

Sanctity of the Accounting Theory: The Application of Theory in the Conceptual Framework of Financial Statements and Accounting Standards

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Abstract

This paper challenges the notion that there are no deliberate systematic and logical theories of accounting and advances the duality theory of accounting inherent in the accounting equation as the basic accounting theory that provides the unifying taxonomy for the fundamental going concern theory and the other accounting theories applied in the conceptual framework of financial statements and accounting standards. The paper adopts the conceptual approach to show that the logical reasoning and meanings, inherent in the concepts and conventions that characterize the system of recording and analysis of accounting information, are governed by the duality theory embedded in the accounting equation. The paper shows that the accounting theory underlie the fundamental assumptions, principles, and conventions and that the conceptual framework of accounting and the standards are guided by several derivative theories such as the going concern theory, the capital maintenance theory, the revenue realization theory, the conservatism theory, and fair value theory.

Keywords: going concern theory, capital maintenance theory, revenue realization theory, conservatism theory, fair value accounting theory

Introduction

There is almost a crisis of relevance of accounting in contributing to the development of theories. While disciplines in the social sciences such as economics, philosophy, political science, management, and even finance have contributed to the development of theories that help to explain several phenomena, accounting has at best provided the apparatus for testing and demonstrating the application of those theories. Accounting has not been at the production end but rather has been at the consuming end of theories developed by other disciplines. Not contributing so much to the development of theories may make some to see accounting as less than a science and therefore not place it in the pride of place that it belongs. Some may even see those disciplines that produce the theories that are tested in the field of accounting as superior. Be that as it may, this may not necessarily be the case. By providing the space for testing and validation of theories, accounting has proved its relevance. There is also another sense in which the relevance of accounting has been proved since time immemorial as accounting does indeed have its theory. However, it does appear that the accounting theory has suffered much through lack of elucidation and imprecision in its specification by writers of the accounting literature. In fact, there are almost as many divergent views of what accounting theory is as there are those that have written about it. Even books on accounting theory almost always contain no theories.

This paper challenges the notion that there are no deliberate systematic and logical theories of accounting and advances the duality theory of accounting inherent in the accounting equation as the basic accounting theory. The paper expounds the accounting theory as the unifying taxonomy for the fundamental going concern theory and the other accounting theories applied in the conceptual framework of financial statements and the accounting standards such as the international financial reporting standards (IFRS).

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The paper argues that accounting researchers and practitioners should recognize and understand how accounting theories inform the accounting rules, principles and conventions. This paper also responds to Nagdee (2016) who called for the development, clarification and refinement of accounting theories for the enhancement and usefulness of accounting practice worldwide. He lamented the apparent absence of theories inhibiting the development of accounting into a more robust academic discipline due mainly to the supposed absent bases of accounting theory. This study however, holds out that accounting theory simply require refinement and specification in such a way to easily explain the accounting phenomenon and facilitate multidisciplinary discourse with other disciplines. The understanding of and correct specification of the theories in accounting will enhance accounting standard setting and remove any arbitrariness in the process. Accounting researchers equipped with these understandings can now rely on these theories for their analysis of accounting phenomena and thereby use them as steppingstones for the development of other theories within the accounting domain.

A theory should explain but despite identifying the central issue of accounting theory to be that of measurement, there is no cogent explanation of the underlying theory or theories that explain how "assets and liabilities should be measured" (Godfrey, et al, 2010). This inability to provide a theoretical basis of measurement in accounting has resulted in a crisis characterized by competition amongst accounting regulators and interest groups projecting different paradigms, and the politicization of the accounting standard-setting process, and the acceptance that measurement in accounting is an evolutionary process (Belkaoui, 1992; ICAEW, 2006). Authors of books in accounting theory adopt the anthropological approach to document the accounting history, the evolution of the accounting professional organizations, international accounting harmonization and shift into the pragmatic approach in which accounting theory is deemed to be based upon observation of practice (Godfrey, et al, 2010; MacNeal, 1939 and Sweeney, 1936) The pragmatic approach is one which researchers tests for consistency in the practice of accounting amongst accountants with a view to establishing a theory. This approach pioneered by Sterling (1970) perhaps led to the development of behavioral studies in accounting. The prominence of the normative theories in accounting is due perhaps to their 'scientific' predictive quality that has come to be known as positive accounting theories. Pioneered by Ball and Brown (1968) and followed by Beaver (1968) this strand of theories relies on empirical regularities that links accounting numbers to stock market returns. They are valued for their securities investment decision usefulness (Watts and Zimmerman, 1998).

