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## **Rules-based Standards and the Lack of Principles in Accounting**

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### **INTRODUCTION**

In September 2002, the Financial Accounting Standards Board (FASB) of the United States published a discussion paper seeking views on whether U.S. standard setting should move from a “rules-based” approach towards a “principles-based” approach as sometimes associated with the International Accounting Standards Board (IASB). That paper was partly in response to the Sarbanes-Oxley Act which was itself a response to such accounting scandals as Enron and WorldCom.

Schipper (2003) points out that the U.S. rules are often based on principles. That is, the standard setters use principles in order to produce the rules for the preparers of financial statements. Nelson (2003, p.91) agrees, and suggests that a particular standard should rather be seen as more or less rules-based. He suggests that rules can increase the accuracy with which standard setters communicate their requirements and can reduce the sort of imprecision that leads to aggressive reporting choices by management. However, he notes that rules can also lead to excessive complexity and to the structuring of transactions.

One of the reasons why standards on several topics need to contain rules is that the standards are inconsistent with the conceptual frameworks of the standard setters. For several topics, the use of the appropriate principle could lead to clearer communication and to more precision without the need for the current rules. That is, before asking how rules-based a particular standard should be, we should ask whether the standard is based on the most appropriate principle.

I identify six topics on which the accounting standards have detailed technical rules. In each case, I suggest that part of the need for rules is caused by a lack of principle or by the use of an inappropriate principle (i.e. one that does not fit with higher-level principles). The lack of clear and appropriate principles can also lead to optional accounting methods in standards because no one policy is obviously the correct one; this leads to lack of comparability. I do not suggest that the use of appropriate principles would lead inexorably to standards with no optional methods but that, on some topics, optional methods could be eliminated.

The six topics are examined one by one. In each case, I attempt to locate the principles being used, to assess the appropriateness of the principles, and then to identify any arbitrary rules or optional methods that result from the absence of appropriate principles. I start with the IASB's standards (hereafter, IFRSs), with frequent comparison with U.S. GAAP. One reason for examining IFRSs in particular is that they are required for the financial reporting of listed companies throughout much of the world in 2005 onwards,<sup>1</sup> and the FASB has announced plans for convergence of its standards with IFRSs.<sup>2</sup> The final section of the paper draws conclusions about how accounting might be improved by substituting principles (or better principles) for the existing requirements.

<sup>1</sup> For example, this is a requirement for consolidated statements in the 25 countries of the European Union, and in Australia, Norway and Russia.

<sup>2</sup> The "Norwalk Agreement" of September 2002 between FASB and IASB.

## **PRIOR LITERATURE AND CLARIFICATION OF OBJECTIVES OF THIS PAPER**

Alexander (1999) investigates the nature of principles and rules in an accounting context. Below, I use the word “principles” to include Alexander’s type A overall criteria (e.g. fair presentation, the definitions of elements of accounting and, in particular, the primacy of the asset and liability definitions) and his type B conventions (e.g. prudence). Such principles are contained in the standard setters’ conceptual frameworks. I contrast this to “rules” which are Alexander’s type C rules (e.g. the requirement to measure inventories at the lower of cost and market). My definition of ‘rules’ includes Nelson’s (2003, p.91) “specific criteria, ‘bright line’ thresholds, examples, scope restrictions, exceptions, subsequent precedents, implementation guidance, etc.” The use of the terms “principles” and “rules” seems broadly consistent among Alexander (1999), Nelson (2003), Schipper (2003), and myself.

My purpose is not to investigate why the U.S. system tends towards the writing of rules (whether based on principles or not). Identifying the roles played by the existence since the 1930s of the Securities and Exchange Commission (SEC) as an enforcement agency and the perceived need of auditors to protect themselves from litigation by encouraging the setting of clear and detailed rules is left to Benston (1976), Zeff (1995), and future research. As discussed below, the IASB also frequently writes rules. Thus, my purpose is to evaluate how the failure to use the appropriate principles can lead any standard setter to rely too much on rules.

As noted earlier, the imposition of rules has some potential advantages. Those identified by Schipper (2003) and Nelson (2003) include:

- increased comparability,

- increased verifiability for auditors and regulators (and a related reduction in litigation),
- reduced opportunities for earnings management through judgements (but increased opportunities through transaction structuring), and
- improved communication of standard setters' intentions.

