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Pondering the Principles: A General Model of the Psychology of Users, Providers and Preparers of Published Accounts Used to Comment on the Accounting Standards Board's Draft Statement of Principles

by

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Introduction

Since August 1990 the setting of formal accounting standards in the UK has been carried out by the Accounting Standards Board. In November 1995, the Accounting Standards Board issued an exposure draft of its Statement of Principles for Financial Reporting (Accounting Standards Board, 1995). The Accounting Standards Board had been working on these for some five years. It had previously issued some individual principles for comment, but this was the first complete draft of the principles, and it included any revisions which had been made based on comments relating to earlier drafts. The piecemeal drafts were the work of different authors, but now in order to aid the consistency of the drafting process, the document was re-drafted by one principal author. The contents of the Draft Statement of Principles represent the views of the Accounting Standards Board at that time.

The statement was issued with the notion that these principles, if accepted, would form the basis for financial reporting by all limited companies in the UK. Perhaps it would also be the basis for all other types of organizations that published financial reports, including those in the public sector. The production and publication of the draft principles for all future reporting was an event of immense importance: the Chairman of the Board, Professor Sir David Tweedie, was reported to have observed, "(i)f people don't like the way we are going, now is their chance to say so or for ever hold their peace. If people don't shout about it the statement is going to go through" (Accountancy Age, 1995).

Background

The ASB requested comments on the Draft, and the author responded briefly and directly (Purdy, 1996). This paper is a far more detailed response. These principles alone should not be allowed to form the basis for financial reporting in the UK, now or in the future. From the author's perspective, there are a number of weaknesses in the way in which the Draft Statement has been constructed. For example, the Draft has the notion that there should be a single basis for all financial reporting, but nowhere has this been justified.

The perspective here is a personal one which has been formed from experience both as an accounting practitioner and as a researcher. Although the Draft seeks one basis for reporting, it has been demonstrated there is more than one way to view accounting activities. For example, it has been found that there are at least three ways in which those involved with convertible debt can consider this financial instrument, so that there are at least three bases on which to account for it in financial reports (Purdy, 1977).

The sources for this paper come from the author's research. It is work which has sought to examine, make sense of and produce understandings about the interaction of people and accounting data. Central to this work has been a concern for the users and the uses of accounting data. The providers and preparers of the accounting data have also been involved. A distinction has been drawn between the two, because an individual who prepares data can be separate from the individual who provides it. The earliest work focussed upon financial reporting within the largest UK listed companies, but the more recent focus has been upon individuals and management reporting in the National Health Service.

The research considered here covers a long time span, is varied in approach and is not research which has been conducted specifically in association with, or in relation to, particular concerns expressed by the Accounting Standards Board. However, the analysis later in the paper is conducted in terms of the Accounting

Standard Board's ideas. The basis and context of the paper have the advantages of coming from one author with a fairly consistent approach to enquiring about the issues of data provision and its receipt over time. The contexts which the author has experienced are not solely concerned with external financial reporting, so that the relevance of work in the management data area has been intuitively compared and related to the financial reporting area.

Of course the use of intuition with management data into the financial reporting area could be considered a weakness of this paper, since the evidence is indirect. The paper takes a psychological approach extending the psychology of personal constructs (Kelly, 1955) by constructing direct statements from the author's research. This is an unusual approach, and readers are asked to read it carefully and consider this alternative.

The paper provides a framework of a General Model of users, providers and preparers of published accounts. This is used to examine and comment upon the work of the Accounting Standards Board and its draft principles. The Board's work is problematic when considered in relation to this General Model, a number of challenges to this work arise, and this indicates that the Draft needs to be re-assessed by the Board. This paper has created an opportunity for the re-orientation of the debate about the provision of data in financial statements by using the approach taken here as its starting point. It is anticipated that others will also have their own views to contribute, and it is hoped that this paper will stimulate these.

This paper continues with a contextual section dealing with psychology and the author's approach, followed by a brief review of the author's research which leads into a General Model of personal constructs about the users, providers and preparers. This General Model is used to evaluate the Board's approach to the setting of the Draft

Principles and the content of these. Where the General Model has nothing direct to offer the evaluation, so the author has used his experience and intuition about the situations.

Theoretical Perspectives - Context to this Paper

The psychological

Accountings cannot be detached from the context in which they occur, because they are part of the context from which they arise. In the same way the content of this paper cannot be detached from its author, an experienced member of the Institute of Chartered Accountants in England and Wales who, as a social science researcher, has been concerned with the psychological interactions of people and accounting data.

