THE INTERNATIONAL ACCOUNTING STANDARDS BOARD'S PROGRESS IN PROMOTING JUDGEMENT THROUGH OBJECTIVES-ORIENTED ACCOUNTING STANDARDS

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ABSTRACT

This study analyzes how the International Accounting Standards Board (IASB) promotes professional judgement by issuing objectives-oriented accounting standards and exposure drafts. We focus on the the role of judgement as outlined in Phase I of the IASB Conceptual Framework (CF), Chapter 1, "Objective of General Purpose Financial Statements" and Chapter 3, "Qualitative Characteristics of Useful Financial Information" (IASB 2010). We discuss how the framework, when viewed through the prism of 'objectives-oriented accounting standards' as recommended by the United States Securities and Exchange Commission (SEC) Report in its "Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System" (July 2003), encourages professional judgement. We analyze International Financial Reporting Standards (IFRS) and Exposure Drafts (ED) issued by the IASB since its inception in 2002 to determine if those documents are consistent with objectives-oriented accounting standards. Our analysis is useful for gaining insights into how the IASB integrates the CF with the SEC's recommended objectives-oriented accounting approach to promote judgement in the interest of IASB/FASB convergence of accounting standards.

1. Introduction

In 2003, the Securities and Exchange Commission (SEC) in its "Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System" (The SEC Report), recommended objectives-oriented accounting Standards (Securities and Exchange Commission 2003), hereinafter referred to as "objectives-based" accounting standards. One of the major goals of objectives-based standards is that they guide management and preparers in making judgements about financial reporting issues.

Subsequently, the (IASB) issued Chapter 1, "The Objective of General Purpose Financial Statements" (OB) and Chapter 3, "Qualitative Characteristics of Useful Financial Information" (QC) of their new Conceptual Framework (IASB 2010). The new Conceptual Framework (CF) project is a joint effort with the United States Financial Accounting Standards Board (FASB). In addition to stating the objective of useful financial information, Chapter 1 underscores the significant role of judgement by stating that the concepts in the CF underlie judgement. This study investigates how the IASB has integrated Chapters 1 and 3 of the CF with the SEC Report to create objectives-based standards and exposure drafts that promote judgement.

In section 2 we discuss the literature on the role of judgement in rules-based versus principles-based only versus objectives-based accounting regimes. Section 3 analyzes judgement within the context of the Conceptual Framework. In Section 4 we present our methodology and in Section 5 we perform our analysis of specific IASB standards and exposure drafts to asses whether they comply with the SEC description of objectives-based standards. Section 6 presents results. Section 7 discusses limitations and Section 8 concludes.

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2. Literature Search

The purpose of accounting is to establish a link between business activities and decision-makers by providing useful information about accounting transactions (events). Useful information presents a true (fair) view of financial position, financial performance and cash flows of the economic entity (IASB 2010a). The subject of financial statements is a business reality that is affected by constant changes in a complex socio-economic environment where it is difficult, if not impossible, to express all relevant business events in monetary values only.

For example, changes in the business environment over the last 50 years have resulted in the emergence of many new types of financial assets and liabilities, which have at the same time caused significant changes in the accounting environment. The internationalization of business and the development of financial markets together with the evolution of the information economy make economic reality more complex and less understandable. Today's accountants are required to make numerous forecasts and projections, assess potential risks, and identify other key sources of uncertainty that may affect the value of assets and liabilities (Cormier and Magnan 2005).

These changes indicate that the preparation and presentation of financial statements is not a mere mechanical process to comply with accounting standards, but the result of the application of objective professional conclusions to provide reports about the level of fair presentation of financial statements and the business effects of the transactions. In the context of modern business, accounting information should be viewed as a function of professional accounting estimates and professional judgement. (Cormier and Magnan 2005)

2.1 What is professional judgement? It is the process accountants use to apply accounting standards, considering the current and future financial environment and risk characteristics of the enterprise. The accountant uses judgement to analyse, estimate and select principles, methods, and models in financial reporting (Xiling 2010). Two key aspects of professional judgment in auditing and/or accounting are: "(1) relevant knowledge and experience, and (2) a choice between alternatives" (Cormier and Magnan 2005).

2.2 Rules-based vs. principles-based accounting standards. Two major questions in accounting regulation are: which type of standard allows for the optimal use of judgement and which results in optimal fair representation and comparability? Historically, the FASB has promulgated rules-based standards and the IASB has tended more toward a principles-based approach. In recent years however, partly because the FASB and IASB are in the process of converging accounting standards and partly because rules-based standards have in some cases eroded judgement and ill served faithful representation of economic substance, some United States professional leaders have admitted to the failure of rules-based accounting. "An ideal standard is one that is principles-based and requires financial reporting to reflect the economic substance, not the form, of the transaction"(Herdman 2002). "Professional judgement is required by all accounting standards, but more in principles-based standards than rules-based standards" (Bennett, Bradbury and Prangnell 2006).