Nelson (2003) and the American Accounting Association's Financial Accounting Standards Committee (FASC 2003) review the literature related to these issues. FASC concludes that:

Concepts-based standards, *if applied properly*, better support the FASB's stated mission of "improving the usefulness of financial reporting by focussing on the primary characteristics of relevance and reliability" (FASC 2003, p.74, emphasis added)

In addition to balancing the advantages and disadvantages of more detailed rules, the standard setters sometimes face competing principles. An obvious example is the difficulty of trading off relevance and reliability: for instance, estimates of current values or future cash flows might be potentially relevant data, but some such estimates have low reliability. Departure from one principle might be justified by the need to follow another one.

Standard setters are also subject to political pressure, especially from the management of large companies (e.g. Hope and Gray 1982 ; Solomons 1978; Watts and Zimmerman 1978; Nobes 1992; Zeff 1997). Giving way to political pressure might be an explanation for departing from principles. However, a bad standard cannot be re-classified as a good one because issuing it enabled the standard setter to survive.

As noted earlier, my purpose is to identify several accounting topics for which the accounting standard could be improved by being based more closely on a principle from the conceptual frameworks. In some cases, merely removing a rogue “principle” that is not contained in the conceptual frameworks is sufficient. The improvements come in the form of increased clarity, decreased complexity, and decreased motivation for the structuring of transactions. That is, in some cases, increased clarity can be associated with a *reduction* in rules.

This is not to say that principles-based standards are always clearer than rules-based standards. For example, development costs can represent an asset that meets reasonable recognition criteria; IAS 38 (para. 57) is based on this argument. In this context, the U.S. requirement (in SFAS 2) to expense development costs could be seen as an un-principled rule. However, in this case, the U.S. “rule” leads to a clearer instruction and to several resulting advantages (see above), although not necessarily to a better balance sheet.

Because some accounting topics are not susceptible to solution by use of appropriate principles without rules, standard setters are then forced to choose, for example, between an unclear principle and a clear rule. However, I and most other authors quoted above do not welcome rules for their own sake. They should be kept to the minimum necessary to achieve the various advantages claimed for them, such as clarity. This warrants an examination of each accounting topic to see if a more appropriate principle could achieve the advantages of rules and yet reduce the amount of rules at the same time.

As mentioned earlier, the use of appropriate principles can reduce optional accounting treatments, with a consequent increase in comparability. I am not talking here of judgments by preparers but of overt optional methods in accounting standards. Optional methods are not prevalent in U.S. accounting standards, although some exist.<sup>3</sup> However, several options continue to exist in IFRS even after the removal of many in December 2003. The options were needed to achieve a three-quarters majority on the IASC Board, but arguing for the options was easier in the absence of clear principles. Using appropriate principles does not guarantee a reduction in options, but the discussion below finds several instances where a focus on principles can reduce options.

## EXAMPLES

### **Lease accounting**

I begin with the well-known case of the capitalization of leases. The IFRS requires<sup>4</sup> that a lease should be capitalized as an asset and a liability when it “transfers substantially all the risks and rewards” to the lessee. The IFRS contains no numerical or other technical rules surrounding that vague principle, which is itself based on the principle of substance over form. In order to make the same principle practicable and auditable in the U.S., SFAS 13 requires<sup>5</sup> capitalization when any one of four technical tests are satisfied, including cases where the length of the lease equals or exceeds 75 percent of the useful life of the asset or where the present value of the lease payments equals or exceeds 90 percent of the fair value of the asset. These rules bring several of the advantages mentioned above (e.g. clarity and verifiability) although, as FASC (2003)

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<sup>3</sup> For example, the choices for the presentation of comprehensive income in SFAS 130; and the choice not to use the “corridor” in SFAS 87 (see later).

<sup>4</sup> IAS 17, paras. 4 and 20.

<sup>5</sup> SFAS 13, para. 7; SFAS 29, paras. 10 and 11.

points out, the bright lines lead to the structuring of leases so that the lease liabilities can be kept off the balance sheet.

This is an example of the FASB making a rule that is based on a principle: substance over form. However, I contend that the IFRS's vagueness and the SFAS's arbitrary detail are caused by using the wrong principle. The more appropriate principles are the definitions of assets and liabilities. For reference, the IASB's definitions are shown in Exhibit 1. McGregor (1996) and Nailor and Lennard (1999) propose that obligations under all noncancellable leases meet the definition of "liability" and should therefore be recognized. Similarly, the lessee has control over resources for a period, and therefore has an asset. Once we adopt the appropriate principle, rounding out the vague "substantially all the risks and rewards" with the arbitrary 75 percent and 90 percent is unnecessary. An alternative view of this principle is given below.

