A Framework for Accounting Theory

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1. INTRODUCTION

Accounting was first originated to serve society. By society the writer means the environment surrounding the accounting profession; i.e. the management, investors, stockholders and the creditors, etc. When the accounting profession started, it served the function of describing only what had been done; accounting was then a study of methods, not causes.

This paper is an attempt to express the writer's views about the possible framework of the Accounting Theory. The Committee to Prepare a Statement of Basic Accounting Theory, henceforward referred to as "the Committee", defined accounting as "The process of identifying, measuring, and communicating economic information to permit informed judgements and decisions by users of the information (1)". The committee defined Theory as "A cohesive set of hypothetical, conceptual, and pragmatic principles forming a general frame of reference for a field of study (2)". Hence the Committee defined Accounting Theory as "A coherent set of concepts explaining and guiding the accountant's action in identifying, measuring, and communicating economic information (3)".

The accounting profession is interrelated with the society within which it operates. Accounting should consequently have as its objective the intention of providing the society (users) with the information needed for decision-making. The Accounting Theory is one that could facilitate the attainment of accounting objectives. The AICPA (4) stated the objectives of the financial statements. These are most appropriate for this paper and the writer agrees that the objectives of financial statements are to provide users with information for predicting, comparing, and evaluating enterprise earning power and to supply information useful in judging management ability so as to utilize enterprise resources effectively in achieving the primary enterprise goal. Because decisions made by stockholders, creditors, and investors based on the information provided by the financial statements can affect society, such decisions may cause the re-allocation of economic resources.

After the objectives have been set, the next step is to examine the assumptions. These assumptions should be tested to arrive at the principles upon which the accounting theory will rest. One example of these assumptions will be given.

Theory serves a description and explanatory function. It describes and explains what is and what should be. For a long time theory and practice in accounting have been in conflict in many areas. We academicians should develop a theory that evaluates all the problems so as to link theory and practice. As academicians, we should not care about how easily or cheaply a problem can be solved, but we should concern

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The deficit of the non-oil sectors was covered by the foreign exchange net receipts of the oil sector.

The increased surplus of foreign exchange indicates that the growth of the Libyan economy has no longer been constrained by this factor.[1]

However the country is obligated by domestic legislation to maintain a specified level of reserves of gold and foreign exchange as a backing for its currency issue (100 percent backing). This requirement freezes a certain component of its gross holdings of foreign exchange as far as commercial transactions are concerned. Although the exchange reserves are accordingly lower than the gross holdings the Libyan position is not strongly affected by substraction of the currency cover.

CONCLUSION

Libya faces many of the general unresolved questions of development that confront any developing country. Although the oil sector contributed very little to the supply of skilled labor, the construction of infrastructure and the establishment of for- and backward-linked industries, it contributed most importantly to the Libyan economic development by providing revenues and foreign exchange earnings to the government. Considering this and the fact that the crude oil is an exhaustible asset, the important potential contribution of oil to the Libyan economy depends upon government policy regarding the allocation of oil revenues and the use of oil contributed foreign exchange.

REFERENCES

1. H. Chenery and A. M. Strout, "Foreign Assistance and Economic Development," American Economic Review, September 1966, pp. 679–733.
2. Central Bank of Libya, Economic Bulletin, Various Issues.
3. International Monetary Fund, Balance of Payments Year-book, vol. 18 to 26.

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[1] H. Chenery and A. M. Strout, "Foreign Assistance and Economic Development", *American Economic Review*, September 1966, pp. 679–733.

this foreign sector had helped to create the gap in the balance of payments as well as to fill it. Even so the situation was a precarious one and the possibility of changing it appeared remote until the discovery of oil had entirely changed the picture.

Table 1 indicates that up to 1964 the amounts of foreign exchange received from the payments to local factors of production exceeded the direct payments to government. This was due to the fact that through 1962 the activities of oil companies mainly consisted of exploration and the quantities of oil produced and exported in the first three years 1961–1963 were small. In 1964 and the following years the flows of tax revenues were large relative to the additional foreign exchange receipts disbursed in local expenditures.

The latter began to decrease as the oil industry entered the phase of production.[1]

The proceeds of oil exports were not large enough to cover the foreign exchange requirement. Only in 1964 the foreign exchange earning of the oil sector began to offset the deficit of the trade balance.

