

# A conceptual framework for accounting for public-benefit entities

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*There is a renewed impetus in the International Accounting Standards Board (IASB) and the International Public Sector Accounting Standards Board (IPSASB) to develop a conceptual framework for financial reporting for both private sector and public-benefit entities. This article takes stock of some of the key issues related to this endeavour with particular emphasis on what the objectives should be and whether it is possible to have one conceptual framework for all entities.*

The search for a conceptual framework for accounting for public-benefit entities (PBEs<sup>1</sup>) in the UK has had reasonably extensive attention, but a number of developments are occurring internationally that are likely to have a considerable impact on the work that has been undertaken to date. The current conceptual framework in the UK is contained in the Statement of Principles (ASB, 1999) and the interpretation and development of this in the specific context of PBEs (ASB, 2007). However, there is a renewed urgency within the IASB and the US Financial Accounting Standards Board (FASB) to develop a new and more far-reaching conceptual framework over the next few years. The IASB have issued a Discussion Paper (IASB, 2006) and an Exposure Draft (IASB, 2008) exploring the objectives and qualitative characteristics of this conceptual framework. Similar ambitious plans are underway in the increasingly influential IPSASB. IPSASB has started work on its own conceptual framework for PBEs, which, as its *Strategy and Operational Plan* makes clear, will 'draw on the work of the IASB framework project particularly since many of the components of that framework are likely to be relevant'. However, as they continue 'the objective of the project is not to simply interpret the IASB framework for the public sector but rather to develop a stand-alone framework using the work of the IASB and other national standard setters as appropriate' (IPSASB, 2007, p. 12). This article takes stock of the renewed interest in developing a conceptual framework, for private sector entities and PBEs, to inform policy debates, particularly in the IPSASB.

The 2006 IASB's 'objectives' discussion paper for General Purpose Financial Reporting (GPFR) (GPFRs in this article include financial

statements and narrative reports, such as the operating and financial reviews and corporate governance reports) generated disquiet, even before its publication. In fact the 2006 IASB's discussion paper was accompanied by a minority report disagreeing with the view that a 'stewardship' objective could be subsumed in the preferred 'decision usefulness' objective that the IASB are advocating. This has led to a robust argument in support of this minority view from the Proactive Accounting Activities in Europe (PAAinE)—made up of standard setters across Europe—in partnership with the European Financial Reporting Advisory Group (EFRAG) that stewardship accounting should be a separate objective in any conceptual framework (EFRAG, 2007). (Note: the PAAinE/ EFRAG partnership will be referred to as simply EFRAG in this article.)

This article explores the nature and ramifications of this disagreement.

## What should the objectives be?

According to the IASB's discussion paper, the objectives of GPFRs 'for business entities<sup>2</sup>...is to provide information that is useful to present and potential investors and creditors and others making investment, credit, and similar resource allocation decisions' (IASB, 2006, OB2). The stated assumption is that this 'decision-usefulness' objective, with its current and future cash flow focus, *includes* a concern with 'providing information useful in assessing management's stewardship' (IASB, 2006, OB28). The IASB's current view is that the objective is 'to provide financial information about the reporting entity that is useful to present and potential investors and creditors in making decisions in their capacity as capital providers' and that GPFRs 'should

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communicate information about an entity's economic resources, claims on those resources and the transactions and other events and circumstances that change them' (IASB, 2008, S2). In other words, there was and is no need for two objectives.

The argument for two rather than one objective has gained momentum in Europe. This challenge has been driven by policy and theoretical arguments (see Lennard, 2007) and also by an analysis of the comment letters to the discussion paper. The latter leads to the conclusion that '78 per cent of respondents who referred to stewardship/accountability as an issue were of the view that it should be a separate objective in the converged framework' (EFRAG, 2007, p. 3). IASB, it seems, are unconvinced by EFRAG's analysis.

IPSASB seems to have a more open mind on the issue, and actually sees the debate as secondary to a wider purpose, judging by the draft consultation paper which they considered at their March 2008 meeting: 'It can be argued that whether the objective of financial reporting in the public sector is identified as the provision of information for accountability purposes or for decision-making purposes or for both accountability and decision-making purposes is secondary to the identification of the user information needs that GPFs will respond to' (IPSASB, 2008, 3.65). Interestingly, the IPSASB refer to 'accountability' rather than 'stewardship', maintaining that there 'is a strong case for using accountability to encompass stewardship in the framework' (IPSASB, 2008, 3.74).