**[insert Exhibit 1 here]**

Incidentally, the principle of substance over form in leasing is a distraction; it is the exact legal form of the lease contract that gives rise to the lessee's obligation and to control over the leased asset. That is, the legal form and the economic substance are not at odds, assuming that one concentrates on the relevant principle of control rather than on ownership.

In the case of this accounting topic, basing a standard on the appropriate principle (the definitions of assets and liabilities) does not lead to the alleged disadvantages of principles as opposed to rules. That is, the principles approach would not lead to imprecision, lack of verifiability, or lack of comparability. All noncancellable leases would be treated in the same way. This reduces the point of transaction structuring to

avoid the thresholds. Also, the intentions of the standard setter would be accurately communicated.

An alternative view of applying the asset/liability definitions to leasing is that a lease is an executory contract, i.e. a contract that is equally unperformed by the lessee and by the lessor for the remaining period of the lease. To be consistent with other executory contracts (e.g. see IAS 37, para. 3), leases would not be recognized as assets or liabilities. Disclosure of the lease commitments would then be the suitable alternative. Whichever of the two views is taken, capitalizing leases on the basis of whether they exceed a 75 percent/90 percent threshold makes no sense.

What explains the lack of use of the definitions by the standard setters? The explanation seems to be that the leasing standards pre-date clear definitions of asset and liability.<sup>6</sup> The standard setters have moved only slowly<sup>7</sup> towards sorting this out because they are aware that any extension of the scope of lease capitalization would be politically unpopular.<sup>8</sup>

### **Employee benefits**

Unlike the leasing standards, the standards on post-employment benefits are consistent with the definition of a liability. However, this time there are problems with measurement rules.

Measurement rules are necessary in the standards on this topic because the definition of liability does not solve all issues; for example, it is unclear whether or not

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<sup>6</sup> For example, SFAS 13 of 1976 pre-dates SFAC No. 3 of 1980; and IAS 17 of 1982 pre-dates the IASC's *Framework* of 1989. The APB's Statement No. 4 of 1970 has a much less clear definition of a liability (para. 132).

<sup>7</sup> The point was acknowledged by IASC when revising IAS 17 in 1997 and again in 2003 (see paragraph IN.4 of IAS 17).

<sup>8</sup> For example, see the extensive lobbying by the leasing industry against capitalization in the comment letters relating to IAS 17.

to restrict the size of the liability to the benefits already vested. However, some of the measurement rules are complex and not based on principles. In particular, IAS 19 and SFAS 87 contain devices to protect the income statement from the truth of the effects of actuarial gains and losses on the net pension obligation. The first device is that “small” actuarial gains and losses (those within a “corridor”) can be ignored (IAS 19, para. 92; SFAS 87, para. 32). The size of the corridor is set, by an arbitrary rule, at 10 percent of the larger of the obligation and the fund. The second device is that the remaining actuarial gains and losses can be smoothed over a period related to the service lives of the employees (IAS 19, paras. 93/96; SFAS 87, paras. 32-33).

These devices were inserted at the demand of preparers in order to reduce volatility in the balance sheet and the income statement. However, the result is a deliberately wrong figure in the balance sheet (because management’s best estimate of the liability is not recorded there) and an expense with no economic meaning (because only a small proportion of the change in the liability is recognized). This seems unlikely to serve the needs of investors. FASC (2003, p.82) agree that these devices are “not appropriate.”

Because the rules are so clearly unprincipled, the standards allow<sup>9</sup> entities to choose not to use the corridor and to choose to recognize actuarial gains and losses immediately in full. This results in lack of comparability. In 2004, the IASB proposed<sup>10</sup> to add yet a further option: full recognition of the liability with actuarial gains and losses taken to the statement of changes in equity.

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<sup>9</sup> IAS 19, para. 93; SFAS 87, para. 32.

<sup>10</sup> Exposure Draft of April 2004.

The application of the principles that liabilities should be measured reliably, neutrally and show a faithful representation<sup>11</sup> would remove the need for these rules and options. The gain or loss in the income statement would not be smoothed but would be the change in the liability, which is what the frameworks suggest.<sup>12</sup>

### **Financial assets**

IAS 39 was a distillation of the voluminous<sup>13</sup> promulgated U.S. GAAP on the subject of financial instruments. The key feature of both IASB and U.S. requirements is that they contain a mixed measurement model: cost-based for some assets and fair value<sup>14</sup> for others. The only underlying principle that I can discern is that the measurement of assets should be based on the intentions of management. For example, held-to-maturity investments (measured on a cost basis) are those “that an enterprise has the positive intent and ability to hold to maturity,” whereas trading assets (fair valued) are those “principally for the purpose of selling ... in the near term” (IAS 39, para. 9, with similar definitions in SFAS 115, paras. 7 and 12).