European leaders caution that "A principles-based standard relies on judgements" (Tweedie 2007) and empirical studies have found evidence that principles-based standards do indeed enable more judgement; but they do not necessarily lead to greater comparability, representational faithfulness, or substance-over-form (Psaros and Trotman 2004, Rentfro and Hooks 2004, Jamal and Tang 2010, McEnroe and Sullivan 2012).

2.3 Objectives-based accounting standards. The United States Securities and Exchange Commission (SEC), which has authority over the Financial Accounting Standards Board (FASB) and also participates as a leader in the IASB standards setting process, promotes "objectives-oriented standards," which are between the two extremes of rules-based and principles-only standards. The SEC claimed that principles-only standards do not provide enough guidance on how to implement the standards or use judgement, and rules-based standards can be used to circumvent principles (SEC 2003). If objectives-based standards are followed, the range of judgements required in accounting decisions will be narrowed and comparability will be improved (SEC 2003).

According to the SEC Report, objectives-based standards are the optimal type of standard and would have the following characteristics:

Be based on an improved and consistently applied conceptual framework;

- Clearly state the accounting objective of the standard;
- Provide sufficient detail and structure so that the standard can be operationalized and applied on a consistent basis;
- Minimize exceptions from the standard;
- Avoid use of percentage tests ("bright-lines") that allow financial engineers to achieve technical compliance with the standard while evading the intent of the standard.

In our study we analyze IASB standards and exposure drafts to assess the extent to which they have achieved the goals of objectives-based standards, keeping in mind that "...the format of standards is related to their contents" (Benston, Bromwich and Wagenhofer 2006). In addition, given that objectives-based standards "must be based on an improved and consistently applied conceptual framework" (SEC 2003), we try to identify whether the IFRS and EDs issued after the new joint CF (2010) are more objectives-based than those issued before.

To the extent that the IASB standards and exposure drafts are objectives-based, we would expect they would be consistent with the new CF, having few bright-lines and with few exceptions; and also that they clearly state the accounting objective. Furthermore, they should provide, either in the main body of the standard or in adequate application guidance, a structure to frame judgement.

3. The Role of Judgement in the Conceptual Framework

Chapter 1, The Objective of General Purpose Financial Statements, provides the link between judgement and concepts (IASB 2010a). First the statement notes that the qualitative characteristics and other concepts in the Framework follow from the objective (OB1). Subsequent paragraphs state the objective and reveal how the link between judgement and concepts should be applied in meeting that objective:

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. (OB2)

Further OB11 states the role of the concepts and judgement in meeting the objective: To a large extent, financial reports are based on estimates, judgements and models rather than exact depictions. The *Conceptual Framework* establishes the concepts that underlie those estimates, judgements and models. The concepts are the goal towards which the Board and preparers of financial reports strive.

The IASB is guided by the CF in setting standards (IASB 2010a). Thus, preparer judgement should be enhanced after the new CF in 2010.

4. Methodology

We assess the following questions in the following order to determine whether IASB documents are "objectives-based." First, do the IFRS and EDs clearly state an accounting objective? Second, is there adequate and appropriate application guidance but not so much guidance that the standard as a whole effectively becomes rules-based. Third and fourth, are the IFRS and EDs based on the CF and do they provide a structure for exercising judgement. We address questions 3 and 4 by discussing each IFRS and ED separately.

Table 1: Analysis of IFRS

Last non-minor amend-ment (a)	IFRS (b)	Title of Standard (Page length) [Application Guidance in paragraphs] (c)	FREQUEN- Judgement (d)	CIES OF Relevance (e)	TERMS Shall Disclose (f)	Objectives-based? (g)
May, 2011	IFRS 13	Fair Value Measurement (46) [47]	8 [5 times in App. B]	16	11	Yes
May, 2011	IFRS 12	Disclosures of Interests in Other Entities (23) [26]	8 [0 in app B)	9	31	Yes
May, 2011	IFRS 11	Joint Arrangements (28) [37]	4 [2]	32	3	Yes
May, 2011	IFRS 10	Consolidated Financial Statements (48) [99]	2 [2]	93	1	Yes
2005-2011	IFRS 7	Financial Instruments—Disclosures (42)[53]	6 [2]	13	54	Yes
Sept. 2010		Chapters 1 and 3 of Conceptual Framework				
2009	IFRS 9	Financial Instruments: Classification and Measurement of Financial Assets and Financial Liabilities (68) [n/a]	0 [0]	17	2	No
2006	IFRS 8	Operating Segments (18) [0]	2 [0]	1	13	No
2005	IFRS 4	Insurance Contracts (30) [30]	0 [0]	19	11	No
2004	IFRS 6	Exploration for and Evaluation of Mineral Resources (12) [0]	0 [0]	4	4	No
2004	IFRS 5	Non-current Assets Held for Sale and Discontinued Operations (20) [1]	0 [0]	1	9	No
2004	IFRS 3	Business Combinations(50) [69]	0 [0]	10	17	No
2004	IFRS 2	Share-based Payments (42) [61]	0 [0]	3	12	No
2003	IFRS 1	First-time adoption of International Financial Reporting Standards (34) [B-E]	1 [0]	0	15	No

