HOW ARE THE CONCEPTUAL FRAMEWORK HYPOTHESES REFLECTED INTO PRACTICE? A SHORT REVIEW OF THE CURRENT LITERATURE.

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Abstract: *The IFRS implementation has marked an important milestone in the history of accounting. Since the beginning, there have been both advocates and critics, debating whether the initial objectives were, in fact, met in practice. The present article examines the Conceptual Framework, which constitutes the basis for IFRS implementation, and identifies the main results of ~~the~~ recent studies on the topic. The research is theoretical, analysing relevant literature and bringing forward up to date concepts, beneficial for future research. Policymakers proclaim their policies are rooted in evidence and often turn to academic researchers for impartial and reliable evidence. In view of the fact that a significant number of studies have been conducted thus far, the present paper attempts to summarize the outcomes and present the conclusion.*

Keywords: *IFRS, COMPARABILITY, FINANCIAL REPORTING*

JEL Classification: *G14, G15*

1. Introduction

Many scholars have studied how the objectives presented in the Conceptual Framework are met in practice. The results are not always homogenous; however, it can be safely stated that, fifteen years following the implementation of IFRS, improvements in financial reporting can be recognized.

Specialized literature is intended to assist the standard setters, that are directly involved in the elaboration and improvement of the IFRS, and, also, for the major players on the market, such as investors or financial analysts.

The present paper is proposing a review of the main concepts illustrated by the Conceptual Framework, while also pointing out the results of studies conducted along the course of several years on whether or not, in the case of IFRS, practice truly meets theory.

2. How IFRS started? A review of the Conceptual Framework

The basis for the IFRS implementation is the Conceptual Framework which presents the main concepts that constitute the basis for preparing and presenting the financial statements for external users.
The main purposes of the Conceptual Framework are: to give guidance to the Board in the scope of the development of future IFRSs and also to review the existing ones; to reduce the number of alternative accounting treatments permitted by IFRSs by harmonizing the regulations, accounting standards and procedures; to create and to develop national standards; to guide preparers of financial statements through the IFRSs standards and how to handle different topics which are in scope of IFRS; to help auditors defining whether financial statements comply with IFRSs; to adapt the information contained in the financial statements in compliance with IFRSs for the users; and to provide information of the IASB and its approach to the formulation of IFRS. (IASB, Conceptual Framework, 2018)
Given the aforementioned purposes of the Conceptual Framework, it is important to keep in mind that it is not an IFRS and it does not define any standards. The scope of this paper is to define the main objectives of financial reporting as well as the qualitative characteristics of the financial information. Moreover, it has also the target to emphasise the definition, recognition and measurement of accounting elements and the concepts of capital together with the capital maintenance.

2.1. Objectives of financial reporting

The objectives of the International Financial Reporting Standards are: improved transparency and comparability, better functioning of the internal market, the efficient and cost-effective functioning of the capital market, the protection of investors and maintenance of confidence in capital markets, and helping EU companies compete on an equal footing for capital within the EU and on world capital markets. These objectives are derived from the main objectives of the financial reporting: to give useful and accurate information about an entity, to provide information regarding the resources of the entity, claims against the entity, and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources and to ensure an information set that will meet the needs of the maximum number of primary users. (IASB, Conceptual Framework, 2018)
The International Accounting Standards Board (IASB) promulgated, in 2018, a revised and refined Conceptual Framework aimed at guiding financial reporting practices with the means of robust and clearly defined guidelines. It stipulates that the cardinal objective of financial reporting is that of providing financial information,

