Exploring the Application of FASB’s “Asset and Liability View” in Standard-Setting

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Abstract

Among the objectives of the Financial Accounting Standards Board’s (FASB’s) Conceptual Framework was to provide guidance for the FASB’s own future standard-setting efforts. One of the major choices made by the FASB when developing its Conceptual Framework was the adoption of the “asset and liability view” of income determination in Statement of Financial Accounting Concepts No. 3 (SFAC 3). Anecdotal evidence indicates that the asset and liability view is central to several prominent standards issued by the FASB since SFAC 3. However, there has not been a
thorough analysis of the application of the asset and liability view in standard-setting. This paper begins to close this lacuna in the literature. Specifically, we report on a systematic examination of citations of the asset and liability view in FASB standards since the issuance of SFAC 3 in December 1980.

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INTRODUCTION

The development of a “conceptual framework” to guide its development of future financial accounting standards was a primary objective of the Financial Accounting Standards Board (FASB) from the time of its founding in 1973. While perhaps the most significant progress was made during the FASB’s first several decades, work on the Conceptual Framework continues today.

Among the conceptual, and political, challenges that the FASB had to confront in developing its Conceptual Framework was the choice between two, mutually-exclusive approaches to the determination of income: the “revenue and expense view” and the “asset and liability view.” The FASB adopted the asset and liability view in Statement of Financial Accounting Concepts No. 3 in 1980 (FASB, 1980), and has not wavered from that view, at least in the Conceptual Framework, during the succeeding forty-plus years.
The adoption by the FASB of the asset and liability view of income
determination has been termed “revolutionary” (Miller, 1985, p. 67). Similarly, Storey and Storey indicated that:

...[the view] that assets and liabilities are the fundamental elements
of financial statements is still undoubtedly the most controver-
sial...concept in the entire conceptual framework. (1998, p. 76)

In what many consider to be among the most definitive histories of
the Conceptual Framework project, Storey and Storey also expressed
their opinion that the FASB Conceptual Framework “has fundamentally
changed the way financial accounting standards are set in the United

Other scholars (e.g., Zeff, 1999; Huber, 2020), however, have questioned
the extent of the impact of the Conceptual Framework in general, and
the asset and liability view specifically, on the FASB’s standard-setting.
Further, Zeff has questioned the extent to which the impact of the
Conceptual Framework on standard-setting would persist over time.
Specifically, Zeff asked:

To what extent have members who joined the board after the
conceptual framework was completed in 1985 “signed on” to the
conceptual framework? At the end of 1986, only 12 months after
Statement 6 was issued, Chairman Kirk wrote, “I have already
noticed that board members who were not involved in the lengthy
debates preceding the [six] Concepts Statements...have less attach-
ment or proprietary interest in them.” In a standard-setting body
with rotating membership, how long will an approved conceptual
framework retain its authoritativeness within the body?” (1999,
p. 125)

It is generally agreed that the asset and liability view is reflected in
at least some standards issued since 1980. For example, Miller (1990)
cites SFAS 76, Extinguishment of Debt (FASB, 1983); SFAS 87, Employers’
Accounting for Pensions (FASB, 1985); and, SFAS 96, Accounting for Income
Taxes (FASB, 1988) as evidence of the impact of the asset and liability
view on the FASB’s standard-setting. However, the extent to which the asset and liability view has impacted accounting standards issued since 1980, and the persistence of that impact, has not been systematically examined. The study described here was undertaken as a first step in closing this lacuna in our understanding of the impact of FASB’s asset and liability view on its standard-setting.

Specifically, our study focused on answering the following two questions:

1. To what extent has the FASB applied its asset and liability view in standards issued since Concepts Statement No. 3?
2. Has the extent of the FASB’s application of its asset and liability view in standard-setting changed over time?

We examined the text of 237 financial accounting standards issued in the forty years from 1981 through 2020 for references by the FASB to its asset and liability view. Our results indicate what appears to a widespread application of the asset and liability view over this period, with nearly half (47%) of the examined standards containing one or more references to the asset and liability view. However, our findings indicate that its application may not have been consistent over time. Rather, we interpret the data to suggest that three relatively distinct periods exist: approximately ten years of increasing references to the asset and liability view, followed by approximately twenty years during which the level of references was relatively constant, and then the most recent decade in which references to the asset and liability view decreased.