The author's approach is of humanistic psychology. This psychology involves a consideration of the way in which people think and act. It does not claim to be complete because it accepts the impossibility of completeness, for at any point a person is at a unique stage in life. It considers people in their contexts as individuals engaged in the process of life and involved with organizations. Organizations are particular collections of individuals that vary in nature or complexity, and involve two or more individuals. The approach is concerned with investigating people's thoughts and actions, and making sense of them. In this and in many other respects, it follows the personal construct psychology of Kelly (1955). It allows for constructive alternativism, namely that it is possible for two individuals to experience an event but to place alternative constructions upon it, or to think about it in different ways.

The psychology considers that people think and act through the use of personal constructs, ways of thought which are unique to each individual. For the purposes of this paper such constructs are expressed either verbally or in writing. It is possible to have commonality of construing or thinking amongst individuals. The psychology is applied in a straightforward manner, using fairly common language both in investigations and in the making of inferences.

The individual is considered as one who thinks so as to more clearly elaborate how the individual anticipates the future. This means that an individual will be handling accounting data in a way which is more balanced or harmonious to achieve this.

Purpose and approach

The purpose of this paper is to use the author's experiences to examine and comment upon both the context of the Accounting Standards Board's work and its draft principles. The psychological perspective runs through the paper with the author's research with users, providers and preparers of accounting data. The findings are used to form a General Model composed of twenty six personal constructs drawn from the author's experiences; this means the author's own personal constructs.

The paper does not intend to consider a wider literature and to produce an eclectic synthesis. It is anticipated that these comments will motivate others to put forward their views and encourage debate about these areas. The model is not exhaustive. It starts with a concern for users and the provision of accounting data, but also includes providers and preparers in the anticipation of the more sound development of accounting data provision.

This approach tries to make explicit the ways in which the objectives of the financial statements are set and then made to operate. (Here the approach draws out and makes explicit the way in which the Accounting Standards Board's Draft Statement has set objectives for financial statements, but then has failed to make these operate.) The processes through which objectives are set for the production of any data are crucial to the understanding of the frameworks constructed and the financial statements which result from this process.

Theoretical Perspectives - Users and Preparers

A user checklist and senior executives' reactions to this

The author's published experiences relate to users and preparers in different operational and organizational contexts. These are concerned with financial reporting and also management reporting. However, the basic issues in financial reporting and management reporting are similar, so that it should be possible for research and other issues to be considered in terms of the organization and so produce fresh insights (Purdy, 1991a). These published experiences are briefly reported here in chronological order.

The author's earliest work in this area was concerned with employees' requirements for information as considered by head office representatives from nine affiliates of the Trades Union Congress, with 49% of its membership at that time. Each union had its own requirements for information, but from these interviews a checklist of various categories of information, including financial management accounting data, was produced. The senior executives from 28 of the top 50 British quoted industrial companies (Financial Analysts Group, 1975) were asked to state which items on the checklist they would be prepared to provide to employees, on the assumption that the company had decided to provide information to employees on a voluntary basis. There were 5 uncommitted responses about such a checklist, 4 respondents generally rejected the checklist, and 2 respondents generally accepted the checklist. The majority of the respondents, 17 of them, reacted to each item on the checklist, and because much of the information was not readily available, many observed that they would have needed to be satisfied that the benefits to be derived from providing the information would have justified the costs. The respondents considered that some of the items on the checklist were not suitable for a written report, which was a sensible response given the nature of some of the items in the list. In aggregate, the respondents were more prepared to provide non-financial data than financial management accounting data (Purdy, 1978).

The analysis of these senior executives' views indicated that there were different approaches from companies to the provision of financial information to employees. The experiences and practices of a company in the area of providing financial information to employees shaped the respondent's views. Some companies with an "open" management style were used to supplying financial information to employees and so reasonably prepared to consider providing similar additional information. Companies without this tradition were not prepared to go beyond that already given in a report to employees (Purdy, 1981a).

The preparers of value added statements

Another study focussed upon the preparers of value added statements. It was concerned with establishing which companies in *The Times 1,000* largest UK industrial companies (Times Books, 1978) were preparing a value added statement, and the rationales for these. Companies had been recommended to publish a value added statement by *The Corporate Report* (Accounting Standards Steering Committee, 1975). Increasing numbers of companies were producing these. One survey found 22 of the top 110 in *The Times 1,000* companies (Morley, 1978), whilst the annual survey of accounts indicated 67 companies (Institute of Chartered Accountants in England and Wales, 1978).

