HOW HAS IFRS EVOLVED?

Humayun Kabir

Auckland University of Technology

Auckland, New Zealand

RESEARCH OBJECTIVE

- This paper examines the evolution of International Financial Reporting Standards (IFRS) from the perspective of whether IFRS has transformed from a principles-based approach to a rules-based approach.
- The IFRS Foundation confirms its commitment to the principles-based approach in its Constitution (section 2(a)). This is a standard-setting approach in which the standard-setter specifies the underlying principles, emphasizes their attainment, and provides sufficient guidance to operationalize and help preparers apply them.

MOTIVATION

- The principles-based approach is suitable for the IASB because IFRS is applied in multiple jurisdictions where pre-IFRS accounting traditions varied greatly (Chua and Taylor 2008).
- Any change in the IASB's approach may impair its credibility as a standard-setter. The IASB's credibility is vital in a standard-setting environment where it lacks the democratic mandate to set standards for multiple jurisdictions (Richardson and Eberlein 2011), and consequently, relies on its constituents' acceptance of IFRS. Any shock to the IASB's credibility may dent its acceptability.
- Although a recent study reports that IFRS has become more rules-based because of convergence with the United States (US) Generally Accepted Accounting Principles (GAAP) (Lin et al. 2024), the result begs the question of whether IFRS has transformed from a principles-based to a rules-based approach.

THEORETICAL LENSES

- One standard-setting challenge for the IASB could be framed as designing the IFRS accounting requirements in a way that facilitates their application by preparers, approximating the application decision the IASB would have made if it had applied the requirements itself in the specific situations preparers face.
- The IASB follows a principles-based approach, which is an intermediate approach within a spectrum. Under this approach, the IASB specifies the principles applicable to a class of transactions, provides guidance on their application, and outlines a strategy based on principles and analogy for transactions not explicitly covered by IFRS. This approach is a fundamental feature of IASB standard-setting.
- Once the IASB adopted the principles-based approach, its constituents began investing resources in learning how to apply, audit, and enforce it, as well as in developing regulations compatible with the principles-based nature of IFRS (Brown and Tarca 2005)(Tokar 2005). Using the terminology of North (1990), there are increasing returns to maintaining the principles-based approach once it has committed itself to it, and there are costs associated with changing the approach. Therefore, consistent with the path dependence theory (North 1990), the IASB is likely to continue following the principles-based approach.

THEORETICAL LENSES

- The guidance initially included in IFRS is unlikely to cover every possible scenario due to the lack of perfect foresight among both IASB members and constituents.
- Furthermore, there may be ambiguity and some inconsistencies in IFRS requirements due to the bounded rationality of IASB members and the piecemeal development of IFRS. Constituents may also sometimes find it challenging to assess the similarity between the transactions at hand and those already addressed in IFRS.
- The bounded rationality constraint is relaxed as IFRS is implemented and preparers encounter difficulties in applying IFRS or experience new scenarios that cannot be resolved due to ambiguities, inconsistencies, or gaps in existing requirements.
- Given the number of firms that report under IFRS across diverse jurisdictions, there will be requests from IASB constituents, especially preparers, for guidance on transactions with unclear accounting treatments or on the application of certain IFRS requirements to specific situations.

THEORETICAL LENSES

- Upon receiving constituent requests for guidance, the Interpretations Committee may refer the issue to the IASB for developing a narrow-scope amendment, may itself develop an Interpretation, or may decide not to add the project to its work plan, resulting in the issuance of an agenda decision (IFRS Foundation 2022a, paras. 5.16&5.19).
- The decisions of the IASB and the Interpretations Committee depend on the costs and benefits, which include a consideration of the breadth and pervasiveness of the issue raised in the constituents' requests (IFRS Foundation 2022a, paras. 5.16&6.12).

RESEARCH QUESTIONS

- RQ1. Do successive IFRS preserve the principles-based nature of IFRS?
- RQ2. Do the Interpretations Committee and the IASB issue new Interpretations and other guidance, respectively, when the application questions can be addressed by referring to extant IFRS requirements?
- RQ3. When does the IASB amend IFRS?
- RQ4. Do amendments result in more guidance?

SAMPLE

- All IFRS Accounting Standards
- 214 agenda decisions issued between 2007-22
- 62 amendment documents, comprising 55 individual Amendment Documents plus seven Annual Improvements Documents, released during 2007-22.
- 7 post-implementation reviews.

