

Paradigms of the Concepts and Principles Substantiating the Elaboration and Presentation of the Financial Reporting Situations

Victor MUNTEANU¹
Mihaela BERECHET (DRAGNEA)²

¹Wallachia University of Targoviste, ¹E-mail: a2c_vm@yahoo.com

²Wallachia University of Targoviste, Postdoctoral School,

²E-mail: berechetmihaela@yahoo.com

Abstract *The present article deals with a number of existing paradigms of the concepts and principles substantiating the elaboration and presentation of the financial reporting situations throughout the world. There are presented and commented the accounting postulates, principles, conventions and doctrines, available in different accounting systems, both across the European continent, and across the American continent. The present article concludes with the authors' comments on the accounting concepts and principles substantiating the preparation of the financial synthesis and financial reporting documents.*

Key words Accounting doctrine, postulate, accounting principles, financial reporting, synthesis accounting documents

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1. Introduction

For all the market economy countries – irrespective of the accounting system on which they are based - the accounting principles represent the starting point in the elaboration of the financial situations. The use of principles as a basis of the conceptual framework is a characteristic feature of the English tradition countries, followed by the United States of America. The principles used to represent the unique criteria of formulation of the accounting judgements and solutions, under the conditions in which the juridical system was not involved in the elaboration of some accounting norms. Thus, in the unwritten law countries, the development of the accounting principles - in terms of their formulation and application – had its most marked evolution, since these countries had a much older tradition than the written law countries. The latter prefer to formulate the accounting solutions by the observation of a thorough system of aggregate rules, representing the main accounting normalization instrument named General Accounting Plan. Due to the increasingly marked globalization of the companies and to the need to protect the private investors more and to loyally inform them, the two positions – of the Anglo Saxons and of the continental inhabitants – have started converging. What was only a set of generally admitted principles, at the beginning, tends to become a set of norms adopted on a national and international level.

2. Literature review

The issue of the accounting principles, of their acceptance and application, has been analyzed since the very beginning of the financial situation normalization process. Although it had not been formal, the set of accounting principles existed and was agreed upon by those who were elaborating and using the financial situations. Within the audit report, reference was made during the financial situation elaboration itself, according to the generally accepted accounting principles, applied on a basis that is consequential in relation the previous financial exercise.

The definition of the starting point in the creation of the accounting principle (Scott, 1941) is made through the subordination of this process to the social, political, juridical and economic features, considering that all these are incurred by the human behaviour. The development of the society, in general, has generated the need to formulate and apply some principles in all these fields. Thus, the authors explain that, like other professional groups, accountants have tended towards a set of principles meant to guide them in their activity.

The original treatment of the concept of generally accepted accounting principles (Chambers, 1966) intended to make of a parallel between the accounting profession and the other professions that require professional rules, meant to guide the ethical behavior. The authors conclude that the status of *principle* in accountancy is opposed to that it has in other fields, namely:

- While, in other fields, the concept is invoked only when an unacceptable social or professional behaviour occurs, in accountancy it is the headstone of a respectable practice; and
- in other fields, the expression is used only as protection against incompetence, never as an ideal of competence and any action must involve more than a general acceptance of some principles.

Beside these comments, the authors analyze the concept of generally accepted principles in the context of their appearance and existence, during a time when the acceptance on general level was not required by any settlement, and the uniformity that should have been generated out of such a set of principles could not be found in practice. Moreover, the attempt of establishing the extent to which a principle is applied is hindered by the modality of its formulation. Most of the times, principles used to include contradictory expressions like: *immobilized assets must be highlighted in point of cost in historical values, unless such values are not significant anymore.*