The first phase of this study was a postal questionnaire sent to the company secretary of each company in *The Times 1,000*. Replies were received from senior managers in 490 companies, and 133 companies, 27%, were preparing value added statements. There were 66 companies (half of the total number of preparers) in the top 200 companies, clearly the incidence in the subsequent deciles was markedly less. In general the larger the workforce the more likelihood that the company had produced a value added statement, and three times as many public companies had produced a statement than private companies (Purdy, 1980). Copies of 113 value added statements from 105 of these companies indicated that 63 were identical to *The Corporate Report's* suggested format, and the other 50 were similar to the format (Purdy and Alexander, 1979).

The second phase of the study was conducted through a postal questionnaire which was sent to the chairmen of the 133 companies identified as producing value added statements. Replies were received from 42. The questionnaire sought to ascertain: the various groups of users that respondents considered would be interested in the company's value added statement, the reasons for producing the statement, the internal uses of the statement, and the effectiveness of the statements. In none of these areas was there any single view which prevailed, although the employees were prominent as anticipated users of the statement (Purdy, 1980 and 1981b).

The users of management reports

The users of accounting data were central to three other studies. The first was with a committee of six members at the top of a Regional Health Authority. This committee had unrestricted access to large quantities of data. The study found that each member of the committee indicated different abilities to construe financial management accounting data. Those who had been trained, even on the job, indicated more complex financial management accounting constructs (Purdy, 1991b). With the second study, the managers of ward units in a teaching hospital received data relating to their own unit in the same format. These managers exhibited some similarities in understanding and handling the data, but also marked individual differences (Purdy, 1993a). The third study, based on ward sisters, indicated that users of similar data had different needs for existing data and further data (Purdy, 1993b).

A General Model about Users, Providers and Preparers of Published Financial Statements

The inferences and implications of these studies are now drawn together in a series of statements or the author's personal constructs.

The bases of the approach

1. One of the bases of this psychology and approach is that individuals are concerned with their balance or harmony in thinking. When handling financial management accounting data, they want to receive data which is more balanced or harmonious to use for their purposes. In this context, the matter of balance has nothing to do with the numerical content of the data provided and whether the numerical content is according to the anticipations of the individual. This matter of balance is dealing with the appropriateness of the data supplied rather than the actual numerical content of the data.

   For example, an individual requires data about an organization's activities over a period of time. So, the individual is provided with an income statement. It is the receipt of the income statement which brings about more balanced or harmonious thinking for the individual. Now the individual may wish that the numerical content of the income statement always indicated an increase in salary. However, simply because a decrease or static salary would be shown is not a reason to withhold the income statement.
2. This approach is based upon the intention to create and provide data which is more balanced and harmonious for the individual, rather than less balanced.
3. The supply of inappropriate data to an individual could result in the recipient not readily accepting and not readily appreciating that data. Using and extending the example in 1. above, if the individual was supplied with a cash statement, when the individual's need is for an income statement, then this may not be accepted and the cash statement may not be appreciated.
4. The way in which the intended recipients will act, ultimately, will vary with each individual and with each group of individuals.
5. a. Some individuals will accept the data with which they are provided as appropriate for their balance.

   b. Other individuals will reject outright the inappropriate data offered.

c. Others will be less forthright in their rejection. They may even appear to accept it.

d. Some will accept the inappropriate data and will have reasons for not indicating otherwise.

The users of data

6. The users of data in an area of activity have both similar requirements for data and different requirements at the same time.

7. Users of similar data have different needs for existing data and for further data.

8. Users of similar data have both similarities and differences in handling the data.

9. Users of similar data have different abilities to construe data, and those trained will have more ability.

Large companies as providers and preparers of data

10. The managers of large companies adopt different management styles towards the provision and handling of data to employees.

11. The management style a large company adopts towards data provision to users in particular categories seems likely to be consistent for all users in any one category.

12. The managers of large companies with a more "open" management style are more likely to react favourably to a request for data and to provide it.

13. The managers of large companies without an "open" management style are not likely to react to a request for data and are not likely to provide it.

14. The managers of large companies are more prepared to provide non-financial data than financial data.

15. The managers of the largest companies are more likely to produce "non-statutory" data than the managers of less large companies.

16. The formats in which "non-statutory" data is provided will vary.

17. The managers of large companies have diverse views about the users of "non-statutory" data.

18. The managers of large companies have diverse anticipations from the preparation and provision of “non-statutory” data.
19. The managers of large companies will not respond immediately to a recommendation to provide “non-statutory” data.
20. The number of large company managers providing “non-statutory” data will increase if they perceive it worthwhile to provide the data.

