

After Decades Of Accounting Standards Why Do We Have Reporting Issues?

The introduction of accounting standards in the US and the UK started with corporate failures, corruption and questionable accounting practices. The stock market crash, corporate collapses and the Great Depression of 1930 in the US resulted in the formation of the Securities and Exchange Commission (SEC) in 1934 and the push to introduce standard accounting practices. In the UK, the push for accounting standards started in the late 1960's when there were financial scandals and questionable accounting practices. The financial reports of two companies in particular, AEI and Pergamon Press which were involved in separate takeover negotiations, were highlighted in the UK financial press for their questionable accounting practices. Similar situations also influenced the decisions of the accounting profession and regulators in many other countries to introduce standard accounting practices. Most of the countries are now part of the International Accounting Standards Board (IASB), an independent private sector body that is structured similar to the Financial Accounting Standards Board of the US (FASB). Thus, accounting standards of most countries are now determined by the IASB.

However, accounting standards in the US did not prevent the collapse of many major US corporations in the late 1990's and the early 2000's. Eugene H. Flegm, who was associated with General Motors for several years, in a paper titled "Accounting at a Crossroad" published in the December 2005 issue of the New York CPA Journal writes that "Through its standards, FASB gave the individuals behind at least four major frauds - Enron, Qwest, Global Crossing, and Parmalat, the tools to defraud their stockholders." This is indeed a very severe indictment on accounting standards.

These collapses and frauds in the US resulted in increased government regulation such as the establishment of PCAOB (Public Company Accounting Oversight Board) and the Sarbanes Oxley legislation. Nevertheless, 2008 saw further major corporate collapses not only in the US but throughout the world. Accounting standards have the force of law in Australia under changes made to the Corporations Act in 2004. Non-compliance with standards leads to legal penalties for the directors of companies and under certain circumstances, the auditors as well. Even such measures did not prevent the virtual overnight collapse of companies, which were thought to be

very profitable in the previous financial reporting period. These collapses were largely due to the financial risks they carried on their balance sheets and not so much because of business risk.

After several decades of attempts to reform the financial reporting practices of businesses and setting standard accounting practices, why do we still have significant incidences of corporate failures and corruption? Accountants have been signing off the truth and fairness of financial statements of most of these entities that collapsed in different countries and confirming that their financial statements have been prepared according to the accounting standards, but the financial statements of these entities had little or no indication of the significant financial risks they were exposed to or adequate warning signs of their impending failure.

Why are accounting standards still not providing relevant and useful information to the users?

Accounting standards and the recent financial crisis

We are in the midst of a global financial crisis of a magnitude not seen since the great depression of the 1930's. Corporate failures and corruption in many countries have impacted the wealth and well being of millions of investors all over the world and also many more millions of persons who were not investors but had financial dealings with these businesses. Bankers, mortgage brokers, architects of



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derivatives and other synthetic financial products, ratings agencies and regulators may have contributed to the crisis but accounting standards too seem to have played a part in it.

The recent market turmoil has triggered a chorus of complaints about financial reporting from financial institutions and other market participants, including many senior government and business leaders. Accounting standards, particularly the standards requiring some assets and liabilities to be measured on “mark-to-market” basis, have been criticised by many who contend accounting standards have failed to provide information that would have highlighted the problems that were likely to arise or that they exacerbated the financial difficulties of businesses, particularly financial institutions. Others like William Isaac, US FDIC chairman from 1978 to 1985 and now the chairman of a consulting firm that advises banks, Wayne Abernathy, the US bankers’ regulatory chief and some in very senior government positions in different countries, argue that mark-to-market accounting was either the root-cause of the financial crisis or it accelerated the crisis.

The concerns expressed recently relate primarily to accounting standards that required financial institutions to value some of their securities, even those held on a long-term basis, at depressed prices that may not have reflected their true value. Further, it is contended that reporting these depressed values has resulted in a loss of market confidence that has further exacerbated the current credit crisis.

Consequently, there is a strong lobby to suspend or substantially modify some of the measurement rules in accounting standards. Whatever the true facts may be, the public perception is that accounting standards either contributed directly to the financial turmoil or at least exacerbated it.