Table 2: Analysis of Exposure Drafts Outstanding at October 2012

Date	TITLE of Exposure Draft (page length)	Judgement	Relevance	Shall Disclose	Objectives-based ?
Nov., 2011	Revenue from Contracts with Customers (89)[130]	14 [0]	3	16	Yes
2011, April	Investment Entities(50) [20]	1 [0]	9	6	Yes
2010, Dec.	Hedge Accounting (65) [82]	2 [2]	8	6	Yes
2010, Sept.	Chapters 1 and 3, Conceptual Framework				
2010, Aug.	Leases (67) [31]	4 [0]	6	15	Yes
2010, July	Insurance Contracts (88) [110]	7 [6]	21	18	Yes
2009, Dec.	Financial Instruments: Amortized Cost and Impairments (48) [34]	4 [0]	10	10	No

In Tables 1 and 2 we arrange the IFRS and Exposure Drafts, respectively, in reverse date order, the date being the last date of a non-minor amendment to the standard. The total number of documents examined is nineteen.

As a point of departure, in Tables 1 and 2 the frequencies of the terms "judgement," "relevance" and "shall disclose" are recorded in columns (d), (e), and (f). We observe the frequency of "judgement" only as an initial indicator that judgement is addressed in the standard and "relevance" only as an initial indicator that the document is based on the CF. "Shall disclose" is used to help identify what may be referred to as disclosure standards, which may be expected to have less discussion of how and when to use judgement because they require fewer recognition and measurement decisions. We perform additional analysis of each document to determine if it is based on the CF and provides a framework for judgement. Our assessment of whether or not the document is objectives-based is in column (g). In column (c) where the title of each document is provided, we show the page length of each document in parentheses and the paragraph length of the application guidance in brackets. This information will serve as a guide to determine further if there is adequate and sufficient application guidance. There were no significant exceptions or bright-lines, so they are neither addressed in the tables nor in our discussion.

5. Analysis

5.1 Question 1: Do the IFRS and Exposure Drafts clearly state the accounting objective? The only standard that did not provide an "objective" is IFRS 8, "Operating Segments" (IASB 2006), which is currently under review. However, IFRS 8 did provide a "Core Principle" in paragraph 1: "An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates." All six of the Exposure Drafts state an Objective. The objective in the "Leases" ED is in paragraph 4 and "Revenue from Contracts with Customers" states the objective in paragraph 8. The other four Exposure Drafts state the objective in paragraph 1, similar to most of the IFRS. The objective of each document is quoted below in the more expansive answers to Questions 3 and 4.

5.2 Question 2: Do the IFRS and Exposure Drafts provide adequate and appropriate application guidance? Only three IFRS appear to lack adequate application guidance: IFRS 8, "Operating Segments" (2006) and IFRS 6, "Exploration and Evaluation of Mineral Resources" (2004) provide no application guidance; IFRS 5, "Non-Current Assets Held for Sale and Discontinued Operations" (2004) consists of only a single paragraph in appendix B which discusses the extension of the period required to compete the sale of an asset and still be classified as held for sale.

IFRS 1, "First time Adoption of International Financial Reporting Standards contains several appendices in addition to the usual Appendix A Defined Terms, but none are called "Application Guidance." For example: Appendix B discusses Exceptions to the retrospective application of other IFRSs; Appendix C discusses Exemptions for business combinations; Appendix D discusses Exemptions from other IFRSs; and Appendix E discusses Short-term exemptions from IFRSs.

All the EDs provide adequate application guidance. Thus, with the exception of IFRS 8, 6, and 5, there appears to be adequate application guidance. Whether the guidance is appropriate or whether it is too rules-based will depend on whether it constrains judgement. For example, IFRS 13 Fair Value Measurement (IASB 2011e) and Exposure Draft Insurance Contracts (IASB 2010b) discuss judgement numerous times in the application guidance. As we discuss these documents below we will assess whether the guidance is in so much detail that it is more rules-based than objectives-based.