The anticipations of users, providers and preparers

21. The anticipations of users requesting data is different from the anticipations of the preparers and providers of that data.
22. If these differences are ignored, this will not facilitate the preparer’s ability to provide the appropriate data.
23. If these differences are ignored, this will not facilitate the user’s ability to obtain appropriate data.
24. If these differences are ignored, this will not facilitate the user’s ability to handle the data.

A balance for users, providers and preparers

25. If these differences between users and preparers or providers are not brought into balance or harmony the differences will remain, and there will be a lack of balance for the individuals.
26. If these differences between users and preparers or providers are reconsidered there is more likely to be an improvement in the balance for the individuals.

The Objectives of the Accounting Standards Board Placed in the Context of the General Model

The Accounting Standards Board’s objectives are now placed into the context of the General Model about users, providers and preparers. The Draft Statement of Principles states that the objectives of the Accounting Standards Board are to establish and improve standards of financial accounting and reporting, for the benefit of users, preparers, and auditors of financial information. Quite clearly the General Model does not deal with auditors. It might be expected that in general there will be differences between auditors and the other groups, but these are not considered here.

The Board's objectives have been set up to deal with user groups and preparer groups. The General Model mainly comprises group derived items, as opposed to individually derived items, and so it would appear appropriate to continue the analysis. The General Model observes that the anticipations of users requesting data is different from the anticipations of the preparers and providers of that data. If these differences are ignored preparers will not provide appropriate data, and the users will not receive appropriate data.

It is accepted that some individuality must be lost when dealing with user groups and preparer groups which are large. Clearly much work will be required to get an acceptable level of agreement and harmony. For example, the author has no knowledge about the views of the individual members of the Accounting Standards Board. However, it is likely that not every member agrees with every word in the Draft, yet, since these members have accepted the Draft, it can be assumed that the Draft Statement is harmonious for the thinking of the members of the Accounting Standards Board.

The author is not aware of the detailed background to the preparation of the Draft Statement of Principles, but at this point it appears that the Accounting Standards Board has not appropriately grounded its work with a separate consideration of user groups, provider groups and preparer groups.

If the Accounting Standards Board has not appropriately grounded its work, then it can be anticipated that at least three things will occur. Firstly, the proposals will not have their origins in the individuals and the groups, and so such proposals are unlikely to come from any internally consistent harmonious view, and in fact could contain or are likely to contain internal inconsistencies. Secondly, because of these uncertain origins, there will not be an harmonious position in the various stages of development of all of the proposals themselves, and consequently it is impossible for this to lead to the production of proposals which present an harmonious view.

Thirdly, any such inharmonious proposals which are made, will not be accepted by these groups, because there is not an harmonious or acceptable position as an outcome. When proposals, which have been inappropriately grounded, are presented to the various individuals and groups there will be a range of anticipated outcomes. Some will find the proposals acceptable, others will reject outright the inappropriate proposals offered, others will be less forthright in the rejection, whilst some will accept the inappropriate proposals and will have reasons for doing this.

The application of the Accounting Standards Board's objectives with the General Model indicates that the Accounting Standards Board is unlikely to reach a satisfactory position with its work. If there are harmonious positions inside groups, then there is the opportunity for progress to be made with setting standards. This applies to all standards from the Accounting Standards Board and not just the Statement of Principles.

If this is the situation, then using the General Model further would indicate that the situation could be improved as follows: accept that there are three broad groups of individuals; each group will have differences between individuals in the group, so each group should be handled on its own, and reports relating to each group prepared.

The Board has ignored the providers of data as a group. It might be that the providers of data are different to the preparers, as the General Model indicates, and if this is the case then providers would require to be dealt with separately.

Commentary on the Proposed Principles

An overview of the Draft

The previous section has applied the General Model of users, providers and preparers to the objectives of the Accounting Standards Board. One of its conclusions was that the Accounting Standards Board has chosen to deal with three broad groups at the same time. As a consequence it is anticipated that within the draft principles:

(i) The principles will not be formulated harmoniously.

(ii) There will be internal inconsistencies in the principles.

(iii) The inharmoniously formulated principles will not be entirely acceptable to the three groups.

(iv) There will be various reactions to the Draft, from acceptable to unacceptable.

(v) It may take years before it is possible to ascertain the reactions of some to the Draft's notions.

The objective of financial statements

The Draft states that "the objective to financial statements is to provide information about the financial position, performance and financial adaptability of an enterprise that is useful to a wide range of users for assessing the stewardship of management and for making economic decisions" and that "users who wish to assess the stewardship of management do so in order to make economic decisions" (p.35). It then notes that financial statements prepared for the objectives above "meet the common needs of most users" (p.35), but continues that not all information needs are met because financial statements concern past events, perhaps lack non-financial information and have "various further limitations" (p.35). Subsequently it observes that "the information in financial statements is largely historical, in that it relates to the position at a point in time and performance for a prior period" (p.35).