The following section of this paper provides further background regarding the FASB’s Conceptual Framework, and particularly the asset and liability view adopted in Concepts Statement No. 3. This is followed by a description of our research methods and results. The paper then concludes with a summary and discussion of our findings, inherent limitations, and possible areas for future research.
The FASB’s Conceptual Framework and “Asset and Liability View”

The development of a conceptual framework was one of the major agenda items for the FASB from the time of its founding in 1973 (Miller, et al., 2016). The FASB has issued a total of eight Concepts Statements since 1978, with a major flurry of activity occurring between the issuance of Concepts Statement No. 1 (FASB, 1978) and Concepts Statement No. 3 (FASB, 1980b). The concepts addressed in these statements became successively more concrete and specific as the framework development progressed. In Concepts Statement No. 1, Objectives of Financial Reporting by Business Enterprises, the FASB established, among other things, that:

Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash [flows]. (FASB, 1978, p. 5)

Concepts Statement No. 2, Qualitative Characteristics of Accounting Information (FASB, 1980a), was issued in May 1980. In this statement the FASB began to outline the qualities that it believed characterized the “useful information” for investors, creditors, and other external users that it envisioned in Concepts Statement No. 1. Among the qualitative characteristics of useful information established in Concepts Statement No. 1 were “relevance” and “reliability.”

Concepts Statements 1 and 2 were considered to be relatively uncontroversial, at least compared to some of the statements that were to follow (Solomons, 1986). When the FASB issued Concepts Statement No. 3, Elements of Financial Statements for Business Enterprises (FASB, 1980b), in December 1980, however, it moved into more contentious territory (Sprouse, 1988). A major issue challenging accounting theorists and standard-setters for many years had been the appropriate method for income determination (see, e.g., Miller, 1990; Baker, 2017). Specifically,
the FASB was confronted with a choice between the mutually-exclusive “revenue and expense” and “asset and liability” views.

The revenue and expense view was closely associated with the theoretical work of Paton and Littleton (1940) and had predominated in both accounting practice and official standards for many years. This approach is grounded in the belief that:

income is a measurement of performance of an enterprise and its management, that income results from the proper matching of costs and revenues, and that most nonmonetary assets and liabilities are byproducts of the matching process. Proper matching of costs and revenues involves timing their recognition to relate effort (expenses) and accomplishment (revenues) for a period. Thus, the effects of past expenditures or receipts that are deemed to be expenses or revenues of future periods are recognized as assets or liabilities (deferred charges or deferred credits) whether or not they relate to economic resources or obligations to other entities in the future. (Storey & Storey, 1998, p. 78)

The notion of “matching” revenues and expenses is central to the revenue and expense view, with the offsetting balance sheet debits and credits often best characterized as “what-you-may-call-its” (Sprouse, 1966). The asset and liability view, in contrast, maintained that:

assets should be defined as the economic resources of an enterprise (its scarce means of carrying out economic activities such as exchange, production, saving, and investment), that liabilities should be defined as its obligations to transfer assets to other entities in the future, and that definitions of income and its components should depend on the definitions of assets and liabilities. Thus, no revenues or gains can occur unless an asset decreases or a liability increases. As a result, income reflects an increase in wealth of the enterprise, and a loss reflects a decrease in its wealth. (Storey & Storey, 1998, p. 78)

Thus, the major question confronting the FASB in the development of Concepts Statement No. 3 was: which financial statement element should
be given primacy in the determination of income? Should primacy be given to the “earning” of revenues, with expenses then being “matched,” and what were nominally referred to as “assets” and “liabilities” being the offsetting debits or credits? Or should “assets” be considered the primary financial statement element, with all other financial statement elements being defined in terms of their relationship to assets?

In December 1980, the FASB answered this question—at least for purposes of its conceptual framework—by clearly adopting the asset and liability view in Concepts Statement No. 3 (FASB, 1980b).

Changes in the approach to accounting for income taxes are illustrative of the differences between the revenue and expense, and the asset and liability approaches. Accounting Principles Board Opinion No. 11 (APB 11), Accounting for Income Taxes (APB, 1967) utilized the “deferred approach.” As Parks explained: under this method, the income statement’s tax provision is calculated by applying current-year tax rates to the current-year differences between tax and financial income and expenses expected to reversed in future years” (1988, p. 24-25). The deferred method results in an appropriate current-period tax expense being matched with revenues reported during the period. However, the method didn’t deal with tax rates and other events that affect the deferred tax accounts in the balance sheet (Parks, 1988, p. 24). The deferred tax “asset” and “liability” amounts reported in balance sheets prepared under APB 11 are one example of what Sprouse’s (1966) termed “what-you-may-call-its,” often representing “hanging” debits or credits, rather than true assets and liabilities.

