Conversations with Constituents—Why the Conceptual Framework Is Important

As an agenda item at the July 2001 FASAC meeting, Council members discussed the importance of the FASB’s conceptual framework and how it provides a foundation for financial reporting standard setting as well as a basis for communications with the FASB and constituents about those standards. Following that meeting, Status Report had an opportunity to talk with three FASAC members, Jeannot Blanchet,* Managing Director, Global Professional Standards Group, Andersen; Gabrielle Napolitano, Managing Director, Goldman, Sachs & Co.; and Wayne Landsman, KPMG Professor of Accounting, Kenan-Flagler Business School, University of North Carolina. These members represent the auditing, investment and academic areas.

While all three participants agree that the FASB’s conceptual framework is a work-in-progress, each believes that the framework is essential to the standard-setting process and that there is a need for more constituents to familiarize themselves with it. (See the accompanying August 2001 edition of Understanding the Issues for a discussion of the FASB’s conceptual framework.)

Jeannot, Gabrielle and Wayne offered their perspectives on a range of topics, including the conceptual framework’s role and how it contributes to communications, decision making, understanding of existing and prospective accounting standards and its importance to international standard setting.

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Jeannot Blanchet,
Managing Director, Global Professional Standards Group,
Andersen

SR: What do you see as the primary purpose of the FASB’s conceptual framework?

Jeannot Blanchet: In my view, the conceptual framework is absolutely an important document for the Board as well as constituents. I believe the primary use of the framework is to make sure that the FASB does not issue standards in a random fashion. The framework provides a necessary common conceptual underpinning that helps the Board resolve issues.

SR: How does the conceptual framework create efficiencies and better communication?

Jeannot Blanchet: To begin with, it brings the discussion about accounting standards to a higher level. So, every time you assess an accounting issue, you don’t start from ground zero again and debate what is an asset, liability, and so forth. You start with the understanding that those concepts have been defined and those are the tools with which you have to work to come up with an answer on an accounting issue.

SR: Why should constituents become more familiar with the framework?

Jeannot Blanchet: Understanding the framework is important because it helps you understand how the Board thinks about issues and puts you in a stronger position to influence the Board on those issues. Having said that, if you engage the Board in a discussion to convince them of your position on an accounting issue, you will have to use the same language they use. Unfortunately, that has probably been deficient over the years because I don’t believe many preparers and other constituents have used the conceptual framework to raise issues with the Board to justify their views. In my opinion, it is inconceivable to think that you can make a difference or influence the Board without understanding the basic language that is being used in this process.

*Jeannot Blanchet recently completed his term as a FASAC member.
SR: Given the diversity of participants in the global standard-setting arena, why is the framework important?

Jeannot Blanchet: In international standard setting, the issue of having a common language is amplified, and it is even more important from a global perspective because standard setters come from different backgrounds. I can only imagine how much more useful it would be at an international level with people from various countries, cultures and backgrounds, coming to the table and trying to set common standards and converge. Take, for example, the task of bringing together U.S. standards and international standards. It would be critical to have that common language inherent in the conceptual framework.

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Gabrielle Napolitano, Managing Director, Goldman, Sachs & Co.

SR: What is the conceptual framework’s role in providing rationale for decision making and implementation?

Gabrielle Napolitano: I believe that the conceptual framework becomes the foundation for a number of amended or new accounting guidelines that the FASB is in the process of formulating for ultimate implementation. The conceptual framework is essential because it adds a level of rigor and discipline that results in more consistent final statements, and also provides constituents with the detailed rationale that underlies new and/or modified accounting rules. In some cases, FASB constituents may debate the merits of adopting an accounting standard change or newly-formulated statement. The Board can then justify the reasoning and rationale behind it by referring to relevant principles within its conceptual framework.

SR: How does the framework help you as an investment professional?

Gabrielle Napolitano: When the FASB introduces a new accounting statement, I typically refer to the section in the final standard that provides constituents with a detailed explanation of the rationale underlying the Board’s thought process. The inclusion of this discussion and discourse is extremely important because it provides a critical “backdrop” that highlights the concerns and reasoning that influenced the way in which Board members ultimately voted and selected one accounting alternative over another. It is also interesting, in my opinion, to (1) have a sense of the “split” among FASB voting Board members and (2) gain an understanding of the concerns that had an impact on those members who opposed, or supported, the accounting change. This information allows me to provide a detailed and well-informed explanation of the accounting rule change to my institutional clients.

SR: How can the FASB’s framework contribute to convergence of global accounting standards?

Gabrielle Napolitano: At this time, I believe that the conceptual framework supports the contention made by many analysts and investors that U.S. GAAP provides a higher level of conservatism and transparency in corporate reporting policies as compared to GAAP frameworks in countries outside the United States. As a result, the United States is typically regarded as the “safe haven” during periods of significant global economic and financial turmoil; this is our competitive advantage. In my opinion, there are a number of benefits that could accrue to the FASB if it decides to highlight (or revisit) this issue to standard setters outside the United States. These would include the fact that the (1) United States has a conceptual framework that underlies all of its GAAP statements; (2) existence of the conceptual framework ensures that the FASB adheres to a rigorous and disciplined standard-setting due process; and (3) conceptual framework is the basis for corporate reporting policies and U.S. GAAP standards that have definitional and historical consistency.

“...without a conceptual framework, decision making becomes an arbitrary imposition of one’s own views on standard setting. Which things do you like? Which things do you think make more sense?”

Wayne R. Landsman, KPMG Professor of Accounting, Kenan-Flagler Business School, University of North Carolina

SR: What is the downside of not having a conceptual framework?

Wayne Landsman: As discussed at the July FASAC meeting, without a conceptual framework, decision making becomes an arbitrary imposition of one’s own views on standard setting. Which things do you like? Which things do you think make more sense? It becomes personalized, and I think the process should be depersonalized as much as possible. Otherwise the composition of the Board determines standard setting decisions. I don’t think anybody really wants that. While you want the best people possible making decisions, you can just imagine if standard setting were arbitrary. You’d have particular constituents who would want to put “their people” on the Board to represent “their views.”
SR: How does the framework add to the accounting curriculum at the university level?

Wayne Landsman: As I pointed out at the last FASAC meeting, in contrast to many schools, the University of North Carolina actually teaches—early in the process—the conceptual framework to our Master’s of accounting students. The way we teach it essentially is the notion that the conceptual framework is really a necessary condition for standard setting. You can view it analogously to a constitution. A constitution is a general set of rules and axioms that provide guidance and structure for making more specific standard-setting rules, which you can think of in the same context as individual laws. The analogy is quite appropriate. You can’t make laws that have any sort of cohesiveness to them unless there is a constitution—something that explains what the framework is about and how we make laws in the first place.

SR: Why aren’t most other universities covering the conceptual framework in the accounting curriculum?

Wayne Landsman: The reason is because most programs are dedicated to teaching the students to prepare for the CPA exam and we don’t. We are training our students for long-term managerial careers in accounting. So, we try to give students more of a liberal arts approach to accounting to give them a broader, conceptual understanding of what they are going to be doing for a living. While specific financial accounting and tax rules change frequently, teaching students concepts provides them a basis to adapt quickly to those changes.

SR: How do you see the framework facilitating convergence of global accounting standards?

Wayne Landsman: There is a strong push towards convergence of standards between the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB). To facilitate convergence, it will be important that the FASB and IASB have similar conceptual frameworks. Without convergence of a conceptual framework, it would be extremely difficult to have convergence of standards because you don’t have a common framework for support. It is critical.