' The most interesting items on the debit side of the oil sector's transactions are the net payments for services and the net factor income paid abroad. The imports of services account for the second highest percentage of the foreign exchange expenditure. Investment income paid abroad is the largest debit item. It makes an average of 21% of the total investment income for the years in question. Details of the calculation of these figures are shown in Table 3.

The direct investment shown in Table 3 cover changes in investment (net of depreciation) in the oil sector. The figures for 1973 include the disinvestment resulting from nationalization by the Libyan government. This becomes more apparent in the years after 1973. (Millions of SDRs — 225 for 1974, — 565 for 1975 and — 480 for 1976).

The gap between the foreign exchange earnings of the non-oil sectors and their import expenditures has widened. Imports increased from 618 millions of SDRs in 1969 to 1,827 millions of SDRs in 1973, while exports increased in the same period from 2 millions SDRs to 7 millions SDRs.

TABLE 3.   *Investment Income Paid Abroad by Oil Sector, 1969–1973.* (In millions of SDRs).

	1969	1970	1971	1972	1973
Income					
Exports and re-exports f.o.b.	2,162	2,389	2,690	2,700	3,344
Other income from abroad	6	3	8	31	14
Local sales of goods and services	30	44	51	29	34
Total income	2,198	2,436	2,749	2,760	3,392
Costs					
Current Costs and capital expenditures					
Imports c.i.f.	151	89	54	51	41
Miscellaneous services obtained abroad	282	220	136	135	144
Salary payments made abroad	33	39	38	31	176
Local costs and capital expenditures, including additions to financial assets	1,388	1,677	2,106	1,926	2,149
Less changes in direct investment (net of depreciations)	− 147	− 140	− 139	12	138
Total current costs	1,707	1,885	2,195	2,155	2,648
Investment income paid abroad	491	551	554	605	744

Source: International Monetary Fund; Balance of Payments Yearbook, vol. 26.

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[1] See Table 2.

TABLE 2. *Libyan Balance of Payments, 1969–1973* (In millions of SDRs).

	1969	1970	1971	1972	1973
A. *Oil Sector*					
Exports f.o.b.	2,162	2,387	2,686	2,700	3,344
Re-exports f.o.b.	—	2	4	—	—
Imports c.i.f.	– 151	– 89	– 54	– 51	– 41
Trade balance	2,011	2,300	2,636	2,649	3,303
Investment income	– 491	– 551	– 554	– 605	– 744
Net payments for miscellaneous services	– 276	– 217	– 128	– 104	– 130
Salaries remitted abroad	– 33	– 39	– 38	– 31	– 176
Direct investment capital	147	140	139	– 12	– 138
Total foreign exchange receipts (net)	1,358	1,633	2,055	1,897	2,115
(Income tax payments to Libyan government)	(1,103)	(1,385)	(1,913)	(1,753)	(1,972)
(Other expenditures in Libya, net)	(255)	(248)	(142)	(144)	(143)
B. *Other goods, services, and unrequited transfers (excluding grants)*	– 766	– 739	– 1,051	– 1,361	– 2,216
C. *Official grants and miscellaneous long-term capital*	– 143	– 82	– 98	– 154	– 187
D. *Net errors and omissions*	– 66	– 104	– 53	– 98	– 855
E. *Short-term capital*	– 7	– 23	12	– 9	258
F. *Total (B through E), excluding oil sector*	– 982	– 948	– 1,190	– 1,622	– 3,000
G. *Total (A through E), including oil sector*	376	685	865	275	– 885
H. *Reserves and related items (increase in assets)*	– 376	– 685	– 865	275	– 885

Source: International Monetary Fund, Balance of Payments Yearbook, vol. 26.
Central Bank of Libya, Economic Bulletin, various issues.

figures in Table 2 are given in special drawing rights (SDRs)[1] at the par value of Libyan dinar 1 = SDR 2.80. Both tables contain also the totals of the other items in the Libyan balance of payments in order to provide comparison between the oil and non-oil sector's contribution to foreign exchange earnings.