The responses of the IASB and FASB to these criticisms have not been convincing. In fact, IASB’s actions, such as the hasty adoption of changes to the financial instruments standards to ensure a “level playing field” between the European and US financial institutions and the three round-table conferences organised by the Boards, one each in Asia, Europe and North America, to gather input on reporting issues arising from the global financial crisis – including responses by governments, regulators and others, indicate that accounting standards and the standard setting processes have some deficiencies which are affecting financial reporting.

Many reasons can be attributed to the issues raised about accounting standards following the financial crisis and the general concern about some of the other standards that has existed for some time. The issues raised may relate to specific standards but the underlying concerns mostly relate to whether the standards enable the provision of information relevant to the users and their decisions, the alternative accounting treatments permitted under some standards that affect comparability, the removal of objectivity and also relevance by requiring the valuation of some assets and liabilities at fair values.

The broader issues and underlying shortcomings relating to accounting standards are whether:

- We have a sound conceptual framework to ensure that standards are consistent with one another;
- There is agreement on significant concepts that need to be in the conceptual framework, such as, identification of users of financial reports, their information needs;
- Information should be presented from the perspective of a single but predominant category of users or be general purpose statements to

meet the information requirements of a number of different category of users and

- Standards ensure the provision of information relevant for the resource allocation decisions of users.

These issues appear to have had a pervasive effect on financial reporting under the current standards for sometime and are likely to affect future standards as well.

The IASB and the FASB are currently addressing these shortcomings through a project on developing an improved conceptual framework. But what are the chances of them successfully addressing all these issues and formulating an improved comprehensive framework in the near future?

These fundamental issues, their effects on financial reporting and the solutions provided by the two Boards so far are examined in the following sections of this paper.

The need for a conceptual framework and its current state of development

A coherent system of interrelated objectives and fundamentals that is expected to lead to consistent standards was considered necessary from the time the accounting profession and regulatory authorities decided to introduce standard accounting practices. (For example, see the monogram published by WA Paton and Littleton titled “An introduction to Corporate Accounting Standards” and FASB’s Statement of Financial Accounting Concepts 1.) Identifying the users of financial reports and their information requirements, determines the contents and limits of the financial statements and the basis of measuring the reported numbers. This has been described variously as accounting theory, accounting principles, the accounting framework

and more recently as the “conceptual framework”.

A framework would ensure the development of accounting standards, which are consistent with one another and reduce the number of alternative accounting treatments. In the absence of a sound framework, accounting standards tend to be a loose collection of principles, rules and conventions. Such standards would lead to a demand for official interpretations to apply them to a plethora of different business situations, as there would be no logical basis to interpret them. A robust conceptual framework would provide accountants a basis for logical and consistent solutions to accounting problems without having to request official interpretations.

Michael Gaffikin in his 2006 paper on Regulation: Standardising Accounting Practice states that “One of the strongest arguments in favour of a conceptual framework is that it forces accountants to consider what they are doing and how they can go about it.” A conceptual framework in combination with good judgement will help accountants to focus on logical and consistent solutions to accounting problems as they arise. (Keiso and Weygandt – Intermediate Accounting – John Wiley & Son Inc) The Financial Accounting Standards Advisory Council revisiting the FASB’s Conceptual Framework in March 2004, identifies the need for a conceptual framework for the following reasons:

“The FASB developed its conceptual framework because it concluded that its decisions must be soundly grounded in a unified set of concepts. The Board’s mission cannot be fulfilled without a conceptual underpinning that provides direction and the means for deciding whether one solution to a financial reporting issue is better than the others. A conceptual framework provides the unity that is required,

and with that, the direction and means to help in making those decisions.

Without a set of unified concepts, standard setters are like a ship in a storm without an anchor.”

Most countries with accounting standards have attempted to formulate a conceptual framework, with varying degrees of success. However, hitherto, no standard setter has issued a comprehensive conceptual framework.

The need for a conceptual framework has been long recognised. A framework becomes even more relevant under the IASB’s approach of issuing principles

Consequently, many countries have adopted additional guidance to the IFRS Framework.

