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Interpretation and application of “new” and “complex” international financial reporting standards in Fiji: Implications for convergence of accounting standards

Parmod Chand [a,*], Chris Patel [a,1], Arvind Patel [b,2]

[a] Department of Accounting and Finance, Macquarie University, North Ryde, NSW 2109, Australia
[b] Department of Accounting and Finance, University of the South Pacific, Suva, Fiji

ABSTRACT

This study extends prior research on accounting judgment and decision making research by examining the effects of ‘new’ and ‘complex’ accounting standards on judgments of professional accountants. It examines whether there are differences in judgments of professional accountants in Fiji when interpreting and applying selected International Financial Reporting Standards (IFRSs). A significant within-country difference in judgments of professional accountants has serious implications for convergence of accounting standards. The results show that interpretation and application of accounting standards are affected by complexity of the accounting standard and professional accountant's familiarity with the standard. The study also finds strong support for an interactive effect of familiarity with the accounting standards and complexity in accounting standards on judgments of professional accountants. Furthermore, the results show that differences in judgments exist between the Big 4 and non-Big 4 professional accountants when provided with new accounting standards that require complex judgments. The results of this study are of interest to stakeholders at a time when IFRSs are increasingly being adopted throughout the world and standard setters are struggling to promote compliance with those standards.

1. Introduction

The number of countries adopting the International Accounting Standards (IASs) and International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB) as their national standards is growing.[3] IASs/IFRSs represent a principles-based or ‘substance over form’ regime (Chambers & Wolnizer, 1991; Doupnik & Richter, 2003; Abacus Editorial, 2004). A ‘substance over form’ approach, in contrast to a legalistic approach, is driven by principles and concepts rather than by the application of strict rules. Principles-based accounting standards provide accountants with guidelines which require the application of professional judgment (Brown, Collins, & Thornton, 1993, 275). The existing core IASs and the new generation of IFRSs contain significant recognition and measurement alternatives and incorporate broad guidelines that can be applied in various contexts. To be able to consistently apply these standards, it is crucial to understand the rationale behind the principles espoused in particular standards (Picker et al., 2006, xiii). Therefore, with principles-based IASs/IFRSs, professional judgment is important and the desire for unbiased reporting is paramount (AAA Financial Accounting Standards Committee, 2003; The Institute of Chartered Accountants of Scotland, 2006).

Since a large number of countries are adopting the IASs/IFRSs (Deloitte Touche Tohmatsu, 2009), it is important to examine whether professional accountants in these countries are interpreting and applying the IASs/IFRSs in a consistent manner. The implicit assumption in the convergence of accounting standards is that greater comparability in financial reports across countries will result if they adopt the IASs/IFRSs (Schultz & Lopez, 2001, 273). Apart from the use of a single set of standards, comparability in financial reporting also requires consistent interpretation and application of those standards across countries (Doupnik & Richter, 2003; Doupnik & Riccio, 2006; Tsakumis, 2007). Motivated by the global thrust towards convergence and the implicit assumption that it will achieve international comparability in financial statements, this study examines the importance of consistency in interpreting and applying IASs/IFRSs in a country that has already adopted these standards in Australasia–Fiji.

The Fiji Institute of Accountants (FIA) has adopted a set of standards based on extant IASs and IFRSs, which led to the modification of some of the previous standards and the introduction of new accounting standards. The previous set of standards in Fiji was based on Australian, New Zealand and the IASB standards. For the purpose of this study, the accounting standards that the professional

* Corresponding author. Tel.: +61 2 9850 6137; fax: +61 2 9850 8497.
E-mail addresses: pchand@efs.mq.edu.au (P. Chand), cpatel@efs.mq.edu.au (C. Patel), patel_a@usp.ac.fj (A. Patel).
[1] Tel.: +61 2 9850 7825; fax: +61 2 9850 8497.
[2] Tel.: +679 321 2499; fax: +679 330 1487.

[3] A survey by Deloitte Touche Tohmatsu (2009) reported that almost a hundred countries have adopted or intend to adopt the IFRSs for all their domestic listed companies.

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accountants had historically been applying and were familiar with are denoted as 'old' standards, while the new standards that were introduced are denoted as 'new' standards. This categorization of standards as 'old' and 'new' provides a unique research setting to empirically test the differences in judgments of professional accountants, given both the 'old' and 'new' sets of standards.

Specifically, using a sample of professional accountants from Fiji, this study examines the effects of familiarity with the accounting standards and complexity in accounting standards on judgments of professional accountants. While previous studies have shown that task familiarity has varying effects on professional judgment in various contexts (see Asare & McDaniel, 1996 for a review of these studies), they have not specifically considered whether accountants interpret and apply a 'new' set of standards in a consistent manner. This relationship between a 'new' standard and professional judgment is now paramount given the global thrust towards convergence and the frequency of changes to the IFRSs.[4] Therefore, it is important to consider whether there is consistency in application of both an 'old' and a 'new' accounting standard. Examination of the effects of complexity in accounting standards is also important because a number of countries have found IFRSs to be 'complex' to apply (Devi, 2003; Wong, 2004). For example, the Financial Services Authority (FSA) in the UK allowed a 120-day extension for companies submitting half-year reports under IFRS at 30 June 2005 (FSA, 2004). This example indicates concern by the regulators that companies reporting under IFRS would not be prepared in time because of complexities in interpreting new requirements under IFRSs.