#### *A new way to explore the disagreement*

Figure 1, which is built around three axes/continuums, provides an analytical framework for exploring this disagreement on objectives.

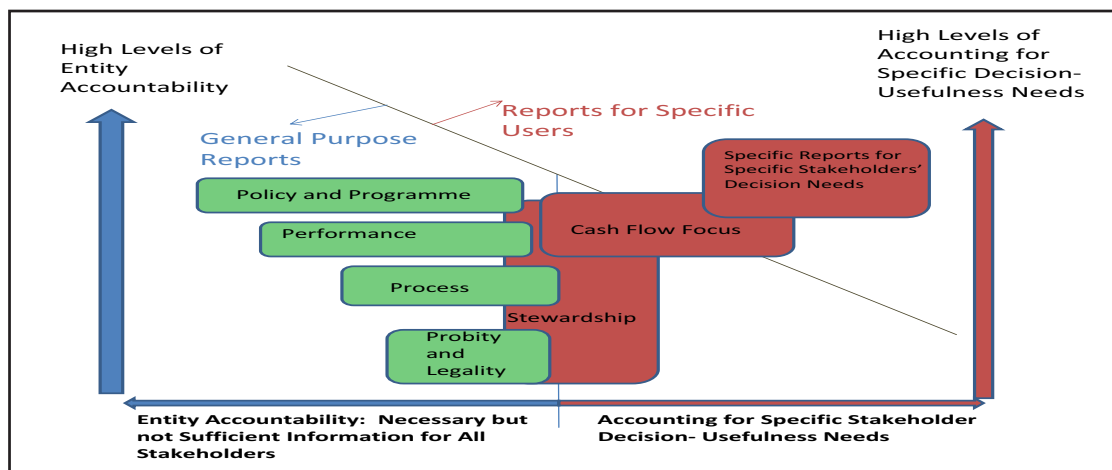
The horizontal axis makes a key distinction between 'entity accountability' (rather than 'stewardship') and 'decision-usefulness' information. The fundamental difference between these two purposes is well captured by explicating the distinction between what has been called the difference between 'entity' versus 'proprietary' accounting theory (Mattessich, 1964, p. 37). This distinction, while dated, captures something of lasting importance of which we have too easily lost sight. Entity accounting, or 'entity accountability' as used in this article, is a report about the activities and actions of the entity to inform any and all users, but with no particular users in mind. This concentration on entity accountability avoids the IASB's emphasis of making sure that the

GPFs meet the information needs of 'primary users' (IASB, 2008, S2). Proprietorship accounting, or decision-usefulness information, is concerned with reports for particular stakeholders for particular purposes and can be seen as a separate objective even if the concentration is only on GPFs. The centre of the horizontal axis is the cross-over point between entity accountability and decision-usefulness. Where any information straddles this point then it is likely to be relevant for *both* entity accountability and decision-usefulness purposes.

The vertical axis highlights that there can be increasing *levels* of entity accountability and decision-usefulness information. Closer to the base on either continuum, the information is not as comprehensive entity accountability or decision-usefulness information as would be the case nearer the top of these continuums. The assumption is that being positioned at the top of either continuum would include everything below. This is certainly the case in terms of entity accountability. This is not as clear-cut, however, when it comes to decision-usefulness information, since this can range from GPFs at the lower levels (which have implicit user needs in mind, despite their apparent general nature), to more explicit reports for specific users for specific purposes at the highest point. The latter might only partially refer to the former and, in certain circumstances, may make no reference to it at all.

This distinction is reflected in the diagonal, sloping axis in the body of the figure. This axis highlights a distinction between the different structural nature of the resulting reports, ranging from GPFs for all users, to specific reports for different users for different decision-usefulness needs. What is also apparent from figure 1 is that some GPFs have particular users and particular decision-usefulness information needs clearly in mind. This becomes more apparent when these reports are positioned further away from the midpoint on the horizontal axis and higher up the vertical axis, on the decision-usefulness side.