When Statement of Financial Accounting Standards (SFAS) 96, Accounting for Income Taxes (FASB, 1988), was issued to replace APB 11, the FASB switched from the “deferred approach” (which was essentially a revenue and expense approach) to an asset and liability approach². As Parks explained, under SFAS 96:

Simply stated, the goal is to reflect in the balance sheet the appropriate assets or liabilities related to the future settlement of
tax obligations. The current year’s deferred tax provision is the net change in those assets or liabilities during the year. (1988, p. 25)

As is typical, the FASB explained its reasoning for this change in the text of its official pronouncement on SFAS 96, stating that:

The Board believes that the asset and liability approach to accounting for income taxes is most consistent with the definitions in Concepts Statement 6 and other parts of the conceptual framework. The Board also believes that the asset and liability approach produces the most useful and understandable information. (FASB, 1988, par. 117)

In 1998, Storey and Storey indicated that “this...concept—that assets and liabilities are the fundamental elements of financial statements—still is undoubtedly the most controversial, and the most misunderstood and misrepresented, concept in the entire conceptual framework” (p. 76). Observations suggest that both the controversy and misunderstanding surrounding the asset and liability view continue to the present.

In addition to establishing what it saw to be the primary purpose of external financial reporting in Concepts Statement No. 1, the FASB also articulated in that first statement the purpose for establishing a conceptual framework, stating that:

The purpose ...is to set forth fundamentals on which financial accounting and reporting standards will be based. More specifically, Statements of Financial Accounting Concepts are intended to establish the objectives and concepts that the Financial Accounting Standards Board will use in developing standards of financial accounting and reporting. 1978, (p. 6; emphases added)

Anecdotal evidence suggests that the FASB has applied the concepts introduced in its Conceptual Framework, including its asset and liability view, in at least some subsequently-issued standards. For example, it has been noted that the following standards issued in the decade immediately following the issuance of Concepts Statement No. 3--SFAS
FASB’S “Asset and Liability View”

76, *Extinguishment of Debt* (FASB, 1983); SFAS 87, *Employers’ Accounting for Pensions* (FASB 1985); and, SFAS 96, *Accounting for Income Taxes* (FASB, 1988)—are all based on the asset and liability view (Miller, 1990, p. 27). However, there has been little systematic, empirical examination of the application of the FASB’s Conceptual Framework in its standard-setting in general (see Hudack & McAllister, 1994 for a notable exception), and no research that has systematically examined FASB’s application of its asset and liability view in its standard-setting. Therefore, while we know that the FASB’s asset and liability view has been applied in some statements issued since 1980, we don’t know how pervasive its application has been, or whether it has changed over time. The primary objective of the study reported here is to begin closing this gap in our understanding.

**Research Questions, Data and Analysis**

More formally stated, our study was focused on answering the following two questions:

1. To what extent has the FASB applied its asset and liability view in standards issued since Concepts Statement No. 3?

2. Has the extent of the FASB’s application of its asset and liability view in standard-setting changed over time?

It is impossible to know precisely what the FASB as a whole, or the individual Board members, may have been thinking as they developed and ultimately voted to approve individual financial accounting standards. However, the final pronouncement documents issued by the FASB normally include formal, detailed descriptions of both the new requirements themselves, and also the Board’s rationale for its decisions. Therefore, we chose to examine the FASB’s own writings, as documented in its individual financial accounting standards pronouncements, in an attempt to begin answering the above questions.
Concepts Statement No. 3, which formally adopted the FASB’s asset and liability view of income determination for the first time, was issued in December 1980. We began our analysis at that point, with an examination of the FASB’s 312 official financial accounting standards issued from January 1981 through December 2020. Certain pronouncements issued during that time period were excluded from the analysis in an effort to reduce undesirable noise in the data resulting from the inclusion of standards that did not address substantive financial accounting or reporting issues; additionally, we decided to focus the analysis on only those standards related to for-profit organizations. A total of 75 standards were excluded from consideration through this process. In addition to those related to not-for-profit entities (e.g., SFASs 117, 136, 164; ASUs 2010-17, 2017-02), the majority of the standards excluded related to deferrals of effective dates of previously-issued standards (e.g., SFASs 59, 75, 99, 100), the designation of previously issued AICPA guides as GAAP in particular areas (e.g., SFASs 56, 83), various technical corrections (e.g., ASUs 2009-07, 2010-04, 2014-06), and rescissions of previously-issued standards (e.g., SFASs 111, 135, 139, 145). Finally, the standard establishing the FASB’s Accounting Standards Codification (SFAS 168) was also excluded from consideration.

