

UNDERSTANDING ACCOUNTING STANDARDS: OUTCOMES FROM THE FINANCIAL REPORTING POLICY THINK TANK

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This report summarises the outcomes from a *CPA Policy Think Tank* event, exploring issues that affect the understandability and interpretation of accounting standards. The feedback and recommendations from the Think Tank will be of interest to members working in financial reporting, standard-setters and regulators.

Snapshot

In May 2021, CPA Australia hosted a *Policy Think Tank* to enable members interested in financial reporting to engage with academics, standard-setters, regulators and other experts on the topic of "understanding accounting standards".

This event provided early and mid-stage CPAs with an opportunity to share their experiences and recommendations on improving the accessibility of accounting standards that underlie financial statements.

As economic activities and transactions become more complex, accounting standards develop to capture and present information on these changes. These and other factors contribute to challenges surrounding the understandability and interpretation of accounting standards.

A team of University of Adelaide academics; Associate Professors Bryan Howieson FCPA and Janice Loftus FCPA, and researcher Dr Sabine Schuhrer CPA, conducted a research project "Are accounting standards understandable?" The findings from this research provided the backdrop to our event.

Around 100 people attended, including members from corporates, public practice, the public sector and academia. All participants have been, or are, engaged in different aspects of financial reporting, including preparation, auditing, teaching and advisory services.

Five key aspects were discussed:

1. Who are accounting standards for?
2. What are accounting standards?
3. Understanding the role and purpose of accounting standards

4. Recommendations for improving the understandability of accounting standards
5. Challenges for public and not-for-profit sectors in understanding accounting standards

Participants nominated the **complex structure and legalistic language of standards**, and **insufficient knowledge about the complex economic transactions**, as factors which make accounting standards difficult to understand.

Participants recommended **using technology, simpler language and visual aids in standards** as some of ways to address these challenges. They appreciated the value provided by professional accounting bodies, the large accounting firms, standards setters, and regulators in developing resources to simplify and guide users of accounting standards.

Are accounting standards understandable?

The University of Adelaide team analysed 65 accounting standards to measure their overall readability, based on the average length of sentences and the number of syllables per word. They found the accounting standards were either "difficult" or "very difficult" to read. The researchers also interviewed 25 financial statement preparers, auditors and other industry practitioners.

Key research findings

- Accounting standards are becoming increasingly complex and harder to understand and making them simpler would be beneficial.
- Older accounting standards are considered easier to understand than newer ones.
- Accounting standards include too much rules-based detail.
- Accounting standards are excessively long.
- The application guidance accompanying accounting standards is too generic.

- Help from technical experts is needed to interpret and understand accounting standards.

Coping strategies adopted by users

- Heavy reliance on material provided by large and mid-tier accounting firms, including digital templates.
- Reference to the basis for conclusions that form part of accounting standards.
- Relying on a national and international network of technical experts to discuss critical technical issues.
- Small entities reliance on audit firms and technical consultants.
- Public sector users reliance on specific financial reporting guidance, including those issued by Departments of Finance/Treasury and local government associations.

Think Tank recommendations

In view of these research findings, think tank participants offered the following recommendations to improve the understandability of accounting standards:

Using technology

- Digitalising jurisdiction specific accounting standards (noting that International Financial Reporting Standards (IFRS) are already digitalised – e-IFRS).
- Including hyperlinks for easy access to topics covered in multiple accounting standards.
- Identifying and developing solutions involving machine or artificial intelligence in making many of the professional judgements associated with interpreting accounting standards.

Improving language

- Using simple language.

- Considering the impact on understandability and interpretation when translating accounting standards into other languages.
- Avoiding use of double negative statements.

Improving content and presentation

- Providing a clear explanation of the rationale and objective behind each of the accounting standards.
- Providing hyperlinks to the *Conceptual Framework for Financial Reporting* (Conceptual Framework) and using hyperlinks for subject matter that is addressed in multiple accounting standards.
- Providing practical and specific examples (these could be hyperlinked through from the relevant paragraph in the body of the accounting standard).
- Making summary versions of accounting standards available, highlighting the key requirements.
- Making disclosures succinct.
- Including more visual aids and flowcharts.

Improving the process for developing accounting standards

- Considering the challenges faced by different users of accounting standards. Examples include:
 - public sector/not-for-profit sector specific accounting challenges
 - users with different levels of expertise
 - users for whom English is not a first language.
- Seeking feedback from practitioners on the applicability and auditability of accounting standards' requirements, prior to finalising and publishing them.

The role of professional accounting bodies

Professional accounting bodies should continue to:



- Advocate on behalf of their members to provide feedback that is relevant and representative of members' perspectives.
- Provide platforms to facilitate feedback on local and international consultations. Such platforms should encourage feedback from members who are less engaged in the development of accounting standards.
- Support their members through the publication of guidance, including articles, webinars, podcasts, and factsheets.
- Produce policy papers on challenging accounting issues.

Themes discussed

Insights that arose during discussion include:

1. Who are accounting standards for?

Participants identified a range of users of accounting standards, including preparers and auditors who use accounting standards to meet statutory and accountability requirements. Other users identified included investors, investment advisers, educators, professional accounting bodies, and researchers, among others. Participants considered interpreting company results and achieving consistency of financial reporting as key uses of accounting standards.

2. What are accounting standards?

The term "accounting standards" is often used to refer to both the main body of the accounting standard and the accompanying material. Accompanying material includes implementation material and guidance, illustrative examples, bases for conclusions, interpretations of the accounting standards, the Conceptual Framework and interpretive agenda decisions.

Other resources that can assist in understanding accounting standards include:

- frequently asked questions and technical pronouncements issued by standards setters

- resources published by large accounting firms
- guidance published by governments, regulators and standard setting bodies
- guidance issued by professional accounting bodies
- guidelines issued by the Treasury and local government associations for public sector financial reporting.

3. Understanding the role and purpose of accounting standards

Participants considered the question of why accounting standards have become difficult to understand. In many jurisdictions (including Australia) accounting standards have the force of law and the language used needs to be technically precise.

Newer accounting standards are becoming lengthier (examples include accounting standards on revenue and financial instruments) as they deal with complex economic activities and transactions. The use of extremely long sentences and double negatives adds to complexity. These challenges are further compounded for non-native English language-speaking users of accounting standards.

Some participants expressed the view that users of accounting standards should have an understanding of the economic basis underlying them. Although Accounting standards are expected to reflect the economic substance of transactions, they may be more difficult to understand for those who do not understand the underlying economic characteristics.

Therefore, accounting standards should be considered as a reference document that presupposes an understanding of the economic activities to which they relate, rather than be seen as a source of knowledge and education on underlying economic activities. For example, with complex transactions that involve financial instruments or leases, preparers are expected to possess a working knowledge of the underlying economic criteria as a prerequisite to understanding the requirements within the respective accounting standards.

4. Challenges in the public and not-for-profit sectors

Participants from public sector and not-for-profit (NFP) organisations identified challenges specific to these sectors. The accounting standards in some jurisdictions (e.g. Australia) are based on standards which are not developed specifically for the public or NFP sectors. Hence, important areas of reporting for these sectors, such as service performance reporting, are not addressed in the accounting standards.

Participants also flagged the importance of developing different conceptual frameworks to underpin accounting standards with public sector and NFP sector objectives.

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