In this study, the authors assert (Chambers, 1966) the usefulness of the accounting principle, on one condition: *in order to be understood, the declarations regarding the accounting principles should contain preliminary discussions on the way principles should be interpreted.* The definition “principles are declarations with general features, abstract character, on classes of events or transactions” should not lead to the idea that generalization makes them implicitly useless. Chambers asserts this idea by exemplifying some theories of physics and mathematics, *such as the principle of rectilinear propagation of light in a uniformly dense environment or by the way of characterization of a straight line: it has no width, height, curved zones or end.* Anyway, they are concrete examples of abstract notions that we use, and on which we rely in our attempt to specify and to create representations of the common images. Also, the accounting principle is part of this area. It is a conceptual notion, defined as an imposition of some rules expressed on a general level, without specifying the possible concrete treatment that might be applied when a specific phenomenon occurs. The principles are generated through the observation and analysis of certain aspects of the experienced universe. Their usefulness consists in the capacity to inform on actions of a great variety in the context in which the described phenomenon represents just a part. It is not sufficient that principles be described as generally accepted. The test of their usefulness is made by their users who attest or do not attest the consequentiality with the economic activity reality.

3. Accounting postulates, principles, conventions or doctrines?

Another discussion topic in the American accounting literature of the 1950s-1960s is about who should influence the most the way in which the application principles and methods are formulated. The conclusion supported by most researchers is that trade and industrial companies should be those that should have the most important word to say. Anyway, actually the main accountancy users are those who set the accounting principles, as well, their application being let up to them unlimitedly. It is in order to avoid such situations that the profession of accountant, a profession authorized by a professional body, has been supported.

But, let us go on with this idea and ask ourselves: if the trade and industrial companies are much too involved to be able to establish the set of accounting principles, then who would be neuter enough? As a result of the disputes occurred, a number of criteria have been reached regarding the appointing of those who should take on the responsibility for the accounting normalization, namely:

- experience in accountancy, which should be proved;
- interest in the domain of accountancy, in quality of common and independent user.

In this class, a number of authorized accountants may be included, who should preferably not be employed in the industrial or public/governmental domain. We may consider that this is the starting point of the settlement of the accounting profession and of the delimiting of the independent normalization bodies.

Starting from this reality, in time, the discussion moved towards the achievement of a set of general principles clearly defined and accompanied by methods and procedures regarding their application. The situation became more complicated with the statements of those who considered that *there are activity domains which require specific methods of application of the principles, and these domains should constitute exceptions*. Such an idea is supported by Professor Lloyd Morey of Illinois University who militates for a separate set of accounting principles for the non-profit institutions.

Concepts like continuity, connection of expenses to incomes or to the historical cost have been undisputable since the 1940s. Prudence also named conservatism or “the postulate of the non-anticipation of profits and of the recognition of the probable losses” (Hylton, 1954) has been accepted to a quite high extent. While the acceptance of such general principles is universal, there are disagreements, however, in terms of the methods used for their application. We believe that this is a normal situation, considering the definition of the adjective *general*, which means “for the greatest part, in majority, but not in all cases”.

The generic reference by using the concept of principles must be nuanced by highlighting the fact that *we may speak about a general consensus among the accountancy professors and among practitioners depending on the existence of a number of concepts which detail or interpenetrate with the accounting principles*. The first coherent statement of the concepts in the accounting literature was given by the American Accounting Association (AAA). Seven concepts are discussed, by the development of a previous paper of Professor Paton. The basic concept from which we start is that of conditions, further found under the name of postulates, defined as *physical realities and existent mental condition involving the necessity of accountancy and governing its form* (Paton and Littleton, 1940).

Terms like postulates, principles, procedures, rules, concepts, standards and directives are frequently, but inconstantly, used in the accounting literature. For example, an inconsistency in use is related to the terms postulates and principles, found in the very *Accounting Terminology Bulletin and Accounting Research Bulletin of AICPA* (American Institute of Certified Public Accountants), published in 1961. In the first issue, the postulate is subordinated to the principle and in the second, the principle is subordinated to the postulate. Both terms are used in the accounting literature. The Institute reconsiders the terms’ definitions as a result of the studies carried out and published in the 1960s: the postulates are few in number and constitute the basis on which principles are built. They are derived from the economic and political environment, from the thinking modalities and from the business community traditions. Thus, we may accept that the main idea of any accounting methodology is the establishment of objectives, those goals towards which efforts lead. For the trade companies, for example, the goal aimed at is the measurement of the obtained profit. Therefore, the objective of accountancy must be not only the measurement and reporting of performance and of factors that influence it, but also its definition.

