], the model based on fair value has its main objective to provide relevant financial information that offer users an exact representation of economic transactions and events. Moreover, respect the opportunity principle by facilitating the forecasting of future cash flows and contributing substantially to the decision-making process (Damant, 2001; Young, 2006; Power, 2010; Miller şi Power, 2013) [14].

Having as its primary source the information provided by the market, fair value incorporates the ability of market indicators to aggregate in an efficient and fair manner investors' expectations regarding the cash flows generated by the trading of assets and liabilities. Under the assumption of aggregation, market indicators are able to meet the different information needs of users, contributing to the achievement of the objective of decisional usefulness of financial reporting. Without being the only argument that argues in favor of the use of fair value, the hypothesis of aggregating information is individualized by generality and theoretical substantiation (Hitz, 2007) [15], being asserted since the emergence of the concept of fair value and constituting the guiding thread of research in its field. Widely accepted by major current regulators, the fair value paradigm finds its way in IASB and FASB regulations in often-convergent approaches. The treatment of financial instruments in the two benchmarks provides for the presentation at fair value of most of them (IFRS 7 "Financial Instruments; Disclosures", SFAS 107 "Presentation of Financial Instruments at Fair Value"). Both IAS 39 "Financial Instruments: Recognition and Measurement" and SFAS 133 "Accounting for Derivatives and Hedging Activities" require the trading of securities and financial derivatives held for trading at fair value with the recognition of gains and losses directly in profit or loss.

The international framework applies similar rules to asset impairment (IAS 36 "Impairment of Assets") but extends the use of fair value on a larger scale. Thus, IAS 16 "Property, plant and equipment" and IAS 38 "Intangible assets" provide the unconditional use of fair value, and assets must be accounted at a revalued amount that includes the recognition of changes in fair value by deducting depreciation and accumulated impairment losses. The standards on investment property (IAS 40 "Investment property") and on agriculture (IAS 41 "Agriculture") stipulate the direct recognition in profit or loss of gains and losses arising from the application of fair value as a basis for measurement.

Focused on estimating future cash flows based on the current value of assets and liabilities, fair value provides predictability and timeliness for financial indicators (Francis et al., 2004). Unlike the approach to valuation from a historical cost perspective which is conservative, respecting to a greater extent the principle of accrual accounting by recognizing changes in value only when they have been made. Permanently connected to the information provided by the market, the fair value method involves frequent adjustments in the value of the elements of the financial statements with implications on the evolution of profits, determining the choice of various accounting policies (Fields et al., 2001; Quagli şi Avallone, 2010) [16], providing a better protection to investors when making decisions. If information on future cash flows from the use of fair value as a basis for measurement is preferred in the capital market, due to their ability to reduce the asymmetries between the book value and the market value of companies, the use of historical cost is preferred, in terms of ease of application and the low costs involved.

Another clue provided by Holthausen (1990) in the decision-making process regarding choosing the basis for evaluation, focuses on the asymmetry of information that are available to the companies on the market (Liao et al., 2013) [17]. Fair value is generally recognized as superior to the cost-based method in terms of relevance and intrinsic information content because it is a concept primarily connected to the indicators provided by the market (Barlev şi Haddad, 2003) [18]. Determined based on prices on an active, liquid, and transparent market and being less exposed to the subjectivity of companies' internal estimates and forecasts, fair value has a high potential to reduce the asymmetry of information available on the competitive market. Its use according to specific accounting standards is thus part of the long-term strategy of companies with the aim of reducing discrepancies between the book value and the market value (Hayoun, 2019) [19].

The progressive adoption of fair value in IFRS began in 1977, marking the first appearance of this concept in international accounting standards (IAS 17 “Leases”), being used to separate financial leasing from operational leasing, and for determining the result in lease-back transactions. The concept of fair value started gradually into other specific standards, and in 1995, the IASC and the International Organization of Securities Commissions (IOSCO) signed an agreement on the development of a set of standards, as a common basis for the reporting needs of transnational corporations as a result fair value has become a pervasive notion in international regulations. Already present in IAS 16 “Property, plant and equipment”, the concept was a novelty in the 1999 revision of IAS 39 “Financial Instruments: Recognition and Measurement” and was received with skepticism by financial institutions that called for increased volatility in financial statements because of using the new assessment base. Once initiated, the process of implementing fair value in the application of international accounting standards has continued systematically, with the IASB / IASC constantly reviewing specific standards and indicating situations in which the use of this valuation basis is mandatory, as well as cases where it may be optional. Analyzing the current state of fair value use in international accounting standards, Mala şi Chand (2012) [20] summarize these regulations in Table no. 1, grouping them according to the mandatory or optional nature of the application of this valuation method as an alternative to the historical cost method. Thus, the authors identify 11 standards that make it mandatory to use fair value in both initial recognition and subsequent revaluations, and five standards that allow the rapporteur to exercise the option of initial valuation based on fair value or historical or assumed cost. The subsequent revaluations, however, will be made at fair value.

