IFRS

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Topic

Cover note - *How to deal with the conceptual issues at stake at the present juncture* – a paper prepared by Jérôme Haas

This paper has been prepared for discussion at a public meeting of the IFRS Advisory Council. The views expressed in this paper are those of the author.

HOW TO DEAL
WITH THE CONCEPTUAL ISSUES AT STAKE
AT THE PRESENT JUNCTURE

There is a growing consensus on the need to devote great attention to concepts in IFRS. This came up recently in more than one recent IFRS AC meetings, for example; and this was evidenced also by many speakers last September during the World Standard-Setters meeting.

This could be seen as a **key factor** in the present international development of IFRSs, and the obstacles encountered in the pursuit of the “convergence” strategy and more fundamentally for the adoption of IFRSs, with many “reserves” or doubts expressed by new partial or potential adopter countries, as well as debates or critics expressed in countries already applying IFRSs (or the most of IFRSs).

This has become more and more true in recent years, and has taken different forms.

In general terms, on can speak of “inconsistencies” – a word often heard in this context, with more than one meaning. First, standards are often seen as not in accordance – sometimes at odds - with the Conceptual Framework (CFW); certainly the CFW is not explicitly in a higher hierarchical position than standards, but that is not perceived as reassuring. Standards are also sometimes seen as in contradiction with one another. Furthermore, sometimes the same “horizontal” issue appears to be treated in different manners in various standards.

However, there are not only such perceptions of such formal inconsistencies, but also the understanding that they may reveal deeper uncertainties or divergences about substantive issues ; or a shift in strategy that may have lead from one view to another about a given subject.

For example, each of the four present draft standards under discussion exemplify, some claim, the weight of a “balance sheet approach” (lease contracts transformed into abstract rights with no known –and enforceable- existence, for example), or excessive references to market values even in the absence of such markets (like for insurance liabilities), or the gap between the projects and business practices.

More and more do stakeholders claim that they do not “understand” companies through the accounts and they tend to blame it on concepts underlying accounting standards.

Finally, some (in the WSS for example) also interestingly question the need for a conceptual framework altogether, noting that it impinges on local law requirement and in any case does not seem to play a decisive role in the evolution of the IFRSs.

How to address these questions? There may be no “silver bullet” to respond to this challenge. But there seems to be an imperative need to bring an urgent and credible response. The need to take position arose during the discussion about the future agenda in the last AC meeting.

The present paper, meant to be thought provoking, is a contribution. It is presented with the goal of helping promoting IFRS globally.

The logical option would be to treat as a matter of priority the current revision project of the conceptual framework, that started in October 2004. After 6 years of efforts however, it must be noted that only the first of the 8 scheduled phases (phase A on objectives and qualitative characteristics) has been finalised and issued in September 2010. During a workshop with Board and Staff members in the WSS meeting, it appeared that a minimum of ten years would be needed to achieve such project – cut it by half, supposing that resources were made available and the necessary time for such endeavour compressed: it would still be very long.

In addition, some note that the current project does not seem to be meant to address some hard issues and challenge statements dating back to decades ago (the seventies), contrary to a similar project undertaken by the IPSASB for the public sector, for example. Others note that even the latest "phase A" piece of work is in fact at odds with, for example, the recent positions taken by the Trustees in their Review document about many subjects, in a more modern and open spirit.

Another option would consist in attempting to change fundamentally the way in which this project is conducted. This would in any case mean to aim for a totally different product, starting with a much lighter piece of literature – but of course, there is no chance that such shift in strategy can be made without many consequences about the nature, and therefore the substance of the project, and of the CFW itself. This may thus not be realistic in the short run, nor would it lead to concrete changes soon or where they are thought to be needed.

Another option would consist in identifying, from a more practical perspective, the perceived "inconsistencies", and to strive to identify possible ways to address them. That would be very close to initiating a different project about so-called "cross-cutting" issues. This would be plain logical and useful in practice. Yet none of these "issues" can be dealt with by a "quick fix" approach. It would likely soon lead to substantive debates, which would in turn possibly block progress on all fronts.