that is both pertinent and transparent, that sheds light on the reporting entities' financial situation, which proves beneficial to potential and existing investors, as well as to all participants in the financial world.
Coherent and truthful financial information assists stakeholders in decision-making processes by enabling them in appraising the company's' future net cash inflow and in evaluating the management's stewardship of the company's financial resources. Any alteration in economic assets and obligations that occur due to the entity's financial activities and other events should be reflected in the financial statements. The revised framework emphasizes on the importance of accrual accounting. Accrual accounting is translated in a key principle that refers to the acknowledgement of events and transactions, more specifically, the effects of transactions and other events must be recognized at the time they occur, not when cash or its equivalent changes hands. Based on this principle, these transactions and other events are reflected in the entity's accounting records and reported in the financial statements that correspond to the time periods they are associated with. The framework states that, except for cash flow information, an entity is required to use the accrual basis of accounting in the preparation of its financial statements. This means that an entity should recognize assets, liabilities, equity, income, and expenses only when they meet the recognition criteria and satisfy the definitions laid out in the Conceptual Framework, and this recognition is not purely tied to payment of cash, or receipts. That said, when an entity sells services or goods on credit, the income must be recognized at the time of the sale, not when the payment is later received. Likewise, when the entity receives a bill for utilities used over a specific period of time, the expenses should be acknowledged for the timeframe in which the utilities were consumed, not when the bill is actually paid. In the 2018 revision, the IASB emphasized on the concept of stewardship, highlighting the amplified demand for transparency and accountability in terms of company management. Stewardship encompasses management duty in regard to entrusted resources, and involves the necessity to provide information that aids users in assessing management's decisions and actions. (IASB, Conceptual Framework,2018)

2.2. Qualitative characteristics of useful financial information

The qualitative characteristics of useful financial information apply to the financial information provided in the financial statements, as well as in other ways. For the financial information to be useful, it should be on one hand relevant and faithfully represented, and on the other hand comparable, verifiable, timely, and understandable.

The fundamental characteristics are relevance and faithful representation. Financial information is relevant if it can make a difference in the decisions made by users. It must have a predictive and/or confirmatory value. The predictive value implies that the information represents an input to processes employed by users to predict future outcomes. The confirmatory value refers to ability of the information to provide feedback about previous evaluations. Both values are interrelated.

Faithful representation means that the financial statements should be complete, neutral, and free from error. A complete representation includes all the necessary information for a user to understand the phenomenon being depicted, with descriptions and explanations. Neutrality in representation refers to unbiased selection or presentation of the financial information. Neutrality suggests a certain level of caution, referred to as prudence, which implies a conservative approach when making judgements under conditions of uncertainty. However, while dealing with uncertainty, if prudence translates into bias in reporting, the concept would end up being incompatible with neutrality, due to misrepresentation of gains, losses, assets, liabilities, income, expenses or the overall equity. The 2010 Framework omitted any direct reference to the concept of "prudence", which was heavily criticized, as the lack of such quality was perceived as inadvertently encouraging over-optimistic reporting. The return of the concept of prudence addressed critiques targeted at the 2010 Framework, whilst reaffirming that prudence, is indeed a crucial element of providing a faithful representation. Faithful representation translates in financial statements that are free from errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied without errors. Besides the fundamental qualitative characteristics of financial information, some enhancing qualitative characteristics are worth mentioning, such as: comparability, verifiability, timeliness, and understandability.

Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. Unlike the other qualitative characteristics, comparability does not relate to a single item. A comparison requires at least two items. Consistency, although related to comparability, is not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Comparability is the goal; consistency helps to achieve that goal.

Verifiability assures users that information faithfully represents the economic phenomena it represents. Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Quantified

information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified. Verification can be direct or indirect. Direct verification means verifying an amount or other representation through direct observation. Indirect verification means checking the inputs to a model, formula or other technique and recalculating the outputs using the same methodology.

Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is. However, some information may continue to be timely long after the end of a reporting period because, for example, some users may need to identify and assess trends.

Classifying, characterizing, and presenting information clearly and concisely makes it understandable. Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

The quality of the financial information presented in the financial statements also implies a cost. There are several types of costs and benefits to be considered. Providers of financial information expend most of the effort involved in collecting, processing, verifying, and disseminating financial information, but users ultimately bear those costs in the form of reduced returns. Users of financial information also incur costs of analysing and interpreting the information provided. If needed information is not provided, users incur additional costs to obtain that information elsewhere or to estimate it. Reporting financial information that is relevant and faithfully represents what it wants to represent helps users to make decisions with more confidence. This results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole. An individual investor, lender or other creditor also receives benefits by making more informed decisions. However, it is not possible for general purpose financial reports to provide all the information that every user finds relevant.

