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Assessing financial reporting comparability across institutional settings: The case of pension accounting

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ABSTRACT

The drive for comparability of financial information is to enable users to distinguish similarities and differences in economic activities for an entity over time and between entities so that their resource allocation decisions are facilitated. With the increased globalisation of economic activities, the enhanced international comparability of financial statements is often used as an argument to advance the convergence of local accounting standards to international financial reporting standards (IFRS). Differences in the underlying economic substance of transactions between jurisdictions plus accounting standards allowing alternative treatments may render this expectation of increased comparability unrealistic. Motivated by observations that, as a construct, comparability is under-researched and not well understood, we develop a comparability framework that distinguishes between four types of comparability. In applying this comparability framework to pension accounting in the Australian and USA contexts, we highlight a dilemma: while regulators seek to increase the likelihood that similar events are accounted for similarly, an unintended consequence may be that preparers are forced to apply similar accounting treatment to events that are, in substance, different.

1. Introduction

The worldwide drive for developing and implementing international accounting standards has its genesis in the globalisation of economic activity, which led to "increased demand for high quality, internationally comparable financial information" (Australian Accounting Standards Board (AASB), 2002, PS 4: paragraph 2). An objective of the International Accounting Standards Board (IASB) is

> "…to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions". (International Accounting Standards Committee Foundation, 2007, p. 43).[1]

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[1] The forerunner to the IASB, the International Accounting Standards Committee's (IASC) 1973 Agreement and Constitution (paragraph 1) did not refer directly to comparability of financial statements nor to the users of the financial statements, but instead referred to worldwide acceptance and observance of financial statements. It was not until November 1988 that the IASC approved exposure draft E32: Comparability of Financial Statements (Camfferman & Zeff, 2006, p. 262).

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In this context, 'comparability' is a key factor in achieving the decision usefulness of financial information. Until relatively recently, comparability of financial information has been considered one of the four *principal* qualitative characteristics (with relevance, reliability and understandability) in international and national conceptual frameworks that together make information in financial reports useful for decision-making.[2] While comparability is now viewed as an 'enhancing', rather than a 'fundamental' characteristic in the IASB (2010b) conceptual framework, it is nevertheless essential for financial information to be useful. Comparable information enables users to evaluate trends in an entity's financial position and performance over time, and evaluate those aspects in relation to other entities at one point in time and through time (IASB, 2010b: paragraph QC20). Thus, comparability exists when users of financial information are able to distinguish similarities and differences in economic activities within an entity and across entities. Expectations of inter-entity comparability now extend beyond national boundaries for those countries that have adopted international financial reporting standards (IFRSs).

This paper is motivated by the dearth of literature on comparability (Parker, 1975; Revsine, 1985), and observations that comparability is a construct which is not well researched (Schipper & Vincent, 2003, p. 104) or well understood (Zeff, 2007, p. 290). The IASB/Financial Accounting Standards Board (FASB)'s (2008) exposure draft on an improved conceptual framework and the IASB's (2010b) Conceptual Framework for Financial Reporting highlight the need to improve comparability of financial information by reducing any (unintended) dysfunctional consequences that may flow, for example, from an over-emphasis on uniformity or permitting too many accounting options for the same transaction (IASB & FASB, 2008: paragraphs QC18 and QC19; IASB, 2010b: paragraphs QC23 and QC25). Yet, as Zeff (2007, p. 290) comments, comparability is a somewhat elusive concept in that we do not really know "when we have it, and when we do not". Schipper (2003, p. 71) suggests that, as a first step, an assessment of the understanding of the current state of comparability is needed.

We address these concerns by first developing a comparability framework to distinguish different types of comparability and then apply that framework to pension accounting. Our comparability framework distinguishes between four types of comparability: "surface" comparability (Schipper, 2003, p. 67), "deep" comparability, "non-convergent" comparability and "intrinsic differences" comparability (see Fig. 1 in Section 2). We identify surface comparability and non-convergent comparability as carrying (potentially) dysfunctional consequences for financial statement users, while deep and intrinsic differences comparability do not. The IASB's 2010 conceptual framework also warns of the need to reduce surface and non-convergent comparability type events, although they do not employ this exact terminology (IASB, 2010b: paragraphs QC 24–25).

Our analysis highlights how non-comparability can arise from implementing essentially the same accounting standard across different jurisdictions (surface comparability), and arise from the number of available options in the international accounting standards to represent a single event (non-convergent comparability). Accounting for defined benefit pension (DBP) funds provides an appropriate context for an investigation of comparability given that the IASB (2008a) is concerned about options in accounting standards that permit deferring the recognition of employee benefits, including pensions, leading to a lack of comparability. Also, the varying social and institutional arrangements for DBP funds across jurisdictions potentially change the underlying economic substance of the pension transaction so that global pension accounting standards may create a false appearance of increased comparability. Surface comparability that reduces inter-jurisdictional comparability may result.

The USA and Australian settings are chosen to compare pension accounting standards because, although similar on many economic and social dimensions, their differing institutional arrangements alter the underlying substance of the pension transaction, potentially leading to surface comparability between these two jurisdictions. Both pension accounting standards also permit options for the treatment of actuarial gains and losses (AGL), which can lead to non-convergent comparability where both intra- and inter-jurisdictional non-comparability does result.[3] We focus on the number of accounting options permitted for AGL, although the IASB recently announced its intention to eliminate the deferral option (IASB, 2010a, p. 4).[4] This research is timely and contributes to the current debate on improving comparability of financial information with the aim of ensuring "like things … look alike and different things … look different" (IASB, 2010b: paragraph QC23).

Our comparability framework, outlined in the next section, considers how accounting standard setters may better assess comparability in practice. Section 3 discusses the varying social and institutional pension contexts in the USA and Australia that affect the underlying economic substance of the DBP transaction and considers how these differing origins influence their accounting for the pension transaction. We apply our comparability framework to pension accounting and identify how underlying institutional differences leads to inter-jurisdictional non-comparability (that is, surface comparability), and allowing options for AGL leads to both inter- and intra-jurisdictional non-comparability (that is, non-convergent comparability). In Section 4 we conclude that assessments of comparability are incomplete if they do not consider the four-way analysis of comparability developed in this paper. The broad approach of the IASB that overlooks differences in

[2] The IASB (2010b) now delineates these qualitative characteristics on the basis of those that are 'fundamental' in distinguishing useful and misleading or not useful information, and 'enhancing' characteristics that distinguish more useful information from less useful information. 'Relevance' and 'faithful representation' (instead of 'reliable') are identified as fundamental qualitative characteristics, and 'comparability', 'verifiability', 'timeliness' and 'understandability' are considered enhancing characteristics.

[3] Actuarial gains and losses emerge when actuarial assumptions are not realised or actuarial assumptions change, for example, a change in the discount rate assumption.

[4] The optional accounting treatments for AGL include immediate recognition through the profit and loss, deferral methods such as the "corridor" method (see footnote 8) and recognition through equity statements.