It then turns to consider that investors provide risk capital and not only want data about performance but also to assess the ability of the enterprise to pay dividends and to determine whether they should hold, buy or sell their investments. Next, it notes that financial statements that meet the needs of investors will also be a useful frame of reference, and meet most of the needs of other users that can be satisfied through financial statements. There is no explanation about how the needs of investors will meet most of the needs of all of the six other user groups. The Draft has a brief section of issues for each of the six other user groups, namely employees, lenders, suppliers and other creditors, customers, government and their agencies, and the public, but it expects these other user groups to "evaluate more specific information they may obtain in their dealings with the enterprise" (p.36). In other words, the Draft sets up the definition of objectives to include all users, but then removes all other users except investors.

The idea that there could be only one objective to financial statements for assessment by a range of users seems unsustainable because of the different data needs of users as indicated by the General Model. Perhaps it is for this particular reason that the Accounting Standards Board removed all other users except investors. Perhaps the Board was even unaware of this as an issue. In view of the subsequent restriction of users really to mean investors, the Draft is effectively only dealing with the investor user group. This single objective may be sufficient, but only if the needs of the individuals in the investor group are very similar and have been soundly established. Because of this restriction to investors, the rest of the Draft only relates to investors, consequently, the resulting financial statements would relate most closely and acceptably to investors. There are several implications which arise in relation to the General Model for users.

A part of the Accounting Standards Board's objective is to benefit users in general, but it has chosen to concentrate upon the investor user group. Consequently, if the needs of the individuals of the investor group are similar, and agree with the notions in the Draft, then the outcome of the Draft is likely to be acceptable to this group. The six other user groups are not likely to find the proposals as harmonious as the investor group and will react appropriately.

Through deciding to focus upon the data needs of investors, the Accounting Standards Board will be able to specify what the management of companies or preparers should provide to investors, but the six other user groups do not have this opportunity. The General Model indicates that as the anticipations of users and preparers are different, unless these differences are brought into harmony, the preparer will not provide appropriate data, and the user will not receive appropriate data.

As a consequence, it would appear that the six groups will have to rely upon their interaction with each company's management. It will be the company managers who will decide what data will be provided to the other user groups. These managers will also decide what is ‘internal’ and ‘management data’, and therefore perhaps not for provision to other users, and what is ‘external’ and ‘annual report data’ and solely on that basis is suitable for other users. In this way the Accounting Standards Board seems not to have completed a part of its objective in relation to the other user groups.

A related issue is the notion that the principles in the Draft are likely to be required to be applicable to all published financial statements for any organization, and not just limited companies. This is similar to the issue of the applicability of the Draft to the other user groups. If the organization is one that has investors similar to those found with limited companies and the investor user group, then presumably the draft principles would be applicable and acceptable. If this is not the case, then the non-limited company organizations would be required to produce data which may not be suitable for their users. Again there is likely to be a variety of reactions.

The qualitative characteristics of financial information

The qualitative characteristics of financial information “are the characteristics that make the information provided in the financial statements useful to users for assessing the financial position, performance and financial adaptability of an enterprise” (p.40). The Draft notes that some qualitative characteristics, primarily relevance and reliability, relate to the content of information in financial statements, whilst others, primarily comparability and understandability, relate to the presentation of that information. It considers that materiality is the prime determinant for the inclusion of information. There is no indication why these particular characteristics have been chosen or categorised in this way, although the majority would appear to come from notions about providing accounting data to shareholders.

With the characteristic of relevance is the notion that financial statements represent attributes that can be expressed in money terms, and that the choice of attribute included in the financial statement should be based on its relevance to the economic decisions of users. Although the Draft notes that relevant information has either predictive value or confirmatory value, and these are interrelated, it is not clear how this concept works, or how the notion of “value to users” arises. In this case "value to users" does not appear to be an attribute expressed in monetary terms. In fact the use of the word value in this context appears inappropriate since it is not expressed in monetary terms. A more appropriate word would appear to be usefulness, in which case there would be predictive usefulness, confirmatory usefulness and usefulness to users. Further, there is no indication of how the relevance to the economic decisions of users was obtained.

With the characteristic of reliability is the notion that information must be neutral, complete, prudent and represent faithfully the effect it purports to represent, presumably the chosen attribute, and in accordance with substance and commercial effect and not merely legal form. It is difficult to consider that completeness can be obtained without, again, the interaction of the user at some point.