It is clear however that to qualify as one, a theory should explain and predict reality, and be acceptable to a body of professionals and scientists. To this Godfrey et al (2010) adds the need for appropriate construction of theory. They went on to articulate the importance of accounting theory to the evolution, improvement, and development of accounting practice. This paper argues that accounting theory has suffered much from inappropriate construction which has left many researchers and practitioners confused as to what the accounting theory really is all about. Despite the importance of accounting theory to the understanding of accounting taxonomy, literature within the accounting domain has not offered much help in explaining the underlying language. Many of the meanings and rules of accounting lack theoretical explanations leading many to believe that they are haphazard and non-systematic. But nothing can be further from the truth as accounting does have the theory that explains accounting rules, principles, and conventions. What perhaps may be the case is the lack of impression in the specification of accounting theories. The challenge of theory formulation and testing has led to the paucity of accounting research output in universities (Inanga& Schneider, 2005).

The conceptual method of analysis is adopted in this study to focus on the basis of accounting theory. The main objective is to challenge the notion of the absent bases of accounting theory and or the idea that there are no theories in accounting. It highlights the theory inherent in the accounting equation as a fundamental basis of theories of accounting that explain measurement problems in accounting. To achieve this objective, the study is organized around the following themes: the natural basis of accounting theory, the property right basis of accounting theory, accounting theory as the basis of the conceptual framework for financial reporting, application of the duality theory of accounting in the decomposition of corporate profits, accounting theory and the recognition and measurement of assets and liabilities, the application of accounting theory in the construction of fair value accounting and conclusion.

The natural basis of accounting theory

The accounting theory is rooted in the sanctity of the accounting equation. It is the mooring, anchor, the tugboat, the rudder, the route and destination of the ship of accounting. It is the fulcrum upon which the wheel of the science and art of accounting revolves. It is the foundation, substructure, and superstructure of this edifice that has oiled the engine of human progress for centuries.

Accounting equation gives character to the recording, reporting, and analysis of financial transactions that comprise all that accounting is about and all that it represents. Recall that originally accounting, as a codified body of knowledge, itself emerged through the confluence of divine ordination, pedagogy, and technology. It emerged from the belief and work of Franciscan Priest Luca Pacioli, a teacher who promoted, using the rhetorical tradition of his day, the argument of accounting through ethical appeals based on his personal beliefs and values (*ethos*), rational appeals to the capacity to reason (*logos*) and emotional appeals to the feelings of his audience (*pathos*). The presentation of Pacioli's argument about 1494 was greatly helped by the invention of printing as a means of communication about two decades earlier. Pacioli believed in the order of things and that this orderliness of things is sanctified by God (Thompson, 1994). It is from the rich tradition of such deference to divine ordination that accounting has emerged.

Flowing from the above convictions of Pacioli is the notion of "balance" which represent that there is order. The accounting equation captures the essence of balance in life and nature. It mimics the giving and receiving that characterizes the two-way breathing by man, plants, and animals. It is reflected in physics as action and reaction being equal and opposite, and in natural law as the law of cause and effect and as the basis of the two-way communication technology. Even after money emerged as a medium of exchange to replace the barter economy, this two-way flow of the giving and receiving of value is reflected in the double line across the many currency symbol. Thus, we have the dollars written as a capital 'S' with a double line flowing from top to down and in the case of the Nigerian currency, the Naira is represented by capital 'N' with a double line flowing across. Similar double lines are reflected in the symbol of many other world currencies such as the Euro, the Pound, and the Yen. All these reflect the fact that the duality theory of the accounting has universal application.

However, it is sometimes shocking to find that leading scholars in accounting have come to accept that accounting is not based on "deliberate and systematic thinking" (Chambers, 1963 cited by Godfrey et al, 2010). In fact, Godfrey et al (2010 p5) went on to say that accounting theory is a modern concept when compared to theories in mathematics and physics. It is consoling to find that authority no less than Fisher (1906, p140) had nearly 50 years earlier posted a counter view that accounting is "not mere makeshift but a complete, consistent and logical system".