The IASB and the FASB at their joint meeting in October 2004, decided to add to their respective agendas a joint project to develop an improved common conceptual framework, based on and built on both their existing frameworks and would use it as a basis for their accounting standards. As stated in the IASB website, “The project’s overall objective is to create a sound foundation for future accounting standards that are principles-based, internally consistent and internationally

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based standards (as compared to the many rules based previous standards), which require a sound theory or concepts to support them. In fact, they assume the existence of such a theory underlying the framework within which such standards are issued, as principles can be formulated only within a specific theory.

When IASB commenced the formulation of the IFRS series of accounting standards, it issued the “Framework for the Preparation of Financial Statements”. The Framework defines the elements of financial statements to make it easier to relate requirements of one standard to other standards. This framework was not a comprehensive statement of concepts.

converged.” The two Boards are conducting the project in 8 phases. Phases A, B, C and D of the project are currently active with the issue of an Exposure Draft on Phase A and a Discussion Paper on Phase D. In respect to Phase A, which is the most fundamental of the eight stages, the FASB together with the IASB issued in May 2008, an Exposure Draft on Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Reporting Information (“the ED”). The Discussion Paper on Phase D deals with the Reporting Entity Concept.

The ED has been described by academics as based on a prescrip-

tive (normative) theory. Accounting literature describes prescriptive accounting theory as one “based upon what the researcher believes should occur in particular circumstances. These theories describe what financial accounting should be: what should be regarded as assets, liabilities and so on, and how they should be valued. Since these theories are not based on observation, they do not necessarily describe accounting practice.” (Prof. Quintus Vorster – Conceptual Framework, Accounting Principles and what we believe is true – Accountancy SA, June 2007.) This approach to the development of a conceptual framework has certain consequences for the achievement of the purposes for which accounting standards are set. Provision of information relevant to the need of users, should be based on well researched conclusions on the users of financial statements and their information needs and not decided on the basis of beliefs of what should occur or should be.

As mentioned above, for effective financial reporting we require a thoroughly researched and tested conceptual framework to serve as an anchor for deriving consistent concepts for the accounting standards. In the past, without a comprehensive framework, the development of accounting standards has tended to be ad hoc and their frequent review and revision are responses to and in some instances a knee jerk reaction to issues as they arise. There have been inconsistencies between standards and many standards are mere accounting rules and conventions. Also, some standards permit alternative measurement rules for the same type of transaction, which makes comparison between reporting entities difficult when entities in the same industry adopt a different measurement basis.

Users and their information needs

An important first step in the formulation of a conceptual framework for financial reporting, is determining the users of financial statements and the purposes for which they use them. The required information varies depending on users. The conclusions on users and their information needs would define the financial reporting perspective and how the reported amounts should be measured. Without identifying the primary group of users of financial reports, the conceptual framework could lose focus and be more abstract and vague.

In the early stages of standard setting, the owners of businesses were identified as the primary users of financial statements. The list of users has been gradually expanded and the current IFRS Framework identifies investors, employees, lenders, suppliers and other trade creditors, customers, government and their agencies, and the public. Nevertheless, it concludes, “As investors are the primary providers of risk capital to the entity, the provision of information that meet their needs will also meet the needs of other users that financial statements can satisfy”.

In contrast, paragraph OB5 of the ED states that “The information provided by general purpose financial reporting focuses on the needs of all capital providers (those with a claim to the entity’s resources), not just the needs of a particular group.” The ED explains in paragraph OB6 that “Capital providers include equity investors, lenders, and other creditors, who have common information needs.” The Confederation of European Businesses has commented on the assertions made in the ED regarding the users of financial reports and states that “Although they do not bring

anything new in the accounting debate, these assertions need more thorough research for credibility. The conclusions which are derived from them form indeed the basis for developing appropriate concepts for financial reporting.” Making assertions on such fundamental requirements without proper research is unlikely to provide a sound conceptual framework for the development of accounting standards.

An equally important issue is determining the type of decisions the users make and the information needed for those decisions. The ED and many previous authoritative statements on concepts, have not commented in detail on the decisions models and information needs of users. Michael J Mumford (of the University of Lancaster and a member of the team led by Prof Edward Stamp, which was in the forefront of the push for accounting standards in the UK) in his recent comments on the ED states that the central problem with the Conceptual Framework as designed in the ED is that “it takes as its core concept relevance to decisions without establishing what the decisions are, or what information they require. What is relevant information depends essentially on defining a particular decision, or class of decisions”. The Dutch Accounting Standards Board and the European Financial Reporting Advisory Group (EFRAG) express similar reservations about the ED and conclude that the ED makes certain unfounded assertions about users and users’ needs.