A keyword search was conducted of each of the remaining 237 standards, using the electronic versions available on the FASB’s website. Various combinations of asset, liability, No. 3, and No. 6 (referring to Statements of Financial Accounting Concepts No. 3 and No. 6, which contain the FASB’s descriptions of its asset and liability view) were searched. The text surrounding each “hit” was then examined to determine whether it did constitute a reference to the FASB’s asset and liability view. Each standard that included at least one valid reference to the asset and liability view was coded “1,” and all other examined standards were coded “0.”

Based on this operationalization, the research questions stated previously were reformulated more specifically as:
1. What percentage of the examined FASB statements include at least one reference to the asset and liability view?

2. Did the percentage of the examined FASB statements including at least one reference to the asset and liability view change over time?

A summary of the initial data analysis is provided in Table 1. As can be seen, a total of 111 of the 237 standards examined, 47%, contained at least one reference to the FASB’s asset and liability view. After determining the overall percentage of examined FASB statements issued between 1981 and 2020 containing references to the asset and liability view, attention turned to the second research question: examining the patterns in references to the asset and liability view over time.

Table 2 provides a summary for each year from 1981 through 2020 of: (a) the total number of examined standards issued, (b) the number of those containing at least one reference to the asset and liability view, and (c) the percentage of examined standards containing at least one reference to the asset and liability view. As can be seen, both the total number of examined standards issued annually, and the percentage of those containing a reference to the asset and liability view, varied greatly over the forty-year period examined. However, it is hard to discern overall patterns from this presentation of the data. The remaining analyses were undertaken in an effort to identify any patterns in the FASB’s references to the asset and liability view in its issued standards. The analyses from this point forward all focus on the percentage of examined standards each year that contain references to the asset and liability view, in an effort to mitigate the effects of annual differences in the number of standards issued.

The annual data provided in Table 2 is presented graphically in Figure 1, showing the percentage of standards containing references to the asset and liability view in each year from 1981 to 2020. The graph in Figure 1 also includes a linear regression line and equation. While we hesitate to draw any inferences from a regression analysis based on so few observations, we believe that the regression line aids in visualizing the overall pattern. As can be seen, while there is considerable variation
across individual years, the overall trend line is almost flat over the 40-year period examined. Our qualitative analysis of Figure 1, however, suggested that it may be useful to segment the overall data into several sub-periods. Specifically, we judgmentally decided to segment the data into 10-year intervals for further analysis.

Table 2 presents the same data as in Table 1, summarized for each of the 10-year periods from 1981 to 2020. This data is then presented graphically in Figure 3. Based upon this analysis, it appeared that there may be three major sub-periods in FASB’s references to its asset and liability view in its issued standards: (a) an initial period of about 10 years in which the reference rate is below the overall average, but increasing; (b) an approximately 20-year period with the reference rate above the overall average, and relatively steady; and (c) the most recent decade, in which the reference rate is again below the overall average.

The three panels of Figure 4 then present each of the three sub-period analyses individually. A separate linear regression line has been added to each to aid in interpreting the data. These analyses support the earlier qualitative interpretation. There do appear to be three distinct sub-periods: an initial period of increasing references by the FASB to its asset and liability view; an extended period of relatively high and steady rate of references to the asset and liability view in FASB pronouncements; and, then the most recent period with declining references by the FASB to its asset and liability view.

One final set of analyses was undertaken in an attempt to further identify patterns in the FASB’s references to the asset and liability view. The FASB changed its vehicle for the promulgation of GAAP from Statements of Financial Accounting Standards (SFASs) to Accounting Standards Updates (ASUs) when it created its Codification through the issuance of SFAS 168 in December 2009 (FASB, 2009). An analysis of these two sub-periods is presented in Figure 5, with the pre-Codification period (1981-2009) in Panel A and the post-Codification period (2010-2020) in Panel B. Linear regression lines and equations have again been added
to aid in interpretation. These analyses appear to indicate a change in the FASB’s rate of reference to its asset and liability view at the time of issuance of the Codification, with the citation rate increasing through 2009, and then decreasing in the period thereafter.

SUMMARY AND DISCUSSION

A primary objective of the FASB in developing its Conceptual Framework was to provide a foundation for its own future standard-setting. Some accounting scholars (e.g., Storey and Storey, 1998) have indicated that the Conceptual Framework “fundamentally changed” future accounting standards and the process of standard-setting. Others, however, were more skeptical about both the extent and duration of the Conceptual Framework’s impact (e.g., Zeff, 1999).