Perhaps the most surprising feature in this section is that information contained in financial statements must be neutral, i.e. free from bias, and so statements will lack neutrality if information influences the making of a decision or judgement to achieve a predetermined result or outcome. It is difficult to consider that information can be neutral, since the purpose of information in this Draft is to assess management and make economic decisions. It would appear that the requirement should be for appropriate information, as the first personal construct in the General Model indicates.

The Draft notes that when information is presented it should be readily understandable by users, and presented in an understandable way to users who have a reasonable knowledge of business, economic activities, accounting and a willingness to study the information. The provision of data to individuals who do not have knowledge or constructs about accounting cannot be an objective, in general, for the provision of data in financial statements. However, there are likely to be individuals in some user groups who do not have knowledge or constructs about accounting, and this must be recognised and then dealt with. The Draft implicitly ignores such individuals, but then the Draft is only really concerned with the investors, and these are presumed to have suitable knowledge.

The Draft uses the notion of disclosure in a narrow manner. The General Model indicated that the managers of companies with an "open" management style are more likely to react favourably to a request for data. Consequently, there does not seem to be any reason why such managements should not be encouraged to provide additional data.

The elements of financial statements

The Draft considers that the elements (seven) of financial statements are: assets, liabilities, ownership interest, gains, losses, contributions from owners and distributions to owners, and "any item that does not fall within one of the definitions of elements should not be included in financial statements" (p.52). To appear in a statement an item also has to meet the recognition criteria. There is no accompanying rationale explaining either how the elements arise, or how these particular items were selected and how others were not. The General Model does not deal with these matters. Intuitively from a shareholder's perspective, there could be reasons why these elements are required, and certainly the majority of the data elements would appear to be available from current annual reports, but the Draft does not provide any guidance about the source of these seven elements.

A distinction can be made between these elements when viewed in terms of a transactions-based double entry approach to the preparation of accounts. The ownership interest, gains and losses are outcomes which depend upon the financial amount of those items which are included as assets, liabilities, contributions from owners and distributions to owners (both capital). Consequently, the Draft's implicit notion of parity for each of these elements may be correct until financial amounts are added. At this point, the bases upon which the financial amounts have been calculated becomes relevant if this is not at historic cost. Also, the concept that only items occurring within the definition of elements should be included, is a restriction which, whilst not totally excluding other items, is not explained.

Recognition in financial statements

The Draft notes that the objective of financial statements is achieved, largely, by the recognition of elements in the primary financial statements. The recognition of an element "involves depiction of the element both in words and by a monetary amount, and the inclusion of that amount in the statement totals" (p.66). It might be anticipated that any item which meets the definition of an element should be recognised. However, this is not the case. The Draft does not provide parity of treatment for the recognition of the elements, which is in three stages.

The recognition is partly based upon the distinction that can be made for assets and liabilities, as opposed to the other elements. By using only the assets and liabilities, the Draft takes the outcome as either gains or losses. Both of the capital items, contributions from owners and distributions to owners, along with the ownership interest (the difference between assets and liabilities) are ignored in the recognition process. No explanations are provided about why this is the situation. If it is the case that equity = assets *less* liabilities, then perhaps the Draft should state this.

There are three stages of recognition for assets and liabilities. Initial recognition (the first time the item is included in financial statements) occurs if there is sufficient evidence of a change in assets and liabilities, and it can be measured at a monetary amount with sufficient reliability. Subsequent measurement (changing the monetary amount at which a previously recognised item was recorded) occurs if there is sufficient evidence that the amount of an asset or liability has changed and the new amount of asset or liability can be measured with sufficient reliability. Derecognition (removal of a previously recognised item from the statement) of an asset or liability occurs if there is sufficient evidence that the entity no longer has access to future economic benefits or obligation to transfer these benefits.

The notions of initial recognition and derecognition may operate in a fairly satisfactory manner for investors. However, to be consistent with the stages of initial recognition and derecognition, it would appear that there should be a notion of continuing recognition, or re-recognition, which occurs in place of the notion of subsequent measurement, and so lies between these two stages. Consequently, an item would pass through the same two steps as initial recognition. In this way the event will be identified and the notion of subsequent remeasurement would be included.

In this part of the Draft is the notion that only these prescribed elements are to be included in financial statements. It is considered that this approach is not useful for either organizations or the users of their data, because this is a restriction. A more useful approach would be to encourage organizations to prepare and provide any data, suitably explained, which should lead to a more open and informative atmosphere.