Figure 1 provides a different way of exploring the disagreement between the IASB's and EFRAG's understanding of stewardship and decision-usefulness—with the latter depicted as a 'cash flow focus', due to this being the dominant emphasis of the IASB's understanding of decision-usefulness information. Despite the strident disagreement, figure 1 shows that there is not as much distance between the two as the debates would seem to



**Figure 1. Conceptualizing entity accountability and decision-usefulness.**

suggest. Stewardship reporting sits on the borderline between entity accountability and decision-usefulness information. Yet, as EFRAG (2007) make clear, the commonly-accepted understanding of stewardship, based on both their view as well as those who responded to the discussion paper, has an underlying decision-usefulness emphasis. This is summarised well when EFRAG highlighted that ‘most respondents that commented on stewardship consider that the stewardship objective is about assessing management’s competence and integrity including the success of their strategy in managing the business. They state that one objective of financial reporting should be to serve as a type of dialogue between management and shareholders with the information they need to make decisions, as owners of the business’ (EFRAG, 2007, p. 6). Given this understanding, the IASB, not surprisingly, are of the view that this stewardship objective can be achieved within their wider decision-usefulness objective. This is rather belittling of the differences but, at another level, it is possible to make this claim. To reinforce this point it is worth noting the view of one of the respondents to the IASB’s discussion paper, echoing the view of the IASB, when they made clear: ‘we believe that the concept of stewardship is embodied in and is an essential part of decision-usefulness information’ (EFRAG, 2007, p. 8).

Stewardship reporting, as understood by EFRAG, has a ‘weak’ decision-usefulness emphasis relative of the ‘strong’ emphasis of the IASB and the FASB. The two objectives share a common decision-usefulness ‘worldview’ making them ‘not fully alternatives at all, but simply adjustments within the user worldview.....even though this commonality is not necessarily evident to the proponents’ (Laughlin and Puxty, 1983, p. 475).

What figure 1 also highlights is that the IASB’s suggested ‘cash flow focus’ is only partly satisfying the decision-usefulness objective they are proposing. While the ‘cash flow focus’ of the IASB is still a GPFR its emphasis is geared to the specific needs of finance-providers—hence it is positioned both to the right hand side of figure 1, as well as crossing over the diagonal axis. It is, however, higher up the decision-usefulness vertical axis. But what figure 1 also makes clear is that if the decision-usefulness objective is to be fully achieved, then there needs to be a move to the top far right of figure 1. This involves developing specific reports for specific stakeholders for particular decision needs. Logically, a GPFR report is never going to achieve this. The danger, based on the logic of figure 1, is that the further the GPFR moves away from the left-hand side of the diagram the more these reports fail to satisfy entity accountability.

#### *Entity accountability: an explication*

More needs to be said about entity accountability and the four different levels depicted in figure 1. One of the key characteristics of entity accountability is that it does not have a ‘primary user group’ in mind. Accountability can be described as ‘the giving and demanding of reasons for conduct’ (Roberts and Scapens, 1985, p. 447), but does not necessarily require a specification of who does the ‘demanding’. In this regard, entity accountability is not directly concerned with the needs of users but with the entity and its actions and activities both in terms of the past as well as in relation to future intentions. Entity accountability is intended to be useful, at some level, to all stakeholders but there is less concern about either who these stakeholders are or what their information needs may be in any specific sense. It is for this

reason, as is apparent from figure 1, the resulting information is deemed to be 'necessary but not sufficient for all stakeholders'.

In addition, entity accountability is what can be described as 'political/public', rather than 'managerial', accountability, since the latter has a stronger decision-usefulness emphasis. Day and Klein (1987, pp. 26–27) highlight the differences between these two forms of accountability in the following way: 'Political accountability is about those with delegated authority being answerable for their actions to the people, whether directly in simple societies or indirectly in complex societies... In contrast, managerial accountability is about making those with delegated authority answerable for carrying out agreed tasks according to agreed criteria of performance'.