2.3. Concepts of capital and capital maintenance

A financial concept of capital is adopted by most entities in preparing their financial statements. There are two main concepts of capital defined. Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the entity. Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of

the entity based on, for example, units of output per day. The selection of the appropriate concept of capital by an entity should be based on the needs of the users of its financial statements. Thus, a financial concept of capital should be adopted if the users of financial statements are primarily concerned with the maintenance of nominal invested capital or the purchasing power of invested capital. If, however, the main concern of users is with the operating capability of the entity, a physical concept of capital should be used. The concept chosen indicates the goal to be attained in determining profit, even though there may be some measurement difficulties in making the concept operational.

From the concept of capital, the definition of capital maintenance can be split as follows: financial and physical capital maintenance. For the first one, the profit is considered only if the financial amount of the net assets at the end of the period exceeds the one at the beginning of the period (we need to exclude any distributions or contributions from owners during that time frame). For the physical capital maintenance, the profit is being taken into consideration only when the physical productive capacity (or operating capability) of the entity at the end of the period exceeds the one at the beginning of the period.

The concept of capital maintenance is concerned with how an entity defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured; it is a prerequisite for distinguishing between an entity's return on capital and its return of capital; only inflows of assets in excess of amounts needed to maintain capital may be regarded as profit and therefore as a return on capital. Hence, profit is the residual amount that remains after expenses (including capital maintenance adjustments, where appropriate) have been deducted from income. If expenses exceed income the residual amount is a loss.

The physical capital maintenance concept requires the adoption of the current cost basis of measurement. The financial capital maintenance concept, however, does not require the use of a particular basis of measurement. Selection of the basis under this concept is dependent on the type of financial capital that the entity is seeking to maintain. (IASB, Conceptual Framework, 2018)

3. Literature review

As reporting according to IFRS became over the years mandatory in more and more countries, the question whether the initial objectives stated in the Conceptual Framework were met was asked more often. One can say that the impact of IFRS has remained controversial since its implementation. The costs and benefits of

mandatory IFRS adoption appear to provide an ideal topic on which researchers might support the work of policymakers through their studies. In the upcoming section a brief literature review on the subject is presented.

In order to ensure successful budgeting of capital, companies and investors alike, must rely on efficient and practical tools that help provide relevant financial documentation and information which would allow said companies and investors to accurately assess financial multinational situations. In June 2003, due to a growing need of companies to compare financial data of worldwide business organizations, a financial set of reporting standards has been issued. It has since been adopted by 167 international jurisdictions and is regarded as an efficient and reliable tool in setting guidelines for transparent financial statements. (Hwang et al. 2018) It is safe to state that, ever since the adoption of International Financial Reporting Standards (IFRS), the world of accounting has changed for the better, with long-standing impacts on companies located in countries that ensure reliable outside investor protection (i.e., the United Kingdom, or Australia), however, in Asian countries in which statutory law systems are in place, along with low outside investor protection, the early effects of IFRS adoption do not pass the test of time.

While South Korea has been requesting companies to comply with the IFRS standards with the purpose of narrowing the “Korea Discount” - which stands for a propensity South Korean companies have to being undervalued, which translates in an under-priced stock market -, it was all to no avail. Since the adoption of IFRS, South Korean companies have been proved to invariably lack in terms of accounting transparency, and several fraud scandals have transpired.

In China, the IFRS agenda has been heavily pushed by the Chinese government in hopes of aiding its “Open Door” policy. More than 30% of domestic companies are committed to submit IFRS compliant statements, due to dual listings in Hong Kong and international markets, however, as foreign companies do not yet trade in Chinese securities markets, it is yet to be determined whether these companies will be allowed to adopt and fully implement IFRS standards. (Hwang et al. 2018)

Domestic companies from countries that follow statutory law systems, such as France and Germany, have sustained the quality of earnings (QoE) that was displayed following the IFRS adoption. In countries that follow common law systems, such as Australia and the UK, where outside market capital investors benefit from outstanding legal support, companies have been proved to maintain similar QoE as displayed following the adoption of IFRS.

It’s widely accepted that the adoption of IFRS by a jurisdiction is no straightforward commitment. Many variables come into play when classifying jurisdictions – should IFRS be applied to all industries? should all listed companies comply to the

standards? should parent company statements also comply? While it's no easy task, experts agree, that, in emerging economies, the adoption processes determine just how much of a relevant role IFRS will play.