Being founded on the previously presented ideas, some authors consider that *postulates can neither be characterized as objectives nor as methods or principles but rather as determiners of the accounting operations and do not concern the modality in which the accounting information is used or in which objectives are reached* (Vatter, 1963). Postulates are meant to establish the goals to be reached, such as: delimitation of the elements to be measured, recognized and reported; the users of the reporting, the users’ influence on the reporting structure. By the argumentation of these statements, a theory has been developed in which the conceptual components of the normalization are described by the presentation of some diversified concepts, such as: conventions, doctrines, principles, methods, practices. Starting from the general objective of highlighting the real situations by means of the accounting process, the author outlines a number of generally accepted concepts regarding the usual behaviour, which generates a set of ideas called hereinafter conventions. The same authors (Vatter, 1963) define conventions as general understandings of the use and of the life models that, although appearing arbitrary, are actually generated more or less by a normality state, in a social system.

The conventional elements of accountancy, like the general presentation form of the financial situations or the rules of the accounts’ operation, rely on some conventions such as the reporting period circumscribed to the calendar year and the property concept regarding the juridical, economic or political

aspects. Such concepts connect the accounting process and the environment in which it is applied under normal conditions. Beside conventions, but separated from them, one can find the accounting doctrines. They are set apart from conventions through the fact that they are lessons, ideas inherited from generation to generation, while conventions are modalities of approach of the situations derived from the meeting of the accounting process with the economic reality. Doctrines represent normative ideas, intended to reflect correct practices and to serve as reference for the applicable methods and procedures and producing an effect of the principles. In this class are included: prudence, consistency and significance threshold. They represent attitudes of the profession regarding the way accountants should react under certain conditions. From the *descriptions made we take the liberty to classify doctrines in the class of guide (line)s considering the currently much-debated issue of professional reasoning* (Vatter, 1963).

Under the conditions in which there is a given basis of conventions and doctrines, principles generalize the modalities by which the accountancy objectives may be reached. For example, the author highlights the principles circumscribing the commitment accountancy and representing logic models of the mode in which accounting information may be treated through the perspective of the periodic financial reporting. Beside the notions presented previously, the author also mentions certain stereotypes which she refers to by the notions of procedures and methods. For example, the amortization calculation may be done by several modalities of distribution of the asset cost for the utilization period. The fact that amortization measures the cost transfer for the utilization period is considered a principle, while the rate selection based on which the value is transferred is considered a method. *Selection of one of the possible methods is an issue of application of the principles in a given situation, under the coordination of doctrines and conventions, by the scope of satisfying the objectives generated by the activity operation.*

Vatter states that, being given objectives, conventions and principles, this sets limits within which the methods and practices may be selected, conferring the proper framework necessary to the delineation of the professional reasoning. In the attempt to find the justification of the postulates, Vatter anticipates Chambers's theory conferring normality to the abstract notions and asserts B.E. Goetz's ideas regarding the "usefulness of the impossible". In postulates, he sees the binder needed to get the abstract close to the concrete and to establish connections when certain elements of the logical chain are missing.

The accounting research has emphasized the greater and greater necessity to realize a unification of terminology and to create a structure of the accounting theory. In this respect, there have been two approaches: a deductive and an inductive approach.

The deductive approach starts from general or fundamental propositions and gradually reaches more and more specific elements. This theory (Stead, 1948) starts from the comprehensive principle: *integrity* - explained by two notions: clarity and stability. The next level of the accounting theory structure is that of the *canon*, such as literal accuracy and correct impression, which derive from principles and further serve the clarification of the accounting objectives. Then, there come the structure of *the standards*, in which the author includes the principle of continuity, the integrity of the presentation and the connection of the expenses to the incomes and which serve for the assessment of the leadership and, as a final detail, *rules* are presented, which include accounting definitions and procedures.