In the first place, accounting theory, as encapsulated in the accounting equation, is rooted in nature itself as stated previously, and it is as old as time. Accounting equation reflects the contract that takes place when the exchange of goods and services results in the giving and receiving of value. It is the balance in nature that ensures that anything done to upset the state of equilibrium leads to an adjustment of the initial balance to generate a new state of balance. A typical example is the issue of climate change that has now become the concern of the world. Prior to the industrial revolution, it is believed that the climate of the world was in a state of balance characterized by low temperature and predictable weather. But the subsequent exploitation of ozone layer depleting fossil fuel took away some vitality from the prior existing state of balance and the resultant effect is a new state of balance now characterized by the phenomenon of climate change. An accounting view of this phenomenon will look like this; the pre-industrial revolution state of the climate is a set of assets. From this set of assets, some diminution in value in the form of depreciation has taken place as a result of the usage of the asset (through depleting the ozone layer by the exploitation of fossil fuel) or through the passage of time (as advanced by those who do not believe in the idea of climate change). This depreciation in the value of the set of assets now results in a new state of balance in which temperature has increased and the weather is now unpredictable. The depreciation charge represents a diminution in the value of economic benefits that streams from the set of assets in the ecological environment.

Also, it seems that writers are confusing the developments or evolution of accounting or accounting practice with accounting theory. Accounting academics were accused of following developments in accounting rather leading the developments and thereby became disconnected from the discourse surrounding the theoretical underpinnings of accounting thought. This has resulted in the emphasis of accounting research on technical accounting rather than the socio-economic dimensions that is apt to enhance its academic and social influence (Nagdee, 2016). There is a clear line of demarcation between accounting theory and accounting development. I contend that the basic and fundamental accounting theory encompassing "the logical reasoning" underpinning accounting practice has itself remained constant just like theories in mathematics, physics, and other natural sciences, while the "developments of new (accounting) practices and procedures" (Hendrikson, 1970; cited by Godfrey et al 2010) has evolved over time. As this confusion over what the accounting theory really is subsists, writers have tended to be confused by the variety of the different ways in which the accounting theories are applied as a reason to justify its non-existence and went as far as describing accounting theory as mysterious, and that accounting theory is never a final and finished product (Sage, The Introduction to Accounting Theory).

Sage went further to define accounting theory as a somewhat elusive term that describes "the basic assumptions, definitions, principles, and concepts—and how we derive them—that underlie accounting rulemaking by a legislative body" apparently in reference to the conceptual framework of accounting standards. I further contend that the governing principle underlying the conceptual framework of financial statements is the basic and fundamental accounting theory encapsulated in the accounting equation.

Property Rights as the Fundamental Basis of the Accounting Equation

Accounting equation derives from the fundamental right to property. These rights include the right to own, use, derive benefit from and dispose of the property. Klein and Robinson (2011) define these as a bundle of rights. Property right is fundamental to the functioning of any social and economic system. Indeed it defines how the social and economic systems operate. There are four variants of property right namely (1) private property right, (2) public property (open access) right, (3) public property (closed access) right, and (4) state or government property right. Property right can also be exercised where there is control over the property even when ownership does not exist. Another factor that enhances property right is the enforcement of the right. Where there is a property right and it is not enforced then it practically does not exist. An asset possesses economic benefits only if can be owned or the access rights to those benefits are protected, and it can be securely transferred. Without these guarantees by the rule of law, assets as we know it may not exist. Investments in assets, therefore, have a direct relationship with the guarantees of these property rights. Consequently, law and the existence of the rule of law is fundamental to the exercise of property right and these have been found to stimulate investments in assets. Taking advantage of the fact that the right to private property was first enacted in China in March 2004, An (2013) using data from the Chinese Industrial Enterprise Database, applied the difference- in- differences approach to empirically test the impact of private property rights on investments and on the structure of assets. He found that private property rights stimulated investment in both fixed assets and intangible assets but with a greater proportion in intangible assets. Consequently, the acquisition of assets is directly related to the quality of private property rights.