Political/public entity accountability can be at four different levels in a 'ladder of accountability' according to Stewart (1984, pp. 17–18). At the base, and the most basic, entity accountability is an account about *probity and legality*. This is primarily an account about the receipt and use of money entrusted to the entity to demonstrate that it satisfies a range of requirements, not least compliance with the law. *Process accountability* provides information on the internal processes through which the entity undertakes its work of converting inputs into outputs and outcomes. *Performance accountability* involves making transparent expected and actual performance related to entity objectives notably in terms of outcomes forthcoming. Finally, *policy and programme accountability*, involves information on broader policy issues that drive the reporting entity and the programmes that it is pursuing over particular timeframes. The four levels are indeed a 'ladder', which assumes that each 'step' builds on the previous 'step' so that, at the top of the ladder, all the steps are articulated to provide a comprehensive understanding of the reporting entity.

#### *The objectives question*

Figure 1 allows the 'one versus two objectives' argument to be viewed in a different way. If the alternatives are posed in terms of stewardship versus decision-usefulness, as currently understood by EFRAG and the IASB, then the latter is right to say that stewardship can be subsumed in decision-usefulness. However, if the alternatives are between entity accountability and decision-usefulness, then this poses a real choice. But it can be argued that this choice should not have to be made. A not unreasonable view, if accounting is to serve

an important societal purpose, is that both entity accountability as well as decision-usefulness information are important and, therefore, the conceptual framework should pursue both objectives.

There is, however, a need to be more adventurous as to how these objectives are implemented in the design of actual accounting statements. Currently both the IASB/FASB and EFRAG continue to advocate GPFRs, albeit differing on the contents of these reports. This has to be a severe limitation, particularly for the IASB and FASB, who wish to pursue *only* a decision-usefulness objective. To be effective in achieving this objective there needs to be a more specialist focus leading to specific reports for specific users for specific decisions. As indicated above, GPFRs rapidly become an irrelevancy under decision-usefulness thinking. However, GPFRs, for those pursuing entity accountability, are never an irrelevancy. The question for the proponents of entity accountability is what should be contained in the GPFRs. In this connection, to stop at the probity and legality level is difficult to justify given the other levels in Stewart's 'ladder of accountability'.

#### **One conceptual framework and one general purpose entity accountability report for all private sector entities and PBEs?**

Whether there should be *one* conceptual framework for *all* entities is a question that applies whether or not it is built on two rather than one objective(s). One view on this question is well captured by the Government Accounting Standards Board (GASB) in the USA: 'separate accounting and financial reporting standards are essential because the needs of users of financial reports of governments and business enterprises differ' (GASB, 2006, p. 1). While GASB's economic distinctiveness argument is difficult to refute, their conclusion is more suspect. What they are doing is using decision-usefulness logic in relation to entity accountability. An alternative view is held by the IASB who are content to let the unfortunately named 'not-for-profit' sector to be picked up late in the conceptual framework project. The implication of this is that differences between the sectors are so small that the consideration of PBEs can be left until all the other major issues have been resolved. IPSASB clearly does not share this view, as their early endeavours to produce a conceptual framework for PBEs demonstrate, but that does not mean that they agree with the views of the GASB, or the IASB.

Conceptually there should be a *single* conceptual framework, arguably built on two

objectives, for *all* entities, but this doesn't mean that the resulting information will be, or should be, the same across all entities. There are good reasons why entity accountability *and* decision-usefulness information should become the underlying basis of a unified conceptual framework. However, at lower levels in the conceptual framework, dealing with the actual content of the information supplied across the different entities, this could and should differ.

This is most obvious in relation to fulfilling the decision-usefulness objective, given the different stakeholders involved and their different decision needs. This also assumes that to satisfy a decision-usefulness objective cannot realistically be fully achieved by GPFs, despite the IASB's seeming support for this possibility. However, the IASB, with their 'primary users' in mind and their cash flow emphasis, are stretching GPFs to the extremes of general relevance as figure 1 highlights.

This conclusion, however, is not so clear-cut in relation to entity accountability. The assumption over many years is that private sector financial reporting and accompanying domestic and international accounting standards, taking aside, for the moment, the narrative reporting requirements, will satisfy some of the accountability needs of PBEs. The validity of this argument is explored below.