5.3 Questions 3 and 4: Is each document based on the CF and does it provide a framework for judgement? To assess the answer to these questions, we analyze each document separately. We use "Relevance" as an indicator to reflect the extent to which the document is based on the CF and "Judgement" as an indicator to determine whether a framework for the structure for judgement is provided. We then analyze each document with more scrutiny to determine whether it is based on the CF and whether it describes when and/or how to use judgment. Our discussion of the IFRS and EDs begins with the IFRS (Table 1), addressed in order of most recent date of significant amendment; and then the EDs (Table 2) also addressed in reverse date order.

5.3.1 IFRS 13, Fair Value Measurement (IASB 2011e): The objective of IFRS 13 is clearly stated:

> ... (a) defines fair value; (b) sets out in a single IFRS a framework for measuring fair value; and (c) requires disclosures about fair value measurement. (para. 1)

As seen in Table 1, the CF as reflected by references to relevance is referred to several times, both in explaining what is not relevant and what is relevant. For example, an entity's intention to hold an asset or to settle or otherwise fulfill a liability is not relevant when measuring fair value (IN9). Also:

> ... The valuation technique(s) used should maximise the use of relevant observable inputs and minimise unobservable inputs. Those inputs should be consistent with the inputs a market participant would use when pricing the asset or liability. (IN 10d)

Judgement is framed three times in the main body of the standard. Each time addresses the level of the measurement in the hierarchy. First, when inputs from more than one level of the hierarchy are used, judgement is exercised to determine the lowest level that is significant to the particular asset or liability. Then that lowest level is the level of the measurement (para. 73). Also, judgement about whether different measurement effects need to be disclosed for Level 3 measurements is based on the effect relative to total assets, net income or changes in comprehensive income (para. 93 (h) ii). Finally, the standard cautions that when determining the number of classes for Level 3 measurements, judgement is used because there is more uncertainty and subjectivity (para.94).

More structures for judgement address the approaches to fair value measurement and they are in Appendix B, "Application Guidance." The first issue discusses the ranges to select when using the market approach and suggests that both qualitative and quantitative factors be considered and allows the matrix model as a possible quantitative measurement approach (B5-7). The second issue for judgement arises when considering the present value approach. The question is about whether Method 1 or Method 2 is better, given the facts and circumstances, data available and judgements applied for the specific asset or liability (B29-30). The last guidance about judgement concerns how to measure fair value when there has been a significant decrease in volume (B42).

To sum up, IFRS 13, Fair Value Measurement is based on the CF and provides a structure to frame judgement and is therefore, objectives-based. The application guidance is not so detailed as to render the standard more rules-based than objectives-based.

5.3.2 IFRS 12, Disclosures of Interests in Other Entities (IASB 2011d): The objective of IFRS 12 is to require:

> .. an entity to disclose information that enables users of its financial statements to evaluate: (a) the nature of, and risks associated with, its *interests in other entities*; and (b) the effects of those interests on its financial position, financial performance and cash flows. (Para.1)

Appendix A defines a structured entity based on who controls the relevant activities of the entity. Paragraph B1 states that all relevant facts and circumstances of a particular fact pattern should be evaluated. In discussing the nature of risks from interests in unconsolidated structured entities, B26 provides examples

"...of additional information that, depending on the circumstances, might be relevant to an assessment of the risks to which an entity is exposed...". IFRS 12 is based on the CF.

Paragraph 2 requires disclosure of the significant judgements and assumptions made in determining the nature of an entity's interest in another entity, arrangement and type of joint arrangement, and unconsolidated structured entities. A framework for the level of detail of the disclosure is provided in paragraphs B2-6. B7-9 provides guidance on how to decide if an entity has an interest in another entity. B 21-24 provides guidance on disclosure for interests in structured entities and the nature of risks from interests in unconsolidated structured entities.

Paragraphs 7, 8 and 9 are about how the entity determined the status of the investee. The entity should disclose significant judgements and assumptions (and changes to those judgements and assumptions) in determining whether its interest in the other entity is consolidated, equity method, or joint operation/joint venture (para. 7). Paragraph 8 requires disclosure of judgements and assumptions that were made when changes in the factors or circumstances affected investee status. Paragraph 9 requires the entity to explain why it does not control another entity when it owns more than half the voting rights; or why it does control another entity when it owns less than half the voting rights. Paragraphs 10 through 19 provide guidance for judgement on disclosure of interests in subsidiaries. Paragraphs 20-23 provide guidance for judgement on disclosure of interests in joint ventures and associates. Also judgements and assumptions made in determining that it is an agent or principal need to be disclosed.

In summary, IFRS 12, is a disclosure standard that is objectives-based because it is based on the CF and provides a framework for how to make judgements and provide the disclosure.