Property rights all of which describe "what is often referred to as property... is really the access right to the stream of benefits from a given set of resources" (Meyer, 2016). In accounting, property, and access right to the benefits from the property are represented by the accounting equation. Property is known as an asset while access right to the stream of benefits from the property is known as equity (Ukpai, Kiabel, & Obara, 1998). This is described in the accounting equation as:-

$$\text{Asset} = \text{Equity} \quad (1.1)$$

For a sole proprietor, what is described as equity is simply known as capital. Thus, for a small business that is financed entirely by the owner, the assets of the business are equal to the capital.

$$\text{Asset} = \text{Equity} = \text{Capital} \quad (1.2)$$

That capital is equal to equity ties in with the economic definition of capital given by Adam Smith as "that part of man's stock which he expects to afford him revenue". Thus, capital is invested in asset for the revenue-generating potential. The Adam Smith definition was later to be extended by Fisher (1906) to show the time value of money when he surmised that capital invested now was different from the same amount of capital invested later because of interest. The first implication of the above is the association of capital with the benefits that flow to the owners of capital in the form of interest. The second implication is the implicit assumption in Fisher's economic theory of capital that the economic benefits that flow from assets are equal, with time being the only variable element. This is different from the accountants' view of capital. For the accountant, the same amount of capital invested in different assets could yield different economic benefits, hence the value of the assets is differentiated by the attaching equities. Accounting theory differentiates the equities in terms of owner's equity and debt equity, but an economic theory based on the perfect market model assumes that such a difference does not exist. There are limitations in the economic theory of the capital structure which includes no tax advantages, no transaction cost, and no bankruptcy costs and no information asymmetries (Modigliani & Miller, 1958). It is well known that these limitations are mere assumptions that seek to make the market place a perfect one. The limitations render nugatory the claims of the economic theory of a homogenous capital structure. The reality in the financial reporting world is that these limitations are added claims on the streams of economic benefits flowing from assets. The accounting theory view of capital as representing the net claims on the assets of an entity is therefore superior to the primordial economic theory view of capital. It is noteworthy that the economic theory view of capital has since been adjusted to accommodate the existence of the inherent limitations thus technically reconciling the economic theory view to the accounting theory view of capital.

Equities are claims to the benefits that flow from assets hence there are as many equities as there are claimants. However, for practical purposes, all equities other than owners' equities, such as those from lenders, suppliers, bond holders, etc. are grouped as debt equities. Thus, equities are sub-divided into debt equities and owners equities. Debt equities are the rights of creditors, lenders and other providers of finance to the benefits streaming from the assets. The rights of owners or investors, otherwise known as shareholders, to the benefits arising from the asset, is described as owners' equity, common equity or ordinary equity or simply as equity. Hence the accounting equation is represented as:-

$$\text{Asset} = \text{Debt Equity} + \text{Owners' Equity} \quad (1.3)$$

Hereafter, it is shown that the above-stated accounting equation is the fundamental accounting theory that underpins the conceptual framework for financial reporting legislated by the International Accounting Standards Board (IASB, 2010, 1989) and codified in the International Financial Reporting Standards (IFRS).

Accounting Theory as the Basis of the Conceptual Framework for Financial Reporting

It is necessary to examine the definition of theory to properly situate the accounting theory. Hendrikson (1970) defined theory as "the coherent set of hypothetical, conceptual and pragmatic principles forming the general framework of reference for a field of inquiry". A theory is similarly defined as "the supposition or system of ideas intended to explain something, particularly one based on general principles independent of the thing being explained" (Bing, Theory). In this sense, a theory is a governing or organizing principle for the ideas, thoughts, and meanings of a field of study.

The governing principle in the domain of accounting is the accounting equation which describes the accounting theory. The theory in accounting equation simply states that changes in the set of assets affect either the set of liabilities or owners' equity or both. This is the governing principle of accounting and therefore constitutes the accounting theory. It can otherwise be described as the doctrine of accounting. This governing principle is further extended to various subsidiary principles and concepts or theories that form the basis of the conceptual framework of financial statements and the accounting standards. Some of these subsidiary principles or theories are explained below showing the role of the accounting theory in their determination:

Capital Maintenance Theory

Capital invested in a firm is maintained when the streams of economic benefits from assets are greater than or equal to the obligations for the claims against the assets and distributions. When the streams of economic benefits from the assets are greater than the obligations for the claims against the assets and distributions, equity capital increases. The converse results in a decrease in equity capital. This theory underpins Sterling (1970) argument that the income or profit of a business is the difference between the owner's equity between two accounting periods. The value of capital invested in a firm will increase with increases in the net stream of economic benefits that flows from the assets and will decrease with a decrease in the net stream of economic benefits.