Identifying the users of financial reports, the types of decisions they make and the information needed for those decisions are critical to develop a conceptual framework. Although the need for the identification of users has been identified from the time the standard setting process started several decades ago, we are still debating this issue with

little evidence that adequate research has been undertaken. The lack of adequate research to identify the users and their information needs would and has affected the relevance of information provided in financial statements.

Reporting perspective

The determination of the reporting perspective is another issue that has been debated for many years. The reporting perspective would determine the boundaries of financial reporting, the extent to which assets and liabilities are recognised in the financial statements, how those assets and liabilities are measured and the manner of determining net income. In short, it provides a basis for deciding what would be decision-useful information to the users.

One of the issues being debated for some time now is whether the objective of financial reporting should be to provide information to a wide range of users or only to existing equity owners/shareholders. The perspective from which financial statements are prepared would be based on whether they are intended for a wide range of users or the equity holders.

In the ED, the FASB and IASB state that the objective of financial reporting should be broad enough to encompass all of the decisions that equity investors, lenders, and other creditors make in their capacity as capital providers, including resource allocation decisions as well as decisions made to protect and enhance their investments. Therefore, they have concluded that financial reports should reflect the perspective of the entity (the entity itself is the subject matter of financial reporting) rather than the perspective of the entity's equity investors, the proprietary perspective, (where the proprietor is the subject matter of financial reporting and the reporting entity does not have substance of its

own separately from its proprietors or owners). It is argued that use of the entity concept would result in changes to the classification of liabilities and equity, both of which have claims on the entity's assets and the definition and determination of profits. Consolidated financial statements would be presented from the perspective of the reporting group and the distinction between parent company shareholders and minority shareholders becomes blurred.

The standards issued under the current IFRS framework are predominantly based on the proprietary perspective

A conceptual framework in combination with good judgement will help accountants to focus on logical and consistent solutions to accounting problems as they arise.

although some are a mix or hybrid of the entity and proprietary perspectives and other recent standards are largely based on the entity perspective. The reporting perspective change proposed in the ED is therefore a significant change from the current framework. The ED provides little justification for this change and does not discuss the disadvantages of the current proprietary concept or the improvements expected from the entity perspective.

Some of the major professional accounting firms consider that the Boards' decision on the entity perspective has not been fully considered and justified and also that the Boards have selected the entity perspective after considering only two alternatives, namely, the entity perspective and the proprietary perspective. One of them is of the opinion that the Boards should investigate other potential alternatives, in particular those that fall between the two, and suggested that the choice should be made only

after a thorough analysis of all available options, and consideration of the implications of adopting such reporting perspective. The EFRAG and the Japan Accounting Standards Board, amongst others, have also expressed similar reservations.

A well-researched conclusion on the objective of financial reporting and the financial reporting perspective is essential for accounting standards to provide users with relevant, decision-useful information. The mix of different perspectives in the current standards results in different measurement and report-

ing basis for assets and liabilities and income and expenses within the same financial report. Net income is not an increase in the wealth of the entity but a mix of realised and unrealised income and expenses and net worth becomes a mix of cost and fair value measurements of assets and liabilities and not an indication of the entity's wealth or value. Such mixed approaches to financial reporting affects the quality of the information provided about an entity and the relevance of that information to the decisions of different users.

Relevant and understandable decision-useful information

The role of financial reporting is to assist decision making of users. Hitherto, the providers of equity capital, the owners, have been identified as the predominant users of financial reports, a fact acknowledged in the

ED as well. However, the predominant role of financial analysts in the equities market has resulted in the standard setters requiring a range of disclosures focussing heavily on analysts and other sophisticated financial statement users rather than on investors, creditors, and potential investors and creditors who may not be sophisticated enough to read and understand them.

The issue is whether accounting standards should focus on the information needs and the knowledge level of primary users rather than on sophisticated advisors. Whilst accounting standards and financial information may not be able to cater to the uninitiated, presentation can be improved to make them more understandable (a fact acknowledged by the IASB and FASB in their introduction to the Discussion Paper – Preliminary Views on Financial Statement Presentation issued in October 2008). In any event, primary users should not have to depend solely on financial analysts for their investment decisions but should have adequate information be able to make their own decisions independently.