*Entity accountability: conceptualizing commonalities*

One view on this is that this strategy has been incorrect on the grounds that the economic nature of PBEs and private sector entities is fundamentally different. Simpkins (2006, p. 16) summarises these differences by typecasting PBEs as follows:

- their objective is to provide goods and services to various recipients or to develop or implement policy on behalf of governments and not to make a profit;
- they are always characterized by the absence of defined ownership interests that can be sold, transferred or redeemed;
- they typically have a wide group of stakeholders to consider (including the public at large);
- their revenues are generally derived from taxes or other similar contributions obtained through the exercise of coercive powers;
- and their capital assets are typically acquired and held to deliver services without the intention of earning a return to them'.

A similar listing is contained in GASB's (2006) white paper. It is difficult to dispute the reality

of these differences.

While these differences are significant, this still does not necessarily mean that, at a probity and legality level, separate accounting standards are needed for respectively private sector entities and PBEs. This is because there are some economic commonalities across all entities.

Figures 2 and 3 provide a very basic understanding of these economic commonalities in and differences between the two sets of entities. The figures depict private sector entities and PBEs as an amalgam of three subsystems—a decision and control subsystem that both controls the entity as well as receives inputs and outputs information to the entity's environment; a funds subsystem which both receives and spends money; and an operations subsystem which receives non-financial inputs and processes these into outputs and outcomes (cf. Lowe, 1972; Bebbington *et al.*, 2001). The key assumption in both figures 2 and 3 is that there are three generic fundamental financial transactions of any entity from which financial statements are drawn. There are other transactions—notably those related to credit rather than cash exchanges—but these are refinements to the three transactions highlighted in figures 2 and 3 rather than being of a fundamentally different nature.

Transaction 1 is the capitalization funding flow to allow the entity to function. Transaction 2 involves the expenditure by the entity on inputs needed for the long and short term. Transaction 3 is the financing that comes from and links to these outputs and outcomes achieved. As is apparent from both figures, these transactions have an input and output into and out of the entity. In all cases in figure 2 these are closely connected, but this is not the case in figure 3. Recording this duality, notably for private sector entities, is why double entry book-keeping came into being.

Figure 2 portrays these transactions in relation to private sector entities. The funds input in transaction 1 are receipts from ownership claims and from liability holders. These are connected to outputs from the decision and control subsystem, which contains the formal contractual acknowledgement of indebtedness either in terms of ownership recognition or loan arrangements. Transaction 2 involves the purchase of 'factors' for the production of goods and services, whether of a long-term (asset) or more short-term (current) nature. Again, there is a clear connection between the funds output and the input into the operation's subsystem. Transaction 3 involves the receipts from market sales of the

outputs generated by the entity. Again, the connection between the input into the funds subsystem and output from the operations subsystem is clear because of the market which prices (and values) the products and services sold.

Figure 3 demonstrates that similar transactions exist in PBEs even though the input/output connections are more complex. Transaction 1 indicates that there are capital receipts in PBEs, but there is a lack of clear linkage between these input receipts and any apparent outputs. In the private sector there is always some acknowledgement of indebtedness—marked as an output from the decision and control subsystem. This is not the case in PBEs. There is a genuine uncertainty in the capitalization arrangements of PBEs as to the nature of their indebtedness and/or in relation to ownership claims. Clearly this does not apply to legal liabilities, which are similar to those taken out in private sector entities. Transaction 2 is exactly the same for both PBEs as well as for private sector entities and the same problems with regard to asset and expense classification applies across all entities. The distinction between asset and expense is highly problematic in accounting in all entities due to the similarity of the input into the operations subsystem. The financial scandals of Worldcom and Parmalat are traceable to this problem of deciding when operations inputs are assets or expenses. Ever since resource accounting and budgeting was introduced into the UK public sector, this has been a common problem for