Capital maintenance not arising from a net inflow of economic benefits from the assets is the result of the infusion of additional capital or other capital maintenance adjustment arising from upward or downward revaluation of the carrying value of assets and or the restatement of liabilities.

Going Concern Theory

This theory postulates that capital invested in the business will generate streams of economic benefits in the future for a period long enough to ensure that the net economic benefits is equal to or greater than the amount invested. For this reason, assets are recognized in the financial statement for their future economic benefits generating potential. When the ability of the asset to continue to generate future economic benefits is in doubt, the value of the asset is diminished. The going concern theory holds that a firm shall continue to own and use and shall not dispose of assets so long as the future economic benefits shall continue to flow to the firm. The ability of assets to generate future economic benefits due to the economies of scale associated with long term contracting (Coase, 1937) is the invisible hand that directs the "metering of inputs to team production" (Alchian and Demestz, 1972) by owners of firms for residual claims over the assets thereby resolving the resulting post-contractual opportunism (Klein, Crawford and Alchian, 1978) and maximizing the information generated through data aggregation (Meckling and Jensen, 1986 cited by Watts and Zimmermann, 1990). Since assets are held for its future potential, it is the intention of the investors of capital to continue to operate the business for as long as it takes to maximize the long-term economies. It is not their intention to liquidate the business in the foreseeable future.

Conservatism Theory

One of the fundamental objectives of accounting regulation is to protect the interest of investors who are most times not active participants in the management of the organization. This objective and the theory of going concern both guide the application of the accounting theory in the conceptual framework. The future economic benefit inherent in an asset is reflected in the cost of the asset or in its fair value. Social and economic environment ensure that future economic benefits rise or falls. Conservatism theory holds that when future economic benefits increase above the carrying value of the asset, then the value of the assets held in the carrying value of the asset but when the future economic benefits fall below the carrying value then the assets are recognized at the fair value. Conservatism theory is the natural extension of the accounting equation theory and asserts that assets valued at the lower of cost or market value create the right (equities) to future economic benefits that exist or are realizable. Doing otherwise amounts to increasing the equities attaching to those assets, and when this increase is not commensurate with the stream of future economic benefits flowing the assets, it exposes the firm to the risk of expropriation, capital erosion or capital maintenance failure all of which threatens the applicability of the going concern theory.

Revenue Realization Theory

Accounting theory provides a unifying basis for two or more different conceptual frameworks such as those of the US GAAP and the IFRS. The theory models the concern of accounting standard setters on the need for capital maintenance through "distinguishing the returns on capital from returns of capital" (Pounder, 2009 p40). Consequently, revenue is recognized when an increase in economic benefits results in an increase in assets or a decrease in liability. Using the accounting equation theory, therefore, revenue is the net increase in equity due to increase in assets or decrease in liabilities. The accounting theory notion of income is different from the Fisher theory of income which seeks to estimate the future economic benefits attaching to an asset as the difference between the value of the asset now and the present value of discounted cash flow (Fisher, 1906). Such estimate of streams of future revenues can at best be a good guess and does not amount to a realized revenue. Perhaps it is the guesswork associated with the estimation of future economic benefits that led Boulding (1955) to conclude that income cannot be measured and for that reason, it should be measured by a constant factor for a diversified asset portfolio. However, a realized revenue is that part of the difficult to estimate future economic potential of the asset that has been earned. The accounting theory of income segments the overall future economic potential of the assets into periods which may be quarterly or yearly. This is quite altruistic as no investor will be willing to wait for all those future benefits to be fully realized before earning income from the investment. Revenue realization theory therefore enables equity holders to enjoy the economic benefits that flow from their investment in assets systematically over the life of the asset.