In all options envisaged above, the CFW remains in force, with the doubts about its role and status and the inconsistencies reported to be perceived by users, not to mention the ambiguous signal given by the IASB that the CFW is at the same time still in force, albeit not on top of standards; and in need of revision, yet not as a matter of priority.

Therefore one wonders if the limits of such logical solutions do not show that the issues at stake have more to do with the substance (not the only the consistency among standards, as suggested above) of the concepts used in the current standard setting by the IASB; and if this did not mean that "*less concepts*" would be a relevant orientation to consider at this juncture. In that vein, the most expeditious decision could be to suspend the CFW and the revision project, whilst at the same time giving some elements about the future direction the IASB is headed for taking.

One relevant statement to that effect could consist in assuring that the objective assigned to accounting standards will be to see to it, that accounts reflect the realised performance of an entity. Accounting should be about depicting and explaining the business performed by the entity – including to investors, who, by definition, are not enough knowledgeable about it and need information to digest before they can draw financial consequences *from the accounts*, based on their perception.

Although accounting must give a periodical picture of the financial position, accounting cannot be exclusively about importing market volatility *in the accounts* of *a* company; or endlessly and unsuccessfully attempting to corroborate *in the accounts* the instant stock market value of the company, i.e. (as already mentioned in the AC) do the analysts' or investors' job – or there would soon be no need for accounting at all.

Such statement would thus, no doubt, considerably simplify and optimize:

- the standard-setting process, as it would tend to start with the understanding of the business, not (i) with concepts which always risk to prove inadequate for the understanding of the company through its accounts, which is the sole goal of accounting, or (ii) with "anti-abuse" standards, based on no legitimate mandate, that could move the IFRS away from relevance and acceptance;
- the solution to-, in the form of the disappearance of- many conceptual debates, which often tend to be far from reality – maybe by definition ;
- the fate of the projects underway, some of them being hard to justify from a perspective other than conceptual ;
- the adoption of IFRSs by countries adopting, as well as not yet adopting IFRSs.

Of course, some precise and well known "cross-cutting issues", which there could be merit in trying to clarify, would progressively well "fall in place", from such a simplified – *commonsensical* - point of view.

Some work to that effect could then be achieved in a very simple document, with a handful of pages, no more, that could be used as a guide to understanding accounting based on robust principles.

But clearly it would lead in the first place to changes either in the standards themselves, starting with recent standards or projects underway - *or* in other countries' standards currently in "convergence" with the IFRSs, depending on the issues; and changes on all those fronts where everyone knows that there remain controversial, misleading, unclear or irrelevant features or projects – like in consolidation, measurement, financial statement presentation and disclosure.

Such approach would go some way towards the implementation of the formula evoked in the WSS that accounting standards should be simple, sober, "*economical*", thus more relevant and practical; and more "*economic*", i.e. based on substance and not exclusively on definitions, but without being systematically, exclusively financial in nature and, in addition, highly conceptual.

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A proposed orientation would consist in clarifying, on the occasion of the discussion about the agenda of the IASB, some elements of strategy. The expected clarification sought could be summed up as: ***"less concepts, more common sense"***.

In other words, concepts are tools, not ends in themselves. There is no such thing as a level of abstraction where principles would be pure, perfect and suitable to all, *volens nolens*. That belief only results in a growing gap between "conceptual" accounting standards and "reality".

One may question in theory **what "reality" means**: the answer could not be more concretely spelled out than by the repetition (in IFRS or non IFRS environments) of accounting fraud leading to massive bankruptcies fuelling global crisis; the proliferation of non-GAAP presentations, quarter after quarter, by most companies around the world; past, present and future reserves or carve-outs in the adoption of IFRSs by countries; and recurring calls – although not often publicized -for non adopting IFRS, or for exiting from IFRS.