5.3.3 IFRS 11, Joint Arrangements (IASB 2011c). The objective of IFRS 11 is:

> ..to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly. (para. 1)

The standard is based on the CF. Relevance is a fundamental qualitative characteristic of this standard. The very definition of a joint arrangement is based on joint control and joint control is based on relevance:

> the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities (ie activities that significantly affect the returns of the arrangement) require the unanimous consent of the parties sharing control. (IN6)

Extensive application guidance is provided to assist in judgement about whether an entity in a joint arrangement is a joint operator or a joint venturer. Why is this so important? The accounting for each is different: the joint operator recognizes assets, liabilities, revenues and expenses according to its interest in the arrangement; the joint venturer applies IAS 28, "Investments in Associates and Joint Ventures," which usually means that the entity uses the equity method of accounting for its investment unless there is an exemption.

For joint control to exist decisions about activities that significantly affect the returns of the arrangement require the unanimous consent of the parties sharing control. Implementation guidance B5-B11 addresses how to use judgement in that assessment. Second, judgement is also required when assessing whether an arrangement is a joint venture or a joint operation (para.17). Paragraphs B12-B33 provide extensive implementation guidance, including examples and flow charts, about how to use judgement in making determinations. For example. Paragraph B14 distinguishes between the two classifications and B15 lists factors to consider in the classification of joint arrangements; B16-21 discusses two structures of joint arrangements; B22-B26 provide guidance on the legal form of a separate vehicle; B27 provides an extensive table to guide in the determination of whether the arrangement is a joint venture or a joint operation; and so on (see Table I).

Our analysis reflects that IFRS 11, Joint Arrangements, is based on the CF and provides a structure to frame judgement through extensive application guidance and is thus an objectives-based standard.

5.3.4 IFRS 10, Consolidated Financial Statements (IASB 2011b). The objective of IFRS 10 is:

> ...to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. (para. 1)

The standard defines how to determine if an entity has "control" over another entity or entities. If the entity has control then the financial statements must be consolidated. Most of the judgement issues relate to the determination of control. Control of the relevant activities of the entity is a significant factor. The standard sets out three elements of control: (a) power over the investee; (b) exposure, or rights, to variable returns from involvement with the investee; and (c) the ability to use power over the investee to affect the amount of the investor's returns (IN8). To have power over an investee, an investor must have existing rights that give it the current ability to direct the relevant activities. For the purpose of assessing power, only substantive rights and rights that are not protective shall be considered (see paragraphs B22–B28). For a right to be substantive, the holder must have the practical ability to exercise that right (B22). Determining whether rights are substantive requires judgement so B3 lists several factors to consider in the determination of substantive rights. B24 provides 4 examples. With regard to exercising judgement in determining whether an entity has power over another entity through substantive rights the standard provides ample and sufficient guidance in appendix B.

Since only one entity can have control over any other specific entity. Judgement is also required in assessing how to consider an entity's relationship with other entities to determine which entity has control. Paragraphs B73 states: The determination of whether other parties are acting as de facto agents requires judgement, considering not only the nature of the relationship but also how those parties interact with each other and the investor. B75 lists six factors examples of when other parties may be acting agents for the investor. Thus, once again the application guidelines provide a structure to judge control. Also the standard is based on the CF. IFRS 10 is an objectives-based standard.

5.3.5 IFRS 7, Financial Instruments: Disclosures (2011a). The objective of IFRS 7 is to require:

> ...disclosures that enable users to evaluate: (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks (para.1).

IFRS 7 is based on the CF and places responsibility for determining relevance on the entity. For example, disclosure is required:

> ...if the entity believes that the disclosure it has given, either in the statement of financial position or in the notes ...does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant. (para. 11b)

Other examples are that the entity is required to disclose significant accounting and measurement bases that are relevant to understanding the statements (para. 21); and when discussing a sensitivity analysis of market risk the entity must show the effect on profit or loss and equity of changes in relevant risk variables such as prevailing market interest rates, currency rates, equity prices or commodity prices (B18).

In this disclosure standard, as expected, "shall disclose" is mentioned numerous times. But given the recent date of the last significant amendment (2011), which is after the date of Phase I of the CF (2010) it is not surprising that judgement is required to be exercised in several disclosure decisions; for example, in making specific disclosures about when fair values of a contract containing a discretionary participation feature cannot be measured reliably (para.29-30). In addition disclosures about judgements that have the most significant effect on the financial statements (B5) are required. A structure for judgement is provided in lists of quantitative disclosures about concentrations of credit risk (B8), and the determination of the appropriate number of time bands for maturity of financial liabilities (B11) and transferred financial assets in their entirety but with continuing involvement (B35). IFRS 7 is based on the CF and provides a framework for judgement. Thus it is an objectives-based accounting standard.

5.3.6 IFRS 9, Financial Instruments (2009a): Recognition and Measurement (IASB. The financial instruments project consisted of three phases: Recognition and Measurement, Impairment Methodology, and Hedge Accounting. Chapters on financial assets were added in 2009 and those on financial liabilities, including requirements on embedded derivatives and own credit risk were added in 2010.