Measurement in financial statements

The issue of measurement follows the notion of recognition. The Draft considers that the purchase of an asset will be recorded as an asset and a liability, using the notion of double entry, at transaction cost, the immediate historical cost being equal to the current replacement cost. Subsequent remeasurement can then occur when monetary amounts have changed, so that remeasurement could take place immediately after the transaction has occurred. In turn this provides a justification for other measurement systems to come into operation, and the Draft anticipates that in practice there will be greater use of current values. If there is consistency with the initial recognition procedures then current values will be the basis of reporting. This means that the transaction cost of historical cost then becomes only a recording cost and not the basis of reporting. As noted in the previous section, it would appear more consistent to have the stage of re-recognition so that the event of the change is clear.

Presentation of financial information

In keeping with the objective of financial statements, the Draft notes that financial information will be "presented in the form of a structured set of financial statements comprising primary statements and supporting notes, and, in some cases supplementary information" (p.96). It asserts that this structure highlights information and relationships between individual items of information that are generally most significant, and this makes the financial information more readily understandable to users and facilitates the comparability of financial statements between entities. No doubt the structuring of the elements in this way would highlight the elements, especially since alternatives are not encouraged by the Draft.

The issues of understanding and comparability need to be considered in the context of the framework constructed in the Draft. A preamble to the quotation in the previous paragraph included “meaningful analysis or prudent decision-making ... requires ... a set of information from which the data for a particular purpose can be selected and appraised in the context of other information” (p.96). Despite this section of the Draft repeating the original objective of financial statements as being for a wide range of users, the subsequent development of the Draft has indicated that its principles are focussed upon investors, and this is really the user group concerned. The Draft has selected elements for recognition, and the recognition process has encouraged the measurement of assets and liabilities at current values.

The General Model notes that users of similar data can have differing needs for data. In the Draft, the original objective of many users was later altered so that the only users were the investors. Thus, the Draft intends to provide investors with the current values of a limited set of elements. Under these conditions it seems likely that the financial statements would be readily understood by investors, and the limited elements of one entity would be comparable with the limited elements of another. The organization would only produce sets of data limited to the prescribed elements, suitable for investors and acceptable to them.

The reporting entity

The final chapter of the Draft observes that financial reporting reflects an entity’s accountability for its resources and provides a basis to assess the stewardship of management and make economic decisions. It notes that the reporting entity is the entity that is the subject of a given set of accounts. The Draft continues by considering the different kinds of investments. It uses the notions of the role of ownership, the degree of influence and the nature of the investor’s interest. This results in a categorisation which runs from a simple investment, through associate, joint venture and on to a subsidiary. Also, control is considered to be the power to direct, the highest degree of influence for an investor over an investee. All of this is directed towards, and results in, entities which are proprietorial in form, consequently there seems to be no reason why this chapter does not use such a term. This terminology of proprietorial form could have been used in the objective and the rest of the Draft.

Summary and Conclusions

The Draft Statement of Principles (Accounting Standards Board, 1995) has been evaluated using the author's General Model of personal constructs from his written research experiences, and intuition from experience where there was nothing appropriate in the model. The objective of the General Model is to produce a balance or harmony amongst three groups; users, providers and preparers of data. The basic notions follow Kelly (1955) with roots in personal construction and alternative constructionism. The General Model contains twenty six personal constructs or statements. These cover the notion of balance amongst individuals and the three groups, the bases of the approach, the users of data, large companies as providers and preparers of data and the anticipations of the users, providers and preparers.

First, the General Model was used to evaluate the objectives of the Accounting Standards Board in the Board's own terms of providing standards for users, preparers and auditors. The Board had treated these three areas as one, whilst the General Model indicated that for harmony each area requires to be dealt with separately, at least initially. It was concluded that unless such distinctions were recognised, then the Board was unlikely to reach a satisfactory position in setting any standards.

In view of this background, the General Model indicated that any statement of principles will not be harmoniously formulated and is likely to contain inconsistencies. Consequently, it will not be acceptable to the three areas, will attract a range of views about any proposals and is likely to take years before the full reactions to any such proposals are known.

Then the General Model was used to evaluate the principles of the Draft. The first item was the definition of the objective of financial statements and included with this was the need for financial statements to cover seven groups of users. However, subsequently the Draft narrowed to deal solely with the investor users and removed all other users from consideration. The General Model indicated that the investors would be in general harmony with the contents of the Draft, but that the other users would experience less harmony and react accordingly. However, if the Board implemented these principles, then the reactions from the non-investor users towards these would be occurring years later, and not immediately.

Through taking the investor as the base for financial statements, and, allowing the investor to have the prime place in the Draft, this has left the six other parts of the user group to negotiate their needs with each organization. There is no indication that the Board has attempted to address the needs of these other users, apart from an acceptance that investor-based data would be useful. Some may wonder whether the Accounting Standards Board has acted reasonably towards the other users, they may also wonder what roles the preparers and auditors have taken in the formation of the Draft, since the Board has a duty to these two groups too, but there is no direct reference to them.