Current standards require the preparation of general-purpose financial statements, which provide information about the reporting entity that is useful to a wide range of users although the information requirements of different users vary. The users are then expected to select the information needed for their respective decisions. General-purpose statements are therefore likely to provide information that is only partially relevant to the decisions of different users. The ED acknowledges this fact and therefore does not preclude entities from providing supplementary information primarily directed to the needs of a specific group (e.g., an entity's investors).

In our efforts to provide general-purpose statements with a wide range of "information" which may be considered

useful to different users, the quantum of financial details and disclosures in financial statements has increased to such an extent that the size of an average annual report of listed entities in many countries is now around 100 pages. According to recent research by Radley Yeldar, the average length of a FTSE100 company's annual report was 150 pages; the longest was 458 pages. Some of the narrative reporting and disclosures required under accounting standards are a selective summary of the information submitted to the senior management of companies over the years to help decision-making. Such management information is considered useful to investors and capital providers. Many unsophisticated users may be swamped with information in financial reports and not have the time or the knowledge to read and comprehend them. An alternative to such narrative reporting would be to publish metrics or "headline information" (summary information) that management use for internal management purposes. In the absence of a requirement in accounting standards, publication of such additional useful information within the financial statements is voluntary.

Earnings per share (EPS) are considered an important metric relevant to information needs of owners (a proprietary perspective information). The calculation of EPS is covered by a separate accounting standard. It is an instance where data available in financial statements is presented as a metric to shareholders in a readily understandable and relevant form. However, little or no information is provided at present on the quality or composition of the earnings included in the EPS, especially to indicate the effects of unrealised earnings included in them and the financial risks associated with those earnings. Some companies with a significant component of unrealised earnings included in the EPS calculated according to current accounting stan-

dards, paid dividends out of unrealised earnings using borrowed funds or new capital raisings and subsequently ran into financial difficulties. In such situations, it would have been useful to provide other important information, such as operating cash flows per share to be compared with earnings or dividends per share or have two different forms of EPS classifications; one inclusive of realised and unrealised gains and the other exclusive of such unrealised or non cash amounts.

The two Boards have identified investors as the largest body of users of financial statements. These investors are the primary providers of risk capital to an entity. However, as stated earlier, there is little information at present to highlight overall financial risk in the balance sheets of entities. The recent standard IFRS 7 seeks to provide more narrative disclosures on financial management leaving it to the user to interpret the details given. The difficulties many users face is to relate these disclosures in different parts of a financial statement to the financial results. "Headlining" metrics on gearing, solvency and liquidity, rather than burying them in a mass of data on objectives and policies of financial management, would have warned many investors of the high levels of financial commitments and risks of companies that collapsed in the recent credit crisis. The IASB is currently attempting to rectify this situation by further amendments to IFRS 7.

Another important criticism of the current standards is that they are based on historical performance and are too backward-looking and compliance driven. Decisions to buy, sell or hold are based on the future potential of an entity and not its past performance. The current financial statements provide very little information to assess the quality and sustainability of future cash flows. As a result, investors have to find other ways

to get the information they need or make guesses about future performance. It is the absence of such information that caused the loss of billions by many investors who relied purely on the historical information in financial reports.

Better research into the decisions models of the users and their information needs would ensure that appropriate information is readily available in financial reports so that financial statements would be understandable and decision useful. If information provided cannot be understood it has failed the objective of presenting useful information for user decisions. The absence of decision useful information is perhaps, a significant failing of the current framework and accounting standards, which may have contributed to the lack of relevant information in the financial statements of entities that collapsed in the recent financial and economic crisis.

The introduction of electronic online reporting in many countries and the availability of electronic tools such as, Extensible Business Reporting Language (XBRL) may eliminate the need for the publication of general-purpose statements. XBRL may facilitate the different categories of users to extract the information they require from a common database using special reporting formats. However, accounting standards should prescribe the decision-useful information that should be provided in those special formats.

Fair value debate

One of the first principles established at the early stages of standard setting was that realised and unrealised income should be distinguished and net profit or financial performance measured by matching realised revenues with expired costs. Unrealised gains recognised in certain situations were taken directly to equity in the balance sheet.