Application of the Duality Theory of Accounting in the Decomposition of Corporate Profits

The accounting equation explains the relationship between the composition of the capital structure and the assets of the organization. The capital of the business is invested to acquire the property, plant and equipment and other assets. While investing decision as to what set of assets to acquire is primary, the financing decision as to how to fund the acquisition of the assets gives rise to the composition of the capital structure comprising debt capital and equity capital. Also, operating decision as to what to produce, how to produce and how much to produce involves the application of available resources (cash and non-cash assets) to the best possible ends. In a study that applied the duality theory of the accounting embedded in the accounting equation to the decomposition of corporate profitability, Agburuga et al (2016) noted that fixed assets are acquired primarily to generate future revenues while current assets are acquired mainly to generate current revenue and finance current operations. Fundamentally, therefore, assets comprise long-term fixed assets and short-term current assets. Agburuga et al contended that the accounting equation theory underlie the principles, concept, and convention that has come to be described as accounting theory. They went on to assert that the principle of double-entry derives from the basic and fundamental theory embedded in the accounting equation which states that for every debit there is a corresponding credit. This same theory underlie the reporting of accounting information as in the statement of financial position otherwise known as the balance sheet, the statement of profit or loss and comprehensive income, statement of cash flows and statement of changes in equity. Specifically, the statement of profit or loss and comprehensive income represents changes in equities between two accounting periods other than changes in liabilities. They then used this theory for the financial analysis of return on equity and its impact on future earnings, stock return, and equity valuation.

Accounting Theory and the Recognition and Measurement of Assets and Liabilities

Recognition and measurements are two key issues in financial reporting that have engaged the attention of accounting researchers and practitioners for some decades now. This interest is largely due to the multiplicity of measurement bases namely historical cost, current cost, fair value, realizable value and value in use. Baker (2013) in a critique of the concept of measurement in accounting have argued that the different bases of measurement in accounting negates the concept of measurement but rather advocated that the process of arriving at a value for assets and liabilities should be "described as simply a calculative practice in which certain numbers are associated with elements in financial statements, leading to an aggregation of such numbers, resulting in summations which are difficult to interpret". (Baker, 2013 p 6). In a report on the issues around measurement in financial accounting, the Institute of Chartered Accountants of England and Wales (ICAEW, 2006) notes that the controversies associated with measurements in accounting may have been due to the profession's diverse responses to the variety of uses, needs of different industries, and different types of assets and liabilities, which they said were hardly systematic. Writing on the fallacy of income and income measurement in accounting, Bello (2010) concluded that the inability to properly conceptualize income is implicated in the differences in its measurement. This paper hereafter shows that the differences in measurement bases in accounting or the lack of comprehension of those differences are resolved in the understanding of the theoretical basis of accounting measurement.

To prove the theoretical basis of accounting measurement, the theory of value by Karl Marx is invoked in which he distinguished between value in use and exchange value. According to him, the value in use refers to the uses to which an asset, property or article is applied by the owner, and the usefulness, utility, pleasure or satisfaction derived from using it. Use value is subjective and therefore difficult to measure as different individuals may have different quantitative values. Exchange value, on the other hand, is the power inherent in an asset, property or article to command other assets, property or article to exchange for itself. It is the rate or proportion at which a unit of an asset, property or article can be exchanged for another asset, property or article. For example, if one house is exchanged for five units of a car, then the exchange value of the house is 5 in relation to the car. In the monetary economy, the exchange value is expressed in the price. Use value may or may not be transformed to exchange value and nothing can have exchange value unless and until it possesses some use value. Therefore, use value and exchange value are inherently paired and Karl Marx referred to items that have both use value and exchange value as commodities (Karl Marx Theory of Value, 2008).

Furthermore, Marx theorized that in an economy where there is little or no exchange of goods and services, then assets, property, and articles will have only use value but little or no exchange value. The corollary to this observation is that an asset that is not intended for exchange possesses only use value but no exchange value. Marx noted that the measurement of the use value of an asset is subjective and not subject to market exchange conditions. Consequently, an asset that is acquired at a cost but that is not intended for resale possesses use value only. This justifies the application of historical cost valuation of property, plant, and equipment as contained in IAS 16. On the other hand, an asset that was acquired in an exchange of non-monetary asset only or in combination with a monetary asset is recognized at fair value. The involvement of exchange value in the transaction justifies the application of fair value.