The proposal, and potential basic principle, that a financial statement is for investors to decide whether to buy, sell or retain their investment, has led to another basic principle that specified elements, recognised as the assets and liabilities, are required to be measured at current values. The restrictions about what can be included in financial statements are accompanied by predetermined structures of data to allow greater understanding and comparability between organizations by the investor. However, these limited sets of elements at current values do not propose to allow the management of a company any scope for other views. This may be suitable for investors in the very largest companies quoted on several stock exchanges, and for the management of such companies, but this may not suit investors in companies smaller than these, their management or any of the other six user groups.

What will be the outcome for the provision of data to those in one of the six other user groups identified by the Accounting Standards Board? The General Model indicates that in companies where the management has a rapport about financial management accounting data with any of these user groups, then these discussions will continue along with data considered appropriate by the management. Any user group is likely to contain individuals with many different abilities to handle and use data, and to have many different requirements for data. Under such circumstances the management could provide the consensually agreed data in a generally issued statement, or through the company's management structure - the same mechanism that would deal with the provision of data to individuals with needs for data beyond that consensually agreed.

The use of the General Model and the author's intuition have highlighted other issues. The Draft does not indicate why particular qualitative characteristics or elements for financial statements have been selected, and why it requires neutral information. In contrast, the General Model indicates the need for appropriate data, and also recognises the providers of data alongside the preparers of data.

If the draft is not made mandatory in the immediate future, the General Model indicates that in the short term those large companies whose management perceive that it is worthwhile to prepare financial statements on the basis of the Draft Principles will prepare such statements. The management of these companies will use the principles, aware that investors find such financial statements useful. Some company managers will follow the Draft closely, other less so, and in the longer term, a few other companies will use the principles, sometimes closely, sometimes less so, thus producing similar patterns of usage.

The General Model is based upon the author's research alone, and comprises research completed before the Accounting Standards Board issued the Draft Principles. Some may consider that the lack of empirical work contemporaneous with the Draft, and the inclusion of only the author's work are weaknesses of the paper. Clearly the closer empirical insights are to the subject under discussion, the more salient are the conclusions that can be made. One direction for further research is to deal with the user groups identified by the Accounting Standards Board, as well as providers, preparers and auditors, to ascertain their views about matters.

The General Model is derived and constructed from research published before the Draft. A finding supportive of the General Model is that it has been capable of, and used successfully to evaluate the Draft. Perhaps it would have been more successful if it had incorporated the work of others. However, one factor preventing this here is the lack of similar personal work by others that could be incorporated. This evaluation has demonstrated the weaknesses in the proposals put forward by the Accounting Standards Board and in fact the weaknesses of the Board's whole approach. If there is to be a sense-making basis to the construction of financial statements, then it requires a basis of user needs, similar in character to that used in the General Model.

The use of personal construction and alternativitism, following Kelly (1955), in the General Model has moved the presence of personal construction into the arena of published financial statements and so extended the notions and uses of personal construction.

In addition to the lack of appropriateness for the overwhelming number of companies, it is not clear how these principles could be applied in non-proprietorial organizations, which was the intention. The use of such principles could only make sense if the investor was a part of the bases of a non-proprietorial organization, and clearly currently in the UK this is not the situation.

The situation with the 'approved' setting and setters of accounting standards for financial statements is at perhaps its most interesting point since the late 1970s. This is because there is an imperative to the Accounting Standards Board to do something, and hence one reason for the Draft. With the largest companies already following or likely to follow the Draft, as it suits their needs for investment with funds from the capital market, and the less large and smaller companies likely to reject it because it does not suit their needs, at least one division in financial reporting seems likely to appear. In this way, and in analogous other ways, it may be anticipated that the principles for the preparation of financial statements will become separated into a number of different requirements. The next five years may not only clarify the situation with the largest of companies, but also with the great variety of others on the register of companies in the UK. This could prove to be the most interesting and productive times for financial reporting, if it is informed by sensible research.

After the author had completed the first draft of this paper, the Accounting Standards Board decided to revise the Draft of the principles (Accounting Standards Board, 1996). Unfortunately, the intention of the Board's revision does not appear to be aimed at the fundamental issues raised in this paper.

This paper is a personal statement drawn from personal research in the areas outlined. It acknowledges that others will have different constructions of events and different views. In this way the author hopes the paper stimulates a wider debate about these issues amongst both the accounting community and the wider community.

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