The inductive approach starts from the practical details of accountancy and goes towards general elements (Littleton, 1956). He sees the principle system in a pyramidal form. The structure is based on the company's rights, including property, obligations and rights generated by documents and transactions. He goes on with the company's actions directed towards the transaction recognition by the recording of the debit and the credit and by the elaboration of the financial situation. Depending on the company's actions (transaction assessment, analysis and recognition of the debit and credit for different elements, establishment of specific adjustments and transactions of the annual accountancy, elaboration of the financial situations and their auditing), first, the objectives justifying such actions are established, then the reasons supporting the objectives found during the previous stage, so that, finally, the fundamental objectives found in different references may be delimited under different names: accounting principles, general principles, general considerations or concepts etc.

As a result of such approaches, a structure (Welsh and Zlatkovich, 1989) of the accounting theory has been developed, formed of: fundamental axioms (fundamental underlying assumptions), which include notions like the separate entity principle; fundamental theoretical concepts, such as the entity theory;

generally accepted accounting principles, such as the historical cost principle; and accounting procedures. In time these were re-grouped in two classes: principles and procedures.

One of the most important projects meant to clarify the accounting thinking is the research programme of AICPA (American Institute of Certified Public Accountants) which aims to establish the accounting normalization fundamentals. The first research study (Moonitz, 1961) brings into discussion the problems of the accounting postulates and the second accounting principle (Sprouse and Moonitz, 1962). The studies lay at the basis of the accounting theory the concept of postulate and start from the fact that functions are determined and principles are established by a deductive logic applicable to postulates which, in turn, are generated by aspects possible in a certain domain.

Within the first study, 14 postulates are defined, of which the most important are: measurement of the resources owned by the economic entity; reflection of the rights and interests in the economic entity; assignation of modifications to some time periods and expression of estimation in monetary terms. Postulates are defined as fundamental notions, supposed to be true for asserting certain argumentations or for analysing and developing certain notions. They are considered axioms, which must not be defended. In Moonitz's monograph, the described postulates may be classified in:

- postulates of environment, which do not impose rules, but only describe the economic environment in which any activity occurs and create connections to the other economic domains;
- postulates of connection, between the economic and accounting environments, which direct the assessment modalities and establish the limits of reporting to the wealth of the analyzed entity;
- imperative postulates, which represent fundamental, undisputable ideas, on which reasoning and practice are based, such as: fairness, permanence or monetary stability.

The conception by which principles derive from postulates confers the latter a leading and determining position, which must ensure the general framework needed for the definition of a set of ideas that should be applied in practice. It is asserted that principles cannot be generated by hypotheses established deductively since they must answer the general issues. Scientific laws begin through generalization, which requires an empiric and inductive process, but must be completed by predictions. These two monographs have served as a basis for discussion for the accounting literature and induced the realization of the complex study called ARS (Grady, 1965). In the present paper, postulates and principles are considered as deriving from the experience in the analysis of the business management and in the accomplishment of responsibilities within the framework of a company having the following objectives:

- exercise of the governmental power in a manner that should answer the population's requirements; and
- the maintaining of an economic system based on individual initiatives and employment and opportunities of investment in competitive companies.

The paper as a whole brings to light the idea that the achievement of a classification of the concepts and of the principles lies on criteria depending on which we could assert that a principle is more useful than other alternatives. Such criteria, found throughout the paper are: "the fulfilment of the fundamental useful requirements and goals for achieving the credible control of the financial and operational information within a society".

Based on the analysis of their own experience, different authors would choose different concept lists. The study (Grady, 1965) contains a 10-concept list, each of them justified by the usefulness and dependence on the accounting information or on its limitations, regarded through the financial situation perspective. In the paper, the idea that a set of concepts is absolutely necessary to confer coherence to principles is asserted. These concepts are:

1. Observance of the private property rights by society and governmental structure;
2. Economic (business) entity;
3. Continuity;
4. Monetary expression in accounts;
5. Consistency (permanence) in time for the same entity;
6. Diversity for different entities;
7. Prudence (Conservatism);
8. Dependence on the information generated by the inner control;