RESULTS
RULES-BASED CONTINUUM (RBC) SCORES

TABLE 1

RBC Score Trends

Year	RBC1		RBC2	
	Mean	t-statistic	Mean	t-statistic
2001	1.47		1.38	
2005	1.37	0.58	1.40	-0.16
2010	1.54	-0.93	1.49	-0.50
2022	1.62	-0.38	1.73	-1.16
ANOVA F-statistic	0.66		1.54	

The t-statistic is for the difference between the mean in that row and that in the immediately preceding row.

RESULTS
RQ1. PRINCIPLES-BASED CHARACTER OF SUCCESSIVE IFRS

- Successive IASB Chairs stressed the need for IFRS to be principles-based, and successive IFRS Foundation Constitutions expressed commitment to the principles-based approach.
- IFRS 2, issued in 2004, states the basic principle that share-based payment transactions must be recognized at fair value (IASB 2004 paras. 7-8, 10 & 30) and provides guidance covering the most common features of employee stock options (IASB 2004 para. BC194). The IASB acknowledges that there may be features of employee stock options that it has not considered (IASB 2004 para. BC193), and abstains from providing extensive application guidance (AG) because the guidance could become outdated if new features are developed (IASB 2004 para. BC194).

RESULTS
RQ1. PRINCIPLES-BASED CHARACTER OF SUCCESSIVE IFRS

- IFRS 3, which replaced IAS 22, incorporates the core principle that all business combinations are acquisitions and all the identifiable assets acquired and liabilities assumed in a business combination must be measured at the acquisition-date fair values (IASB 2008c). This contrasts with IAS 22, which allowed alternative measurements for assets acquired and liabilities assumed in an acquisition, and allowed some business combinations to be accounted for as a uniting of interests (IASB 2001c paras. 33, 35 & 78).
- The IASB has also changed its approach from IAS to IFRS to specify the disclosure requirements. IAS provides only a list of items to be disclosed. In contrast, under the new approach, the IASB stipulates the disclosure objectives and specifies a list of items that the IASB believes will achieve these objectives. The list of specific disclosures serves as guidance.

RESULTS
RQ1. PRINCIPLES-BASED CHARACTER OF SUCCESSIVE IFRS

- Despite the principles-based nature of IFRS being maintained, IFRS increased in length when an IFRS replaced an IAS.
- The total length of the eight IFRSs (254,870 words) is 236.47% higher than that of the replaced IASs and SICs (75,749 words). Most of the increase in length resulted from the issuance of extensive guidance. IFRS 9 represents the extreme case, encompassing 89,339 words in guidance. In contrast, IAS 39 had no guidance in 2001.
- Potential reasons for the increase in guidance:
  - IASB's attempt to address concerns about minimal guidance in IAS (US SEC 2000; 2008).
  - Adequate guidance is needed to apply the principles in multiple jurisdictions with varied accounting traditions and legal and business systems.
  - Convergence with US GAAP (Lin et al., 2024).
  - Complexity of transactions (e.g., financial instruments)
- There are concerns about increased guidance. Mason and Gibbins (1991) raise the possibility of decreasing returns to details in accounting standards.

RESULTS
RQ2. AGENDA DECISIONS

- The number of agenda decisions (n = 214) the IASB issued between 2007 and 2022 far exceeds the number of ADs issued (n = 62) during the same period. Of the 214 agenda decisions, 185 were accompanied by explanatory materials, and 47 had other outcomes.
- Typically, consistent with the principles-based approach, the Interpretations Committee drew the attention of request submitters to the applicable requirements of pertinent IFRS and refrained from providing specific answers to questions.
- The most common reason (n = 132) cited by the IASB for not including the submitter's request in the Interpretations Committee's agenda was its conclusion that IFRS contained sufficient guidance on the issue raised in the submitter's request. This approach limited the number of rules in IFRS.
- Although the Interpretations Committee was reluctant to specify the accounting for specific transactions and events, it specifically answered the submitter's question in several agenda decisions, thus supplanting preparer and auditor judgments in the situations considered.

RESULTS
RQ2. POST-IMPLEMENTATION REVIEWS

- During post-implementation reviews (PIRs), constituents often expressed concerns about the complexity of certain IFRS requirements during the PIR and asked for additional AG and illustrative examples (IEs) to ensure their consistent application. The IASB sometimes provided further guidance in response to such requests. One example was amending the definition of business and providing further AG on the definition.
- The IASB also sometimes decided to research the requested issues further. One such example is the current project on disclosures on goodwill and business combinations (IASB 2020c). This project arose from constituent feedback on the subsequent accounting for goodwill and the ineffectiveness and complexity of the goodwill impairment test during the PIR of IFRS 3.
- However, the IASB generally declines to develop additional AG and IEs in response to such requests. For instance, during the PIR of IFRS 13, many constituents asked for further guidance on how to assess whether the market was active and whether an unobservable input was significant (IASB 2018c, p. 16). The IASB noted that the requirement was principles-based and hence would require judgment (IASB 2018c, p. 16). It further noted evidence of the emergence of practice-led guidance to assist these judgments (IASB 2018c, p. 16).