The “intentions of the directors” is not a principle to be found in the frameworks. It is a poor principle because intentions can change, cannot directly be audited, and are sometimes unclear even to the directors. This poor principle brings with it numerous rules about intermediate categories, changes of intentions, and the audit of intentions. This is partly what made the U.S. GAAP voluminous and led the IASB to publish 351 pages of rules as “Implementation Guidance.”

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<sup>11</sup> For example, see paras. 31 – 36 of the IASB’s *Framework*.

<sup>12</sup> For example, IASB’s *Framework*, para. 70.

<sup>13</sup> The IAS 39 file at the IASB records that the project director, Paul Pacter, considered 12 FASB Statements, 9 FASB Technical Bulletins, 7 APB Opinions, 19 AICPA Statements of Position and 109 EITF consensuses.

<sup>14</sup> In this paper, “fair value” is used with its standard IASB meaning of a current market exchange price (e.g. IAS 16, para. 6).

The unsatisfactory nature of the principle led, in the case of IFRS, to the inclusion of optional methods in the standard. IAS 39 (former para. 103) originally allowed the gains and losses on available-for-sale securities to be taken either to income or to equity. The revisions of 2003 to IAS 39 insert<sup>15</sup> other choices by allowing any financial asset to be designated as “fair value through profit or loss” and therefore treated like a trading asset.

An alternative approach would be that all financial assets should be measured at fair value. This would remove the need for much of the complexity, documentation of intentions, and audit judgements involved in the present standards. It would also increase comparability because identical assets would be valued identically, irrespective of what management states that it thinks about the assets. If the “principle” of intentions is discarded, a standard with far fewer rules results, as shown in the Draft Standard<sup>16</sup> issued by the FASB, the IASC and others in December 2000. Political pressure explains, rather than excuses, the lack of movement towards this solution.

A further use of the “principle” of directors’ intentions in U.S. GAAP<sup>17</sup> and in IAS 39 (para. 71) is that hedge accounting can be used when an enterprise documents its intentions for signing various financial contracts. This leads to very complex rules (e.g. paragraphs 72 to 84 of IAS 39) that could be avoided if these contracts were all treated in the same way irrespective of the alleged intentions of directors. The latest twist to the story is that IFRS 1 has to make rules (paras. 29 and 30) about the retrospective documentation of intentions.

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<sup>15</sup> As part of the definitions in para. 9.

<sup>16</sup> *Draft Standard on Financial Instruments and Similar Items*, Joint Working Group of Standard Setters, 2000 (published by FASB, IASC and others).

<sup>17</sup> SFAS 133, para. 18.

A caveat relates to the term “these contracts” in the previous paragraph. Unless all contracts were required to be marked to market, a principle or a rule would be necessary to establish a clear distinction between financial contracts (that should be marked to market) and non-financial contracts (that should not be).

A further caveat is that hedge accounting relates to the measurement of performance rather than to the measurement of assets and liabilities. The lack of clear principles for performance measurement is the concern of a current project of the FASB and the IASB. Several of the suggestions in this paper raise issues that might lead to controversial outcomes in reporting performance.

### **Government grants**

U.S. GAAP contains limited guidance on government grants. IFRS deals with this subject in IAS 20, which is based on the principle of matching:

Government grants should be recognised in income over the periods necessary to match them with the related costs which they are intended to compensate (para. 12)

The inappropriateness of IAS 20’s principle becomes clear when applied to grants for the purchase of fixed assets. The grant is treated as income over the life of the asset. This leaves unanswered (and unanswerable) the question of what to do with a grant for the purchase of land, which has no depreciable life. It also raises the problem of what to do with the credit balance until it is fully taken to income. In the absence of a proper principle, a choice is given in IAS 20 (para. 24): net off against the asset or show as “deferred income.” The first treatment leads to no clear measurement basis for the asset,

and the second leads to an item shown like a liability<sup>18</sup> which does not meet the definition.