An asset that has only use value may have some benefits such as social values, aesthetic values, etc. but it does not necessarily possess embedded economic benefits as economic benefits can only be realized through commodification. Therefore, assets that have only use value and without economic benefits are recognized at cost. Assets with exchange values have embedded economic benefits and the valuation of such asset should take cognizance of its economic potential hence the use of fair value.

The Theory of Fair Value Accounting

The property in an asset is the access rights to the stream of economic benefits. For this reason, accounting for assets that involve exchange transaction takes cognizance of the market values of those assets as they reflect the valuation of the embedded economic benefits. Similarly, liabilities are acquired at a value embedded with all claims. The embedded claims in liabilities are the present value of all future claims (interest payments) and this is calculated at the rate implicit in the cash flow of contracted payments (IFRS 16.26). Consequently, the theory of fair value accounting is that owners' equity is the fair value of assets acquired in an exchange transaction net of all liabilities and their embedded claims.

When an asset no longer commands economic benefit, it is useless and therefore ceases to be an asset (Karl Marx, 1887, 1867). Therefore, the market for the exchange of value is significant in the determination of economic benefits inherent in an asset. Sterling (1970) also argued that the difference in owners' equity should be determined by the market (i.e. exit) prices of the net assets of the entity at the beginning and the end of the accounting period. The market prices represent the exchange value or fair value. Consequently, the value of financial and non-financial assets that are intended for sale in an exchange transaction is determined by the forces of demand and supply in the marketplace (an exit price) at the measurement date.

An asset that is not subject to exchange transaction, being one that has been acquired for use and not intended for resale, possesses use value and according to Karl Max the use value or value in use of an asset are subjective. But note however that this asset may have been originally acquired at a cost determined in an exchange transaction (i.e. the entry price at initial recognition). The price at which the asset was acquired less subjectively determined depreciation rate is the best valuation for the asset. Consequently, assets that are not intended for resale but are held to maturity are valued at their previous market-determined value (entry price) less accumulated depreciation. The fair value accounting theory holds that the equities attaching to assets acquired and liabilities assumed through an exchange transaction are valued at market price and this price subsists subject to any diminution in value or depreciation over time.

Application of Fair Value Accounting Theory to the Measurement of Financial Instruments

The international financial reporting standards (IFRS) No. 9 became effective from 1st of January 2018 and replaced the international accounting standard (IAS) No. 39. The replacement was informed by the difficulty to understand, apply and interpret the provisions of the old standard resulting in reduced complexity. An understanding of fair value accounting theory demystifies the complexity associated with accounting for financial instruments. Financial instruments include financial assets, financial liabilities, and contracts to buy and sell non-financial assets (IFRS 9. IN1). The distinction between use value and exchange value is paramount in understanding how to account for the economic benefits and obligations inherent in financial instruments. The purpose of IFRS 9 is to enable the determination or measurement of the amount, and timing of future cash flows related to both financial assets and liabilities. According to the fair value accounting theory, the equities in financial assets and financial liabilities acquired and assumed through the exchange transaction are embedded in the market price. Consequently, financial assets not held for trading are valued at the cost (entry price) less amortization. Similarly, liabilities not held for trading are not adjusted for credit risk while those held for trading are accounted for at the fair value (exit price) although such valuation is expected to take cognizance of the transaction cost of acquisition of assets and issue cost of liabilities.

Conclusion

From the foregoing, it is obvious that there is a single thread running through the accounting theories in the conceptual framework and international financial reporting standards showing that the duality theory of accounting inherent in the accounting equation is the fundamental accounting theory. The paper recommends that the understanding of how accounting theories inform the accounting rules and convention and standard setting will remove any arbitrariness in the process. Accounting researchers equipped with these understandings can now rely on these theories for their analysis of accounting phenomena and thereby use them as steppingstones for the development of other theories within the accounting domain. The paper re-specifies, perhaps for the first time, the fundamental going concern assumption and other concepts, principles, and convention as theories that draw from the basic duality theory of the accounting and reveals that accounting standards rulemaking is copiously guided by these accounting theories. The paper successfully debunks the maintained notion that there are no theories in accounting.

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