This principle was considered a conservative approach to reporting income to the owners of a business. Under this approach the residual balances after matching income and costs became assets and liabilities, which did not provide a realistic picture of the net worth of an entity. Therefore, many recent accounting standards have selectively introduced fair value measurement principles for some assets and liabilities. The measurement of assets and liabilities at fair values and recognition of unrealised gains as income was introduced for some of the financial assets and liabilities and also assets like investment property. Agricultural assets, including long-lived plantation assets, are also measured at fair values and unrealised gains treated as income.

these institutions to sell off assets to meet capital requirements, thus depressing the market further;

- When there is a dearth of willing buyers and sellers there is essentially no fair price in the market;
- Fair values create issues of practicality and volatility;
- Financial performance measured using fair values creates financial reporting that is misleading and disconnected from the reality of business activities and that it also creates unjustified and unexpected economic effects including covenant and regulatory stress and liquidity issues.

Much of the debate on market based fair values is focused on measurement rules in IAS 39, which has a mixed measurement model in which some

The reporting perspective would determine the boundaries of financial reporting, the extent to which assets and liabilities are recognised in the financial statements, how those assets and liabilities are measured and the manner of determining net income.

In the wake of the recent market turmoil, as stated earlier, the use of fair market values for measurement of financial assets and liabilities has been questioned by many, including those at the highest levels of governments in the G20 group of nations. Some of the observations made are that:

- Use of fair values does not provide useful information for investment and credit decisions;
- In times of falling market prices fair value measurement can cause severe distortions and can induce a systematic downwards spiral especially in financial institutions where the downturn of markets is accelerated further by requiring

financial assets and financial liabilities are measured at fair value and others at cost or amortised cost, depending in part on an entity's intention in holding an instrument. Incidentally, IAS 39 is one standard with more rules than any of the other principle based standards issued by the IASB. The many prescriptive rules in this standard may be partly due to the technical nature of the financial instruments being measured and the lack of consensus on the users of the financial report and their information needs. The numerous comments and articles in the financial press throughout the world would confirm the doubts about the extensive use of market-to-market valuation of financial assets and liabilities.

The IASB and the FASB and others in the accounting profession have defended the use of fair values to measure assets and liabilities. However, a statement by the IASB following the recent roundtable conferences referred to above, indicates that the issues relating to the accounting for financial instruments and their valuation are being reconsidered. The statement further states that “participants saw an urgent need for such a broader examination by the IASB and the FASB of the role of fair value measurement for financial instruments, including the issues of improving the impairment requirements, classification issues, the fair value option, and transfers between the categories. The boards have agreed to fast track this urgent project, which could involve significant changes to IAS 39 and the relevant US standards. Given the urgency of the matter, the boards’ intention is to work to finish this project in a matter of months rather than years.”

IASB’s recent efforts to explore the simplification of this standard and the above agreement to fast track the changes required to IAS 39 would indicate there are some significant issues which require urgent resolution. This raises questions as to whether the standard in its current form provided useful information to users, why such issues arose in the first place and the adequacy of the consultations held before the initial standards were issued. There is also the question as to whether the fast tracking of changes would ensure a satisfactory resolution of the issues before reaching a conclusion on broader conceptual issues, such as, identification of the users and their information requirements and the reporting perspective.

There are other standards which, as mentioned earlier, also require or permit market based fair values for measurement of assets such as agricultural assets and investment properties. In the current debate on use of fair values for financial

assets and liabilities there has been no serious discussion of the effects of fair valuation of assets on reported results of entities operating in these industries, especially those in property investment. We have recently seen many instances where in falling markets, recognition of fair value decreases of investment property assets held on a long-term basis, have distorted the reported results and adversely affected the entity’s own share prices and debt covenants relating to profitability. Some of these entities have been forced to sell off assets at significantly reduced prices to repay debt or meet redemption calls from investors, thus depressing the property market further. It is however noted that the drops in the market values of these assets have not stopped them from performing and earning positive cash flows returns. Use of market values of investment properties to recognise losses when there is substantial intrinsic value could be positively misleading. Until trade in these property assets returns to normality it is difficult to gauge the true market value of these assets. In the meantime, we have financial information which may be useful to short-term investors and speculators but is of little use or relevant to decisions about long-term investment in this sector of the market.