IAS 20 is at odds with the *Framework* which states that: “Income is increases ... of assets or decreases of liabilities” (para. 70) and that “the application of the matching concept ... does not allow the recognition of items in the balance sheet which do not meet the definition of ... liabilities” (para. 95). Following the *Framework* would lead to the treatment of unconditional grants as immediate income, because the recipient has an asset (cash) and no liability. Westwood and Mackenzie (1999) champion this treatment, and it is already adopted by IAS 41 (para. 34) in the context of biological assets.

### **Subsidiaries**

An Enron-related example of a “rule” is the U.S. definition<sup>19</sup> of a subsidiary, which is primarily based on ownership of more than one half of the voting shares of another entity.<sup>20</sup> The IASB’s principle<sup>21</sup> in this area is that a subsidiary is an entity that another entity has the *power* to control. It is not necessary actually to exercise control because the first entity’s management would be unlikely to go against the wishes of the other entity. This principle follows directly from the definition of an asset. For something to be an asset, it must be controlled,<sup>22</sup> so for a subsidiary’s assets to be included in the consolidated balance sheet, the subsidiary must be controlled.

Either type of definition might need elaboration. For example, in order to counter off-balance sheet finance, a U.S. group was required<sup>23</sup> to show that outsiders had

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<sup>18</sup> IAS 20 (para. 12) states that the amount should not be taken to equity.

<sup>19</sup> APB Opinion 18, para. 3.

<sup>20</sup> FIN 46 now requires the consolidation of certain variable interest entities despite this general rule.

<sup>21</sup> IAS 27, para. 4.

<sup>22</sup> e.g. IASB’s *Framework*, para. 49(a).

<sup>23</sup> EITF 90-15.

financed at least 3 percent of the total assets of a special purpose vehicle before it could be excluded from consolidation. This added a rule on top of a rule. By contrast, the IASB points out<sup>24</sup> that potential shares should be considered when assessing power to control. This clarifies the IASB principle.

In this case, the trade-off faced by the standard setters is clear. The U.S. system has chosen a complex set of rules whereas IFRS has chosen a somewhat vague principle. The resulting structuring of transactions in the U.S., as evidenced by the creation of Enron's special purpose vehicles, was one of the results of the rules-based approach.

### **Equity accounting**

As noted above in the context of financial assets, difficulties can arise when the standard setters invent "principles" that are not found in any conceptual framework and do not fit with other principles. An example relates to one of the most egregiously arbitrary rules in accounting: the use of a threshold interest of 20 percent of voting shares in the context of equity accounting. The alleged underlying principle of "significant influence" is sufficiently vague that it has to be supported by a rebuttable presumption (in APB Opinion 18, para. 17 and IAS 28, para. 6) that refers to the numerical threshold.

Nobes (2002) shows how the 20 percent threshold arose, without good arguments, in the UK and then slowly spread worldwide. Mulford and Comiskey (1986) show that the arbitrary threshold leads to manipulations of the size of holdings around the threshold.

The "principle" of significant influence is not found in the FASB or IASB conceptual frameworks, and it cannot be clearly related to other principles or to the

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<sup>24</sup> IAS 27, para. 14 (formerly SIC 33).

definitions of asset and liability. Equity accounting involves the group (or the investor)<sup>25</sup> taking credit for income that has not been received in cash and could not be demanded. It also involves a curious rule<sup>26</sup> that requires a group (or an investor) to eliminate some profit on sales to an associate even though the control of goods has fully passed to (and cash has been fully received from) that entity, which is outside the group.

Rather than being derived from a principle, the equity method as used for associates can be seen as an *ad hoc* valuation method. The arbitrary threshold (and the rule on profit elimination) could be dispensed with if investments were instead treated as available-for-sale financial assets (at fair value), assuming that the investments do not involve the control of the underlying assets.

The lack of sound principle led, once again, to optional accounting methods. Before the revision of 2003, IAS 28 (former para. 12) allowed an investor to account for an associate using the equity method, the cost basis, or as an available-for-sale investment.

In this case, accounting would be improved by abandoning the rogue “principle” and the rules that are needed to operationalize it. Instead, the associate would need no special principles or rules. It would be accounted for like other investments in non-controlled entities. This would improve comparability and remove the opportunities for structuring. This idea has already been proposed by some standard setters (Milburn and Chant 1999).

<sup>25</sup> The method has been used in some countries (e.g. Denmark, the Netherlands and Norway) in an investor’s unconsolidated statements.

<sup>26</sup> IAS 28, para. 22 (formerly SIC 3).