	Mandatory use of fair value	**Initial recognition**	**Subsequent revaluations**
1	IFRS 2 Share-based payment	Fair value	Fair value
2	IFRS 3 Business combinations	Fair value	Fair value

3	IFRS 5 Fixed assets held for sale and discontinued operations	Fair value	Fair value
4	IAS 17 Leasing contracts	Fair value	Fair value
5	IAS 18 Income	Fair value	Fair value
6	IAS 19 Employee benefits	Fair value	Fair value
7	IAS 20 Accounting for government grants and disclosure of government assistance information	Fair value	Fair value
8	IAS 26 Accounting and reporting of pension plans	Fair value	Fair value
9	IAS 36 Assets depreciation	Fair value	Fair value
10	IAS 39 Financial instruments: recognition and measurement	Fair value	Fair value (partial)
11	IAS 41 Agriculture	Fair value	Fair value (recoverable amount)
	The optional use of fair value	**Initial recognition**	**Subsequent revaluations**
12	IFRS 1 First time adoption of International Financial Reporting Standards	Fair value / assumed cost	Fair value
13	IAS 16 Tangible fixed assets	Fair value / historical cost	Fair value
14	IAS 28 Investments in associated entities and joint ventures	Fair value / historical cost	Fair value
15	IAS 38 Intangible assets	Historical cost	Fair value
16	IAS 40 Real estate investments	Historical cost	Fair value

Table no.1. The current state of fair value use in international standards Accounting, Source: adaptation after Mala, R., Chand, P., 2012

The IASB's progressive and systematic efforts to generalize the use of fair value as a method of measuring the elements presented in the financial statements is not always beneficial, with many researchers presenting the disadvantages of this concept. Analyzing the benefits and disadvantages of applying the fair value method, Cornett et al. (1996) [21] identifies several arguments that make this concept the main basis for evaluation. These arguments are:

- superiority in terms of relevance and accurate representation of economic events and phenomena.

- revealing the company's ability to redistribute its own resources.

- the ability to reflect changes in financial conditions due to interest rate fluctuations.

- the catalyst size of the increase in earnings from the sale of assets high quality and

- the role of preventing the overvaluation of low-quality assets by the obligation to recognize impairment.

6. Conclusions

The project on convergence in accounting standardization initiated more than a decade ago by the IASB and the FASB is in line with the efforts to achieve a common basis for ensuring comparability and consistency in the presentation of economic information. Sometimes confronted with the differences of opinion of the two normalizers on some accounting concepts and treatments, as well as with the negative effects of the global crisis, the convergence process has constantly evolved, with most of the objectives achieved since the end of 2012. Improving the Conceptual Financial Reporting Framework developed by the IASB is one of the results of the convergence process, the Conceptual Framework facilitating the development of logical and consistent standards applicable to the financial reporting of profit-oriented companies. In order to ensure the fulfillment of the fundamental objective of the financial statements with the general purpose of providing users with the necessary information in the decision-making process, the Conceptual Framework has its basis on financial reporting. It defines the elements presented in the financial statements, as recognition and evaluation criteria, the requirements for capital and the qualitative characteristics that the information must have in order to be able to contribute to the decision-making process. The IASB identifies fair value as the basis of measurement with the highest potential for ensuring the relevance of information and the accurate representation of economic events and transactions through permanent market connection, allowing the aggregation of indicators without diluting the forecast of future cash flows. Although the inherent cognitive superiority of fair value-based evaluation models is widely recognized, its extensive use to the detriment of the historical cost method is still controversial among researchers.There are many who support the use of the traditional method argued by the consistency and ease of application, increased reliability and better ensuring the comparability and verifiability of information. The IASB addresses this concern by allowing the optional application of the fair value method for evaluating certain categories of assets in a particular context, delimiting them from situations where the use of fair value is mandatory.

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