At October, 2012, Phase II and Phase III are still incomplete. IFRS 9 included only Phase 1, Recognition and Measurement, which we analyze here. The objective is:

> ...to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows. (para.1)

All financial assets are initially measured at fair value and classified on the basis of the entity's business model and the contractual cash flow characteristics (the same as IAS 39). Requirements for measuring and recognizing financial liabilities were similarly carried forward from IAS 39, with the exception that fair value measurement is also required for derivative liabilities that are linked to and must be settled by delivery of equity instruments that do not have a quoted price in an active market for an identical instrument. Additionally, under the new standard, effects of changes in a liability's own credit risk do not affect profit or loss unless the liability is held for trading (added in 2010). A flow chart is presented in B3.2.1 to illustrate how to determine whether and to what extent a financial asset should be derecognized (derecognition was added in 2010). B3.2.16 provides examples that illustrate derecognition principles. Although application guidance is provided in B3.1-B7.2, there is no discussion about when and how judgement should be exercised in applying the principles mentioned in the objective.

Concepts are addressed numerous times. For example, relevance is mentioned several times in connection with the option to designate financial liabilities at fair value through profit and loss (B4.1.11-4.1.32). Relevance is also the major deciding factor in determining whether cost may be used to measure investments in equity instruments and contracts on those investments (B5.4.16); and liabilities (B5.7.18 and B5.7.20). "Reliable" is mentioned four times with regard to embedded derivatives.

In summary, IFRS 9 is based on the CF. However, since there is no acknowledgment that judgement should be exercised in applying Phase I, IFRS 9 is not an objectives-based standard.

5.3.7 IFRS 8, Operating Segments (IASB 2006). A core principle is stated:

> An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. (para. 1)

As expected in a disclosure standard, the term "shall disclose" is applied to various items thirteen times, while the term judgement is only mentioned a couple of times: once because judgement is required when deciding if an operating segment that no longer meets the reporting criteria is still reportable (para. 17) and once when assessing whether a government and entities under the control of that government are to be treated as a single customer (para. 34). No framework for judgement is provided in this disclosure standard so it is not an objectives-based standard.

5.3.8 IFRS 4, Insurance Contracts (IASB 2005). The objective of IFRS 4 is:

> ...to require (a) limited improvements to accounting by insurers for insurance contracts, (b) disclosure that identifies and explains the amounts in an insurer's financial statements arising from insurance contracts and helps users of those financial statements understand the amount, timing and uncertainty of future cash flows from insurance contracts. (para 1)

IFRS 4 is viewed as a stepping stone to Phase II of the IASB's insurance contracts project. The term "shall disclose" is used more often than the term judgement, which does not appear even once in IFRS 4. IFRS 4 is not an objectives-based standard.

5.3.9 IFRS 6: Exploration and Evaluation of Mineral Resources (IASB 2004d). The objective of IFRS 6 is:

> ...to specify the financial reporting for the exploration for and evaluation of mineral resources. (para.1)

IFRS 6 is a very narrow and brief (only 12 pages) and is industry specific. There is no framework for judgement and it is not an objectives-based standard.

5.3.10 IFRS 5: Non-current Assets Held for Sale and Discontinued Operations (IASB 2004c). The objective of IFRS 5 is:

> ...to specify the accounting for assets held for sale, and the presentation and disclosure of discontinued operations. (para.1)

As with other disclosure-type standards the term "shall disclose" is mentioned often. There is only insignificant application guidance in paragraph B1. As there is no framework for using judgement, IFRS 5 is not an objectives-based standard.

5.3.11 IFRS 3: Business Combinations (IASB 2004b). The objective of IFRS 3 is:

> ...to improve the relevance, reliability and comparability of the information that are porting entity provides in its financial statements about a business combination and its effects. To accomplish that, this IFRS establishes principles and requirements for how the acquirer (a) recognises and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquire; (b) recognises and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. (para.1)

In efforts to meet the objectives in part (a) and (b) concepts are discussed numerous times, so this standard is based on a CF. To meet the disclosures in part (c), "full disclosure" is mentioned frequently. Although there is extensive application guidance in Appendix B judgement is not mentioned; nor is there a framework for judgement. IFRS is not an objectives-based standard.

5.3.12 IFRS 2: Share-based Payments (IASB 2004a). The objective is:

> ...to specify the financial reporting by an entity when it undertakes a share based payment transaction. In particular, it requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to employees. (para. 1)

IFRS 2 requires share-based payments to be recognized at fair value when goods or services are received. As a consequence "fair value" is discussed 160 times in the standard. "Shall disclose" is also mentioned frequently. Relevance is cited when setting the price of options granted to employees; for example, the standard excludes factors that a knowledgeable, willing market participant would not consider (B10). Contrary to what would be expected when fair value measurements are required, "judgement" is not mentioned in the standard nor is there a framework for judgement. Thus, IFRS 2 is not an objectives-based standard.