IFRS adoption does not come with guaranteed benefits. Although IFRS are financial reporting standards that are internationally regarded as being first-rate, the specific methods for implementing the rules for certain situations are seldom not indicated, which could potentially lead to interpretations of the rules. Moreover, IFRS limit reporting methods, which could be detrimental in a company's performance review. In answering the question of whether or not the IFRS effects continue with the passage of time, the answer largely depends on each country's legal system and relevant institutions.

Developing countries, more specifically ex-communist countries, could widely benefit from adopting IFRS, as Albu et al. (2011) presented in the study "A story about IAS/IFRS implementation in Romania" considering it could help signal foreign investors that said countries have evolved into trustworthy places of business. From 1947 to 1989, Romania was one of Central and Eastern Europe's communist states. After the fall of communism, the country underwent a series of reforms, that also tackled the matter of financial reporting from the French accounting model to the International Accounting Standards (IAS), and finally to the European Directives (ED) concerning this topic – as a result of the country's desire to adhere to the European Union.

In 2005, it was decided to only focus on coordinating Romania's accounting regulations with the EDs, while IFRS implementation was to be requested from listed companies and institutions of the financial system. One could assume that, in the case of emerging or transitioning economies, switching between accounting models should not have major, palpable impacts on the financial sector, however, the lingering after taste of the fallen regimes, has proven itself a much greater hindrance in the convergence process, than the collective need to succeed in progressing.

It's clear that IFRS implementation is influenced by economic development, but historical precedents, as well as the country's heritage, have a say in the process. A generational instinct for fraud, lack of expertise and transparency, and old school mindsets of professionals, entwined with poorly allocated resources, can only result in roadblocks. Education could be the cornerstone of this paradigm, but it should be a constant aspect embraced by every participant in the financial game, from shareholder to auditor. (Albu et al. 2011)

For a stakeholder, one of the most important factors that influence financial related decisions lays in the accounting information that sheds light on the company's financial health, thus, it's only natural to raise questions in terms of how relevant the

adoption of IFRS in providing quality accounting data, in comparison to following domestic standards.

The backbone of decision-making European countries for adopting IFRS, can be summarized by “the contributions of environmental determinism theory and isomorphism theory”

The Environmental determinism theory defines accounting as a consequence of its environment.

In early 2000s, prior to the mandatory IFRS adoption, Europe’s accounting and financial state was seen as clustered with various policies and accounting methods, in dire need of standardization and harmonization. Several high-profile scandals led countries to impose laws on transparency and security, such examples are the Metallgesellschaft scandal, in Germany in 1993, in which one of the country’s largest industrial firm “reported staggering losses of about 1.3 billion USD on positions in energy futures and swaps” (Edwards, 1995), or the Enron scandal (still used today as a case study for corruption and corporate greed) from 2000, which led the French Parliament to pass a financial security law three years later. Belgium also soon followed, in 2003, by passing a law that targeted accounting.

Regardless of the domestic laws imposed by the aforementioned countries, the traditional measures to reform accounting systems fell short of meeting the demands of financial globalization, and as a result, all EU-based publicly traded companies have been mandated to align their financial reports with the International Financial Reporting Standards (IFRS).

Incorporating IFRS into practice has engendered adjustments of the accounting policies, which highly contrast the domestic standards (DS).

Adopting the IFRS led to changes in accounting choices and policies, which differed from the previously used domestic standards. The International Accounting Standards Board’s (IASB) aim is to promulgate a universally accepted accounting lexicon. This profound transformation in accounting methodologies exemplifies the theory of environmental determinism, as postulated by scholars such as Gernon and Wallace (1995) and Rodrigues and Craig (2007).

The concept of isomorphism is used to expound the mechanism that led to the mandatory adoption of IFRS in European countries.