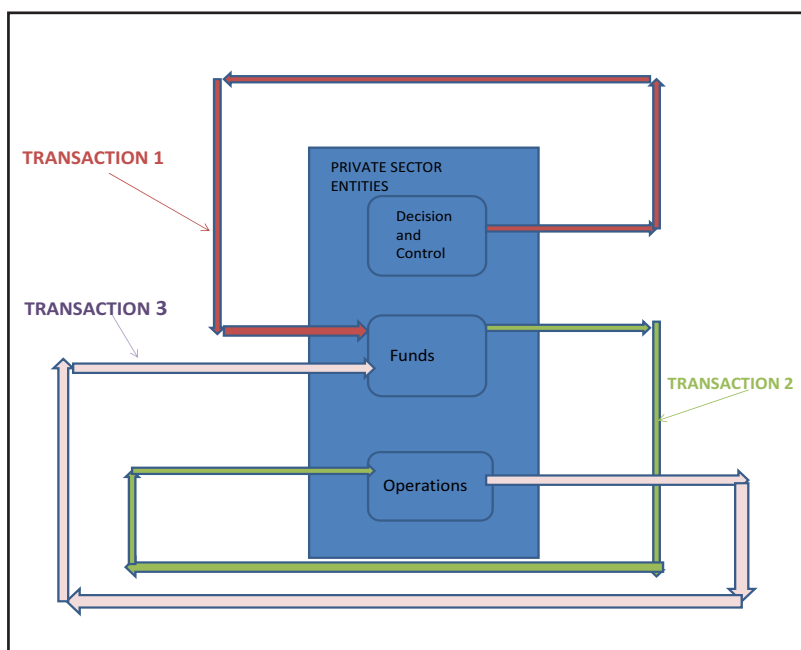
both private sector entities and PBEs.

There are, however, inputs into the operations subsystem that have *not* been purchased through a market exchange. These are marked ‘transaction 2A’ in figure 3. These inputs include gifts of time, property etc. Yet, while these are similar to transaction 2, there is no obvious output apart from, if they are a gift, some information flow (such as an appreciative acknowledgement) from the decision and control subsystem. Transaction 2A causes immense difficulties as to how to account for these as inputs and outputs. So even in transaction 2 the duplication between private sector entities and PBEs is not without problems for the latter. Yet there are certainly more commonalities in transaction 2 than in transaction 1. Finally, with regard to transaction 3, there is a marked difference between private sector entities and PBEs. The connection between funds received by the PBEs (for example government grants) and the services delivered do not have the clear market linkages that are apparent in private sector entities.

#### *Entity accountability: some answers*

What figure 2 and 3 demonstrate is why private sector financial statements fits better for private sector entities and why some of the underlying concepts and standards need reshaping to allow them to fit the context of PBEs.

There are a number of recent examples that illustrate this. Take, for instance, struggles with the definition of liabilities in the Statement of Principles for PBEs (ASB, 2005a, 2007) and the difficulties related to how best to account for heritage assets (ASB, 2006a, 2006b). Both problems are traceable to the fact that the economic and social nature of private sector entities and PBEs differ. Liabilities have been resolved by providing a genuine PBE solution. Heritage assets are less straightforward and remain a problem. Heritage assets are mainly found in PBEs. Only some of them are purchased through a market exchange. The original discussion paper (ASB, 2006a) posed a PBE accounting solution, which involved giving either a value to an entire collection if this could be done, or providing a more qualitative description if it couldn't. This ‘all or nothing’ approach, despite the support received in the consultation, was changed in the Exposure Draft (ASB, 2006b) to, in effect, a private sector solution to a PBE problem by requiring balance sheet valuations, but on individual separate items in collections rather than the collection as a whole. This assumes market values for these individual assets are attainable—something



**Figure 2. Key transactions in private sector entities.**



would require developing GPFs in new ways. This needs to be accompanied with a development of specific information for specific decision-making for specific stakeholders in both private sector entities and PBEs. This will involve often once-off information to be supplied, in addition to the new GPFs. Taking these developments together will lead to a meaningful conceptual framework for both private sector entities as well as PBEs, as well as meaningful information and useful information for all. ■

### Notes

<sup>1</sup>'PBEs' are the increasingly common descriptor of public service organizations by policy bodies. PBEs include organizations that are not just those located in the public sector but have a public-benefit concern wherever located. In the academic literature this has given rise to describing this wider set of organizations as 'public services' some of which are part of the 'public sector' (see Broadbent and Guthrie, 2008). However, in this article the descriptor of PBEs is used.

<sup>2</sup>The IASB and FASB do make plain that this objective has a particular business emphasis and that this will be reconsidered when they come to look at what they call 'not-for-profit' organizations at a later stage in the development of their conceptual framework. The assumption is that the objective might need slight modification in specifics but not in its underlying emphasis, no matter which entities are being considered.

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