5.3.13 IFRS 1: First-time Adoption of International Financial Reporting Standards (IASB 2003). The objective of IFRS 1 is:

> ...to ensure that an entity's first IFRS financial statements, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that: (is transparent for users and comparable over all periods presented; (b) provides a suitable starting point for accounting in accordance with International Financial Reporting Standards (IFRS); and (c) can be generated at a cost that does not exceed the benefits. (para. 1)

IFRS 1 is a disclosure-type standard and is generally rules-based. Judgement is only mentioned once when stating that retroactive restatement is prohibited if it would require judgements by management about past conditions after the outcome is known (IN5). IFRS 1 is not an objectives-based standard.

5.4 Exposure Drafts

5.4.1 ED, 2011, Revenue from Contracts with Customers (IASB 2011f). The objective of this [draft] IFRS is:

> …to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer. (para. 8)

This standard is concerned with when to recognize revenue from goods and services. Relevance of cash flows from revenue is assumed, so the CF focus in the standard is on recognition, which is addressed frequently (229 times). For example, paragraph 47 says that an entity must have reliable information if it is to measure progress towards satisfaction of a performance obligation. Paragraphs 71 and 74 state that as soon as an entity can measure the amount of a probable inflow from a dividend reliably it may recognise it in profit or loss.

Judgement plays a major role in this ED. Judgement is required in applying the standard consistently (para. 5); and in determining whether consideration is predictive (para. 82-83). The entity must disclose judgement and changes in judgements made regarding the timing of the satisfaction of performance obligations (para 125 and 126) and the transaction price and the amounts allocated to performance obligations (para. 127). In addition to discussions of when to use judgement, there are 130 pages of application guidance that illustrate and discuss how to apply the objectives and principles to specific types of transactions.

In summary, the Exposure Draft is based on the CF and provides a framework for judgement. It is objectives-based.

5.4.2 ED, 2011, Investment Entities (2011g). The objectives are:

> ...(a) to specify the criteria for determining when an entity is an investment entity; and (b) to specify how an investment entity shall account for its investments. (para. 1)

The major issue is whether investment entities need to consolidate entities they control or should they measure them at fair value through profit or loss under IFRS 9, 2010. The focus is on relevance. For example; BC 28 states that the board's objective is to identify entities for which fair value measurement of investments would be more relevant.

The Board concluded that investment entities should measure investments at fair value through profit or loss. The Alternative Views of Warren J McGregor, Sir David Tweedie and Tatsumi Yamada were that fair value of investees would provide less relevant information than consolidation. This ED is an example of how judgement underlies relevance and how reasonable people can disagree on the optimal judgement.

The Exposure Draft will be incorporated into IFRS 10, "Consolidated Financial Statements" and IFRS 12, "Disclosure of Interests in Other Entities." The exposure draft requires judgement in determining whether the number of investments is sufficient for the entity to be considered an investment entity. The investment must meet all of the six criteria provided to be exempted from required consolidation (para. 2). Appendix B explains how to apply the criteria. Therefore, the Exposure Draft is based on the CF and provides a framework for judgement. It is objectives-based.

5.4.3 ED, 2010, Hedge Accounting (IASB 2010d). The objective of hedge accounting is:

> ...to represent in the financial statements the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss. This approach aims to convey the context of hedging instruments in order to allow insight into their purpose and effect. (para.1)

The CF focus of the exposure draft is on relevance and adequate disclosure. For example: the determination of appropriate risk components requires an evaluation of the relevant facts and circumstances (IN9). Disclosures about hedging provide information relevant to determining hedging relationships (IN32). In determining whether the requirements for hedge effectives are met, an entity shall use a method that captures the relevant characteristics of the hedging relationship including the sources of hedge ineffectiveness (B33).

Judgement is required when evaluating whether there is a change in the relationship between the hedged item and the hedging instrument (B50); and when rebalancing the hedge ratio when adjusting the ratio would reduce the likelihood of ceasing to meet the objective in the medium term (B59). B46 provides a flow chart for evaluating when to rebalance and when to discontinue hedge accounting. Altogether there are 82 paragraphs of application guidance. The exposure draft is objectives-based because it is based on the CF and states when and how to exercise judgement.

5.4.4 ED, 2010, Leases (IASB 2010c). The objective is:

> ...to establish principles that lessees and lessors shall apply to report relevant and representationally faithful information to users of financial statements about the amounts, timing and uncertainty of the cash flows arising from leases. (para. 4)

As stated in the objective, the main focus of the standard is relevance and representationally faithful information. The exposure draft proposes the capitalization of almost all leases. There are several examples in the application guidance.