RESULTS
RQ3. REASONS FOR AMENDMENTS

TABLE 3
Reasons for Amendments to IFRS

Reasons	**Frequency**
Unclear requirements	52
Gaps in IFRS	20
Onerous/difficult requirements	17
Diversity in practice	16
Inconsistency between IFRS requirements	14
Convergence with the US GAAP	8
Other reasons	18
Total	145

RESULTS
RQ3. UNCLEAR REQUIREMENTS

- IAS 38, para. 97 specifies the principle that the amortization method must "reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity" (IASB 2023d). The IASB received "a request to *clarify the meaning* of the term 'consumption of the expected future economic benefits embodied in the asset' when determining the appropriate amortization method for intangible assets of service concession arrangements (SCA) that are within the scope of IFRIC 12 Service Concession Arrangements" (IASB 2014d para. BC72B, emphasis added).
- During the PIR of IFRS 3, the IASB noted that "many stakeholders had concerns about how to interpret and apply the definition of a business" (IASB 2018b para. BC21A). Consequently, the IASB amended the definition of a business in Appendix A and the existing guidance on it, and provided new guidance on this in the AG section of the standard (i.e., Appendix B), and added nine new examples in the IE section of the standard, illustrating the application of the guidance on the definition of a business (IASB 2018b).

RESULTS
RQ3. GAPS IN IFRS

- IAS 21 requires that the spot rate on the transaction date be used for converting a foreign currency transaction into the functional currency on initial recognition (IASB 2015 para. 21). Constituents asked what the date of the transaction was when consideration was paid or received in advance of the delivery of the goods. In response, the Interpretations Committee developed IFRIC 22.
- The IASB sometimes introduced new disclosure requirements, although related disclosure objectives already existed in IFRS. For example, the IASB inserted, as part of the annual improvements to IFRS during the 2010-12 cycle, a specific requirement for disclosing the judgments the entity used when applying the aggregation criteria for operating segments in IFRS 8 (IASB 2013).

RESULTS
RQ4. IMPACTS OF AMENDMENTS ON IFRS

TABLE 4

Impacts of Amendments on IFRS

Sections of the IFRS	**Added (a)**	**Amended (b)**	**Deleted (c)**	**Increase (d)=(a)-(c)**
IFRS – Main body (#paras.)	225	197	15	210
Transition & Effective Date (#paras.)	216	44	4	212
IEs (#paras.)	147	57	0	147
AG (#paras.)	120	54	8	112
Interpretations (#paras.)	102	13	0	102
IG (#paras.)	24	5	6	18
Exemptions (#paras.)	14	9	5	9
Practice Statement (#paras.)	7	0	0	7
Total (#paras.)	855	379	38	817
Definitions (#number)	6	19	0	6

RESULTS
RQ4. IMPACTS OF AMENDMENTS ON IFRS

- To appreciate the magnitude of these impacts, note that IFRS 9, which is by far the lengthiest IFRS, had, when initially issued in 2015, 150 paragraphs in the main body section, 35 paragraphs in the effective date and transition requirement section, 319 paragraphs in the AG, 147 paragraphs in the IEs section, 35 questions and answers in the IG section, and 28 definitions.
- The amendments led to an increase of 379 paragraphs in IEs, AG, Interpretations, and IG. Thus, the amendments increased the amount of guidance the most.
- 27 ADs introduced new exceptions in IFRS. Two well-known treatment exceptions introduced in IFRS by ADs are the exemptions, under IAS 32, of certain financial instruments that meet the definition of financial liabilities from being classified as such (IASB 2008d). A well-known scope exception introduced to IFRS due to ADs is the exemption of certain investment entities from the consolidation requirement under IFRS 10.

SUMMARY

- The study finds that, consistent with the path-dependence theory, the IASB has followed a principles-based approach. It wrote successive IFRSs to state principles first and offered guidance to achieve them. However, as IFRS was implemented and enforced, and stakeholders communicated concerns—such as unclear requirements, inconsistencies, and gaps in IFRS—to the IASB, it led to greater guidance and the addition of exceptions. Nevertheless, the IASB and the Interpretations Committee have been reluctant to provide extra guidance or issue interpretations for every request, mainly when issues can be addressed by reference to existing IFRS, and developing more guidance would not pass the cost-benefit test, thus limiting the number of rules.