The “asset and liability view” of income determination, adopted by the FASB in Statement of Financial Accounting Concepts No. 3 (FASB, 1980) has been described as “revolutionary” (Miller, 1985, p. 67) and as “undoubtedly the most controversial...concept in the entire conceptual framework” (Storey and Storey, 1998, p. 76). More recently, FASB Board member Christine Botosan has expressed her belief that the asset and liability view remains central to an integrated conceptual framework for financial reporting (Botonsan, 2019). While anecdotal evidence of the application of the asset and liability view in standard-setting exists in the literature (e.g., Miller, 1990), there has been no systematic examination to-date of the application of the asset and liability view in the FASB’s standard-setting.

The purpose of our research was to examine the extent and persistence of the impact of the FASB’s asset and liability view on its own standard-setting in the forty years since the issuance of Statement of Financial Accounting Concepts No. 3 in 1980. Specifically, our study was focused on answering the following two questions:
1. To what extent has the FASB applied its asset and liability view in standards issued since Concepts Statement No. 3?

2. Has the extent of the FASB’s application of its asset and liability view in standard-setting changed over time?

Our results indicate what appears to be a widespread application of the asset and liability view over this period, with nearly half (47%) of the examined standards containing one or more references to the asset and liability view. However, our findings indicate that the influence may not have been consistent over time. Rather, we interpret the data to hypothesize that three relatively distinct periods exist: approximately ten years of increasing references to the asset and liability view, followed by approximately twenty years during which the level of references was relatively constant, and then the most recent decade in which references to the assets and liability view decreased.

Our study has some important limitations, which we want to be sure to acknowledge. Our analysis was restricted to the identification of standards issued during the forty years after the issuance of Concepts Statement No. 3 in which the FASB referenced its asset and liability view. A very simple, binary classification scheme was used, merely separating those standards that did from those that did not include at least one reference to the asset and liability view anywhere in the standard. We didn’t look at the context in which the references occurred, or their relative frequency or location in the standards that include references to the asset and liability view. Therefore, it is not possible for us to provide any insights into different ways in which the asset and liability view may have been deployed by the FASB in standards in which it is referenced. Perhaps even more significantly, we also cannot answer any questions regarding the FASB’s reasons for not referencing the asset and liability view in standards in which it does not appear. Additionally, it needs to be recognized that we only examined 237 of the total standards issued by the FASB during the period studied. While we felt that there were good reasons for excluding the other 75 standards issued during this period,
we also recognize that other researchers may have applied different judgments, and that the choices made may have affected our results.

These inherent limitations, and others not explicitly mentioned, notwithstanding, we believe that our study has meaningfully extended our understanding of the application of the FASB’s asset and liability view on its own standard setting. Our research has identified some interesting patterns in references to the FASB’s asset and liability view. However, we readily acknowledge that our results may have raised as many questions as they have answered, including:

- Why are we seeing these historical patterns in the references to the asset and liability view in FASB standards issued during the past 40 years; and
- How is the asset and liability view being used in the standards in which it is referenced?

The literature cited earlier (e.g., Zeff, 1999) may provide the bases for hypotheses to guide the pursuit of such questions. However, developing this further understanding is likely to take a more detailed approach than has been employed to date. More specifically, a next stage of this research to examine these why and how questions may involve an in-depth examination of the text of the individual standards themselves, as well as the nature of finance and business issues confronting the FASB during particular periods of time. This, however, is left for future research.

References


WEB APPENDIX

A web appendix for this paper is available at https://dx.doi.org/10.15239/j.brcacadjb.2023.13.01.wa03
1. The FASB’s Conceptual Framework project remains a work-in-process. At that time of this paper, the FASB was seeking comments regarding a proposed new Conceptual Framework chapter (Parks, 2023).

2. SFAS 96 (FASB, 1988b) was later superseded by SFAS 109 (FASB, 1992). However, SFAS 109 retained the asset and liability approach introduced in SFAS 96.

3. Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements (FASB, 1985a), was issued to replace the original Concepts Statement No. 3, Elements of Financial Statements of Business Enterprises (FASB, 1980). Concepts Statement 6 retained the same concepts and financial statement elements, including the asset and liability view, introduced in Concepts Statement 3. However, Concepts Statement 6 broadened the applicability of these concepts and elements to include both for-profit (i.e., “business enterprises) and non-profit organizations.