The entity is required to disclose the judgements made in determining amortisation methods (para. 73); and renewal options, contingent rentals, term option penalties, residual value guarantees and the discount rate used (para. 83). The exposure draft is based on the conceptual framework and provides a framework for judgement. Therefore, it is objectives-based.

5.4.5 ED, 2010, Insurance Contracts (IASB 2010b). The objective is:

> ...to establish the principles that an entity should apply to report useful information to users of its financial statements about the amount, timing and uncertainty of cash flows from: (a) insurance contracts that it issues, (b) reinsurance contracts that it holds, and (c) financial instruments containing discretionary participation features that it issues. (para. 1)

The principles of focus are relevance and faithful representation, which are discussed frequently. There are numerous requirements regarding disclosure. Appendix B, Application Guidance, is appropriate and sufficient.

Judgement is required when disclosing a measurement uncertainty analysis of the inputs that have a material effect; specifically when considering the effects of correlations in judging materiality with respect to profit or loss (para. 90(d)). Judgement is used when determining when the contract is an insurance contract; that is, if a contract pays a death benefit exceeding the amount payable on survival (B29). Judgement is required to determine which technique is best in estimating the fair value of an insurance contract (B47); in determining the confidence level for particular insurance contracts (B75-79); and in determining the Conditional Tail Expectation band for portfolios (B80-83). Finally, judgement is used in the selection of the most appropriate risk adjustment technique for a contract (B92).

Application guidance for the definition and measurement of insurance contracts is ample and describes how and when to use judgement. The application guidance, although in significant detail, does tend to be more rules-based than the guidance provided in other documents. However, the guidance does not render the document effectively rules-based.

In summary, the ED on Insurance contracts is based on the Conceptual Framework and provides a framework for judgement. Thus it is objectives-based.

5.4.6 ED, 2009, Financial Instruments: Amortised Cost and Impairments (2009b). The objective of this [draft] IFRS is:

> …to establish principles for the measurement at amortised cost of financial assets and financial liabilities that will present useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of future cash flows. The principles in this [draft] IFRS complement the principles for recognising, classifying, measuring, presenting and providing disclosures about financial assets and financial liabilities in IAS 32 Financial Instruments: Presentation, IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures. (para. 1)

Although this ED is one of the most complex of all of the IFRS and ED documents analyzed here there is very little guidance on how to use judgement, except once in B5 where the entity is required to disclose the judgements that would have a significant effect on the amounts recognized. Judgement is mentioned three more times in IN7 to explain why the ED does not provide a framework for judgement—namely because the Board will seek advice on the nature and extent of guidance they should provide. This initial failure to provide adequate guidance and a framework for judgement doomed the Exposure Draft from the beginning, deeming it non-operational. As of October, 2012 the Board is deliberating on a new ED that will provide a much improved framework for judgement. However, asit now is written this ED is not objectives-based.

6. RESULTS

The results reflected in Tables 1 and 2 indicate that the five IFRS issued after the CF (2010) are objectives-based while the eight issued before the CF are not.. Specifically, the objectives-based IFRS clearly stated the objective, are based on the CF without significant exceptions and bright-lines; and provide adequate application guidance. More significantly, a framework for judgement is provided. The results for the EDs are similar: only ED, 2009, Financial Instruments: Amortised Cost and Impairments, which was issued one year before the CF (2010), is not objectives-based.

7. LIMITATIONS OF THE STUDY

The major limitation of the study is that classification of each IASB document according to whether it was "objectives-based" or not, was partially subjective. Another limitation is that we used "relevance" as an indicator to surrogate for the conceptual framework, except in the case of the ED on "Revenue from Contracts from Customers," where recognition was used because we thought relevance was assumed.

There may be another explanation why IASB documents appear to be more objectives-based after the CF (2010); for example, IFRS 12 Disclosures of Interests in Other Entities, IFRS 7 Financial Instruments—Disclosures, and IFRS 8 Operating Segments focus on disclosures. One could argue perhaps that disclosure-type standards require less judgement. However, IFRS 8, which was promulgated before the CF of 2010 is not objectives-based; while IFRS 7 and IFRS 12 are objectives-based, implying that disclosure-type standards are also objectives-based after 2010.

8. Conclusion

An increasingly complex financial environment demands accounting standards that narrow the range of professional judgements in accounting decisions. Although new accounting principles and approaches do not eliminate the necessity of judgements entirely, the IASB's process of improving transparency and comparability of financial reporting hinges on its ability to promote professional judgment. Its abillity depends on the standard setter and the practitioners. The IASB is issuing more objectives-based standards that provide a framework for judgement. Professional accountants, auditors and managers need to be cognizant of the IASB's efforts so they can cooperate in the pursuit to judgement.

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