As presented by DiMaggio and Powell (1983), here are three forms of isomorphism: coercive, mimetic, and normative. Coercive isomorphism refers to the political pressure that all publicly listed firms need to prepare their financial statements according to international and IASB standards. Mimetic isomorphism consists of the process in which companies adopt behaviours from organizations perceived as prosperous. Normative isomorphism, revolves around professionalism and funding,

with the Big Four (the four largest accounting firms - Deloitte, EY, KPMG and PwC) having played a major role in shaping international standards. (Kouki and Mundy, 2018)
The concept of value relevance, which pertains to the capacity of accounting information to express a firm's market value, is seldomly addressed, as only accounting information that reflects the reality of the firm's financial status is considered value relevant.
In discussing value relevance literature, it's worth mentioning that the mandatory IFRS implementation in Europe has led to a shift in focus from analysing and comparing the legal origins of countries, or accounting systems across different countries, to examining the value relevance of accounting information pre- and post-IFRS adoption, comparing the results between countries that voluntarily adopted IFRS versus countries in which IFRS implementation was imposed, or analysing the contrasts between countries that based their accounting statements on IFRS, and countries that referred to their domestic standards when preparing such reports.
In truth, as determined and presented by Kouki and Mundy (2018), voluntary IFRS implementation did not improve the value relevance of equity book value and earnings. In the cases of Germany and Greece, it has been concluded that companies listed on the stock exchange ended up losing in terms of relevance post mandatory IFRS adoption. In other regions, countries such as Spain or Norway, the mandatory implementation of IFRS had no effect on improving the value relevance of their financial statements. It is, therefore, safe to state that voluntary IFRS adoption did not improve the value relevance of equity book value and earnings.
Barth et al. (2008) found that companies complying to IFRS standards exhibited more value-relevant financial statements compared to firms following domestic standards. Based on a study by Suadiye (2012), same applies to Turkey. Moreover, scholars Iatridis and Rouvolis (2010), reported, that, for companies listed on the Athens Stock Exchange, the transition to IFRS transpired in an increase of value relevance of earnings.
However, Kouki and Mundy (2018) concluded in their study "IFRS and value relevance: a comparison approach before and after IFRS conversion in the European countries", - which adds to the existing body of knowledge by showcasing a comparative analysis across pre- and post-IFRS adoption timeframes in three code-law origin countries, namely Germany, France, and Belgium - that while the value relevance of equity book value and earnings does, in fact, increase as a consequence of the transition to IFRS, the relevance of earnings and changes in earnings do now show great signs of improvement prior to adoption.

5. Methodology and contribution

The present article examines the Conceptual Framework, which constitutes the basis for IFRS implementation, and identifies the main results of the recent studies on the topic. The research is theoretical, analysing relevant literature and bringing forward up to date concepts, beneficial for future research. Policymakers proclaim their policies are rooted in evidence and often turn to academic researchers for impartial and reliable evidence. In view of the fact that a significant number of studies have been conducted thus far, the present paper attempts to summarize the outcomes and present the conclusion reached until now, while also proposing further area of future research.

6. In conclusion

The IASB Conceptual Framework presents the main objectives of IFRS implementation, the qualitative characteristics of financial information, the elements that constitute the financial reports and the concepts of capital and capital maintenance. It is important to note that all these elements are interrelated, as the financial reports should satisfy the qualitative characteristics in order to be able to meet the IFRS objectives. Finally, quality cannot be achieved without knowing what elements to recognize and how to appropriately measure them.

As the Conceptual Framework represents the basis for IFRS reporting it is important to analyse how the objectives presented are met in practice. As it was stated earlier, the research evidence on the benefits of mandatory IFRS adoption is generally not conclusive. But on balance it seems likely that there were overall benefits to transparency, comparability, the cost of capital, market liquidity, corporate investment efficiency and international capital flows following adoption. The research evidence also clearly shows that these benefits were unevenly distributed among different firms and different countries. Due to differences in institutions and incentives, there may have been negligible benefits or even negative effects rather than benefits for particular firms or countries.

Although isolating the effects of IFRS implementation from other events during a specific time period (different government regulations, financial/ health crisis), is no easy task, a really interesting area for future research would be a comparison between Eastern and Western European countries before and after IFRS implementation. It is known that in 2005, IFRS became mandatory for all European companies listed at the stock exchange, but did that mean that the comparability between companies in these two different parts of Europe increased? Did Eastern Europe become more

attractive to investors once they had access to financial reporting done based on similar regulations as in Western Europe? Does comparability improvement differ depending on whether Eastern European companies adopted IFRS mandatory or voluntary, depending on the industry sector, or depending on the level of legal enforcement of the country?
Has the difference in accounting quality and accuracy between developed and emergent countries decreased? Are capital investors more confident to invest in emergent countries now? These questions could constitute a basis for future research and hopefully more conclusive results.

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