## CONCLUSIONS

I follow Schipper (2003) by starting with the assumption that comparability/consistency in financial reporting is a good thing. I further agree with Schipper and with Nelson (2003) that rules can help with clarity/comparability. However, this paper argues that some of the rules in existing standards occur because a standard is based on a poor principle or because it lacks principle. Use of a more appropriate principle would reduce the need for arbitrary and detailed rules. That is, the removal of rules can sometimes be associated with *increased* clarity and comparability. For some topics, use of a better principle would also help in the reduction of optional accounting methods.

I do not mean to imply that a principles-based standard is always better than a rules-based standard, or that concentration on principles will always lead to less complex rules. However, the standards on some topics contain extensive rules and optional accounting methods because of a lack of principle or because of the use of an inappropriate principle not found in the frameworks. In these cases, the standards could be clearer and could lead to greater comparability at the same time as reducing the rules. My analysis concentrates on six examples from IASB standards because listed companies throughout much of the world adopt IASB standards from 2005 onwards and because the FASB has agreed to converge its standards with IASB's. In some cases, standard setters have already examined similar proposals in discussion papers.

Table 1 summarizes the findings of the paper for the six topics. The existing and proposed principles are noted. For three of the topics, the proposed improvement is the

use of the frameworks' definitions of asset and liability. In two other cases, the proposal is that the standard should drop a "principle" that is not in the frameworks.

**[insert Table 1 here]**

I conclude that complexity of the rules could be reduced by adopting a more appropriate principle in all six cases. This reduction in complexity is in itself a good thing, although it could be outweighed by a deterioration in other qualities. For example, in the case of the definition of subsidiaries, verifying control is more difficult than verifying ownership; for associates, verifying fair value is more difficult than verifying equity accounting. Nevertheless, for these two topics, reduced incentives for management to structure transactions would weigh in favour of the proposed improvements.

For topics 1 through 4 (see Table 1), decreased complexity could be achieved at the same time as improvements in some aspects of verifiability or reduced structuring or both. Further, for most topics optional methods could be reduced.

A major issue which is difficult to summarize is the degree to which the proposed improvements would lead to better information for investors. In the end, this is an empirical matter, but Table 2 summarizes some of the relevant points.

**[insert Table 2 here]**

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**EXHIBIT 1 IASB's Definitions of Asset and Liability**

An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Source: Extract from para. 49 of IASB's *Framework*.

**TABLE 1 Synopsis of Six Topics**

<i>Topic</i>	<i>Existing Principle</i>	<i>Proposed Improvement</i>	<i>Complexity?</i>	<i>Structuring?</i>	<i>Verifiability</i>	<i>Reduce Options?</i>
1. Leasing	Transfer of substantially all risks and rewards	Definitions of asset and liability	Decrease	Decrease	Increase <sup>1</sup>	No
2. Employee benefits	Protect financial statements from volatility	Faithful representation	Decrease	-	Increase	Yes (U.S./IFRS)
3. Financial assets	Documented intentions of directors	Removal of rogue principle	Decrease	Decrease	Increase <sup>2</sup>	Yes (IFRS)
4. Government grants (IFRS)	Matching	Definition of liability	Decrease	-	Increase	Yes (IFRS)
5. Subsidiaries (U.S.)	Ownership	Definition of asset; control	Decrease	Decrease	Decrease	No
6. Equity accounting	Significant influence	Removal of rogue principle	Decrease	Decrease	Decrease	Yes (IFRS)

<sup>1</sup> An increase in the sense that policing the capital/operating boundary would cease. However, the measurement of the lease would involve estimations.

<sup>2</sup> An increase in the sense that intent would no longer be audited. However, fair values would be used more extensively, and some of those are difficult to verify.

<b>TABLE 2 The Quality of Information</b>	
<i>Topic</i>	<i>Improvements in the quality of information</i>
1. Leasing	All leases would be treated in the same way. All liabilities would be recognized.
2. Employee benefits	The size of liabilities could no longer be hidden. Meaningless expenses would be removed from the income statement. An option would be removed, thereby improving comparability.
3. Financial assets	Assets of a similar nature would be measured similarly. Options could be removed from IFRS, thereby improving comparability.
4. Government grants (IFRS)	The item “deferred income” which is difficult to interpret would be removed from balance sheets. Income that has been received would no longer be spread over an irrelevant period. An option could be removed, thereby improving comparability.
5. Subsidiaries (U.S.)	The group’s assets and liabilities would be revealed.
6. Equity accounting	Investments of a similar nature (e.g. those of 18 percent interests and 22 percent interests) would be measured in the same way.