Recognising market value gains in the financial statements can also give misleading results when market values rise due to temporary changes in demand and supply, and exceed their true value which is based on the future cash flows they are able to generate from the provision of good and services. It is now accepted that market values of many assets had been artificially inflated in the period leading up to the financial crisis. The recognition of such unrealised gains as income overstated the reported earnings and created unrealistic expectations about the future performance of entities among investors and other users, which

resulted in inflated share prices as well. Many have these investors have suffered significant losses as a result of the drop in value of these assets.

The comments made and concerns expressed in many quarters would confirm that the information provided on the basis of fair value measurements in the existing standards has not always been useful and in some situations positively misleading and not relevant to investor long-term decisions.

Conclusion

There is no doubt that accounting standards, especially in the last two or three decades, have improved the quality of financial reporting and ensured a degree of reliability of financial information. The adoption of the IFRS standards has resulted in greater harmonisation and consistency in measuring and reporting financial performance in different countries. However, the absence of a comprehensive conceptual framework not only makes standard setting decisions difficult but has also contributed to a lack of consistency in the principles adopted in the different standards some of which permit alternative treatments which leads to lack of comparability. The information presented may not have been useful as seen by the many criticisms levelled against some standards. The absence or the lack of agreement on fundamental concepts has resulted in financial statements prepared under the current suite of accounting standards not always providing adequate, relevant and understandable decision-useful information. To some extent there is a crisis of confidence in the current accounting standards.

Many of the conceptual frameworks developed in the past by most standard setting bodies to guide their standard setting decisions, have been incomplete. Inadequate research and the lack of

empirical studies and testing may be one of the reasons for the failure to develop a comprehensive and reliable framework. Even the current ED on the conceptual framework has been criticised on the grounds that it contains many assertions without adequate research or supporting evidence, and decisions based on internal observations and existing practices.

Businesses are dynamic and accounting standards and reporting methodologies should be capable of being adapted to the many new reporting and measurement issues that arise. In the absence of a robust, well-researched and tested conceptual framework accounting standards would tend to be accounting rules (as many have been in the past) and incapable of being applied to the new situations not considered when the original rules were framed. The current IASB approach of issuing principles based accounting standards especially requires a coherent and cohesive set of concepts that is up to date, internally consistent, and comprehensive to provide a sound basis to apply them to different situations without having to request official interpretations.

The attempts of the IASB and FASB to finalise an improved comprehensive conceptual framework and to fast track this process after almost 75 years of standard setting, are laudable. The detailed programme of the Boards

and the work done so far indicate that considerable effort is being put into the development of a framework. However, we have seen only the first of eight possible exposure drafts that may be issued before the framework is finalised. The extent of the debate over the ED on the first phase of this project may mean that it would take some consider-

be inconsistent with the new conceptual framework and therefore require amendment or complete revision. It is therefore very likely, that a complete suite of accounting standards, which conform to a common framework and are consistent with one another may not be available for many more years. In the meantime,

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able time before there is consensus on all eight phases of the project and the completion of an acceptable conceptual framework.

Until such time as the two Boards complete their work on the conceptual framework we may need to continue the present, somewhat ad hoc approach to setting accounting standards and updating them. Further, even after there is an agreed conceptual framework, which would form the basis for future standards, many of the existing standards issued under a different reporting perspective and different concepts may

accounting standards and financial statements prepared using those standards are likely to be deficient and may not provide relevant and useful information to investors and other users (whoever they may be) for their resource allocation decisions for the short-term and the long-term. It behooves on the accounting profession to ensure that we have, as soon as possible, accounting standards which provide reliable, relevant and understandable decision-useful information to those users who cannot demand from an entity, financial information suited specifically to their information needs.

The writer has been a member of the ICASL from 1963, and served on the Council and on many committees including the Accounting Standards Committee. He was a Partner of Turquand Youngs and later Ernst & Whinney (now Ernst & Young) and has served on Boards of Directors of public and private sector organisations in Sri Lanka. He emigrated to Australia in 1984 and now works with Grant Thornton in Perth providing assistance and training on technical issues relating to Accounting and Auditing Standards.