The value of Libya's imports of goods was roughly equal to 50 per cent of the value of its own production. Merchandise imports amounted to about $70 million in 1958 and increased to more than $261 million in 1965 — that is excluding equipment and supplies

directly imported by foreign governments and oil companies. Less than 19% in 1958 and 3% in 1965 of foreign exchange required to pay for these imports was obtained from the proceeds of Libya's merchandise exports; the rest came from invisible exports in the form of the expenditures of foreign governments and oil companies and from foreign aid. In 1961 the oil sector began to contribute directly to foreign exchange earning. In some ways the picture represented by the figures is rather deceptive. A sizeable but undeterminate proportion of the imports was consumed by foreign oil companies and foreign governments (United States and United Kingdom forces). It can thus be said that

[1] SDR/US Dollar rate = 1.

TABLE 1. *Libyan Balance of Payments, 1958–1965* (in millions of dollars).

	1958	1959	1960	1961	1962	1963	1964	1965
A. *Oil sector*								
Exports and re-exports f.o.b.	—	—	—	11.5	133.0	329.0	610.7	788.2
Imports c.i.f.	− 28.3	− 33.8	− 59.4	− 35.3	− 69.4	− 68.3	− 79.0	− 61.0
Trade balance	− 28.3	− 33.8	− 59.4	− 23.8	63.6	260.7	531.7	727.2
Investment income	71.1	91.3	171.6	187.8	133.6	− 3.1	− 202.2	− 193.5
Other services	− 13.2	− 23.5	− 47.9	− 81.5	− 92.4	− 81.2	− 114.0	− 132.4
Salaries remitted abroad	− 2.8	− 3.1	− 4.8	− 5.6	− 10.4	− 12.6	− 17.4	− 17.9
Direct investment capital	—	—	—	—	—	—	51.5	− 24.9
Total	26.8	30.9	59.5	76.9	94.4	163.8	249.6	358.5
Payments to government	0.2	0.8	1.9	0.2	14.6	56.6	143.5	227.1
Net local expenditures	26.6	30.1	57.6	76.7	79.8	107.2	106.1	131.4
B. *Other goods, services and transfer payments*								
Exports and re-exports f.o.b.	13.4	11.5	10.1	10.1	8.4	6.4	8.9	8.4
Imports c.i.f.	− 70.0	− 85.7	− 117.0	− 117.0	− 137.2	− 171.9	− 215.3	− 261.2
Trade balance	− 56.6	− 74.2	− 106.9	− 106.9	− 128.6	− 165.5	− 206.4	− 252.8
Travel	− 4.8	− 4.8	− 1.9	− 5.9	− 8.1	− 7.8	− 8.9	− 12.0
Military receipts	19.3	14.8	19.8	21.0	25.5	19.3	19.3	21.8
Other services	2.8	9.5	− 2.8	− 21.8	− 32.8	− 34.2	− 38.1	− 49.3
Misc. transfer payments	− 3.4	− 1.7	7.0	− 0.8	− 6.7	− 4.8	8.7	− 6.7
Total	− 42.7	− 56.4	− 84.8	− 114.4	− 150.7	− 193.7	− 242.8	− 299.0
C. *Long-term capital and official grants*								
Official grants received	31.1	42.3	33.3	34.2	31.9	30.5	22.4	9.5
Official loans received	0.8	0.6	2.5	2.8	1.1	− 0.3	− 1.1	− 0.3
Direct investment (excluding oil)	0.3	—	− 4.8	− 1.9	− 0.3	8.1	2.8	− 1.4
Other long-term capital	—	—	1.7	− 0.8	2.8	12.8	− 8.4	− 2.5
Total	32.2	42.9	32.7	34.3	35.5	51.1	15.7	5.3
D. *Net errors and omissions*	− 4.0	4.2	0.8	11.6	25.5	7.0	21.7	11.7
E. *Short-term capital*	− 1.7	0.8	3.6	− 0.8	− 1.9	− 1.7	6.2	− 0.6
F. *Monetary movement*	− 10.6	− 22.4	− 11.8	− 7.6	− 2.8	− 27.2	− 50.1	− 75.9

Sources: Central Bank of Libya, Economic Bulletin; International Monetary Fund, Balance of Payments Yearbook, vol. 18.