9. Significance threshold;
10. The delimiting of the financial reporting, in time, requires estimation.

These concepts are still valid and may be found in different accounting reference guides, via a direct or indirect reference. Based on the existing documents, we believe that only a part of these concepts is accepted in most reference guides. *They are: economic entity, continuity, monetary expression, permanence, significance threshold and delimiting in time.* Also, we could include *prudence* on this general concept list, but with the reserve of the inconsistency of the approach from a period to the next and from a country to the next. Although generally accepted, *prudence* is explained and applied to different extents, from excessively prudent to indifferent. Of the others concepts, we believe that the one regarding the *observance of the private property rights* by society and governmental structure is not necessarily a basic concept since it may not be found explicitly in any current accounting frameworks. But, implicitly, it is considered especially in the definition, recognition and assessment of the own capital.

Regarding the *diversity for different entities*, we regard it as a reality of the economy, particularly if the entities belong to different activity domains, but maybe it should not be considered as a basis of accountancy. The diversity of the economy, legitimating the diversity of the accounting practices limits the necessity to achieve comparability in time and space, a need appeared and developed more and more under the current conditions of the international capital markets (Anthony, 1966). Based on that, we assert that if in the 1960s, when Grady carried out his study, diversity was more a characteristic than a basis of normalization, and could be considered indifferent, at present, in the context of the growing efforts of globalization of the accounting norms, diversity has become rather an obstacle that needs to be overcome but not necessarily eliminated.

The concept regarding the inner control, under the conditions of an extensive development, both of the accounting framework and of the audit framework, as complementary domains of the financial reporting, may be allocated, at present, more to the audit and less to the accountancy. The study (Grady, 1965) goes on with the presentation of a structure of the generally accepted accounting principles for trade companies, very interestingly organized. They are classified first in five objectives to which a certain number of principles correspond. These principles are regarded as generally accepted in the context of the fulfilment of the objectives of responsibility based on confidence. The presented principles are rather considered definitive rules, but must be applied in correlation to the time circumstances. Thus, it is considered that, in a changing universe, not only the detailed rules can but also should be modified to suit to the economic requirements. In exchange, the basic principles and concepts must not be affected by such changes, and not due to their inflexibility, but due to the fact that they are conceived precisely to represent a general guide that should answer the requirements of a changing environment.

The ideas presented in this study - although it intensively develops the principle concepts and even extends them to accounting treatments - which, at present, may be found in the accounting standards, do not cover all the concepts, principles and practices accepted.

The further comments, based on these researches, have tried to bring forth simplification. The idea itself of a *unique postulate regarding fairness*, which involves a normative-ethical aspect, has been asserted. Anyway, during a more detailed analysis, it has been found out that such ethical concepts do not meet the definition of a starting point for the achievement of a certain objective and cannot be classified into the qualitative limits allowing one to implement assessment procedures. Thus, though necessary, the ethical concepts must be accompanied by a logical structure. From here, *another unique concept* has been delimited: *accuracy/correctness* which has further been classified in a quantitative structure, necessary to the assessment methodology. The discrepancy between the idealistic concept of correctness and the practical reality leads to the abandonment of this principle. Thus, the attempt to restrict the accounting normalization to a single postulate proved to be not the most inspired.

Such a variety of opinions suggests the existing confusion, not in goals and objectives, but particularly in definitions and connections between the notions used. This confusing situation is generated by the high number of combinations of the application of the accounting reasoning generated by the diversity of situations and problems occurring in the practical achievement of accountancy. Thus, regarded from the investor's perspective, certain aspects of reporting and certain measurement techniques are delineated, while, regarded from the manager's perspective, other techniques are considered more important. We

believe that it is necessary that all the points of view should be considered and the relations between them should be established, so that an acceptable result should be reached for the most parts.

4. Conclusions

Principles are classified uniformly as general conceptual statements meant for the creation of a reference system for building the reported accounting information. They may be found under different names, such as rules/conventions/concepts. Irrespective of the name used and of the detail characteristics which, actually, led to a differentiation in name, principles like the large conceptual area, come and help practice by the creation of a bridge towards theory. At the same time with the evolution of practice, mutations, renewals or reconsiderations take place in the accounting principles. Thus, the dynamics of the economic reality is the one giving diversity to the principles.

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