To provide further insights into our analysis we also assess whether the judgments of Big 4 versus non-Big 4 professional accountants are a function of accounting standards that vary in complexity and familiarity.[5] The major reason for the differences in judgments of professional accountants within a country may be attributed to a lack of experience of the non-Big 4 professional accountants in dealing with complex accounting standards. In a similar manner to most other countries, large enterprises in Fiji are mostly audited by the Big 4 accounting firms and the non-Big 4 professional accountants serve the small and medium-sized enterprises. Hence, non-Big 4 professional accountants are not likely to apply complex standards and deal with issues that require greater exercise of professional judgment. Additionally, the non-Big 4 professional accountants may not have access to the same resources and training as do the Big 4 professional accountants. Given these differences between the Big 4 and non-Big 4 accountants, the objective is to test whether there are differences in the judgments of the Big 4 and non-Big 4 professional accountants when interpreting and applying accounting standards that vary in complexity and familiarity.

This study has implications for the convergence of accounting standards. The aim of convergence is that the financial reports are comparable across different countries. However, there are many reasons why comparability in financial reporting is not determined by accounting standards alone (Ball, Kothari, & Robin, 2000; Ball, Robin, & Wu, 2003). Standards require adequate enforcement and judgment is involved in interpreting accounting standards. Yet, adopting the IASB standards is given almost exclusive attention in achieving comparable financial information. If IASs/IFRSs are not applied in a consistent manner then comparable reporting is unlikely to be achieved even if countries have adopted a single set of globally acceptable financial reporting standards. Given the changes in the business environments and the issue of complex principles-based IASs/IFRSs, it will be an onerous task to train professional accountants to interpret and apply these standards in a consistent manner (Bedard, 1991; Earley, 2001; Vera-Munoz, Kinney, & Bonner, 2001). To the extent that uncertainty expressions are being used in IASs/IFRSs and are interpreted differently by professional accountants in different countries, comparability of financial reports will continue to suffer (Doupnik & Richter, 2003, 16).

2. Background

Much attention has been given in the extant accounting literature to accounting standards, as to how they vary across countries, and the political and economic pressures to reduce variation (Ball et al., 2003, 246). Very limited research has been carried out on the impact of accounting standards on the judgments of professional accountants, though considerable research has been undertaken on the judgments required on auditing issues, including audit planning, internal control evaluation, extent of testing and materiality limits to be used by auditors (see Bonner, 1994; Tan, Ng, & Mak, 2002 for reviews). While several studies shed light on issues related to the purported benefits and costs related to the principles and rules-based accounting standards (for example, Gibbins, Salterio, & Webb, 2001; Hronsky & Houghton, 2001; Dye, 2002; Nelson, Elliott, & Tarpley, 2002; Schipper, 2003), very few studies have actually examined the judgments of professional accountants in interpreting and applying principles-based accounting standards.

Accounting standards contain definitions of accounting concepts whose function is to guide judgments made in practice (Hronsky & Houghton, 2001, 123). A few studies have examined the differential meaning of basic accounting concepts held by preparers and users of financial accounting information (such as Oliver, 1974; Chesley, 1986; Houghton, 1987, 1988; Harrison & Tomassini, 1989; Houghton & Messier, 1990; Amer, Hackenbrack, & Nelson, 1995; Hronsky & Houghton, 2001; Doupnik & Richter, 2003). With the move towards convergence of accounting standards, a few studies have also examined whether the judgments made by professional accountants in different countries will be similar given the same economic facts and similar accounting standards (for example, Schultz & Lopez, 2001; Doupnik & Richter, 2004; Doupnik & Riccio, 2006; Tsakumis, 2007). These studies raised an important question, most relevant to the current study, of whether a common set of accounting standards can be applied consistently within and across countries.

Generally, the studies undertaken in the literature on accountants' judgments have so far provided some evidence for the effect of the interpretation of uncertainty expressions in the principles-based standards on the judgments of professional accountants and financial reporting. Additionally, studies with an educational focus have shown that the meanings of accounting concepts held by students change over time and meanings held by inexperienced accountants are not identical to those held by more experienced accountants (see Hronsky & Houghton, 2001, 126 for a review). Surprisingly, little theoretical guidance exists as to how a set of 'complex' and 'new' accounting standards impacts on judgments of professional accountants.

3. Theory and hypotheses development

3.1. Theory

3.1.1. Interpretation and application of 'complex' accounting standards

Accounting standards interpreted by professional accountants vary in their level of complexity. Professional accountants routinely deal with accounting standards that are both simple and complex. The impact of task complexity on individuals' judgment has been widely considered in the psychology and audit literature (for example, Payne,

[4] The IASB indicated in July 2006 that it will not introduce any new IFRSs, or activate amendments under development, until 2009. Instead, discussion papers will be released to facilitate conceptual input in response to criticism that the pace of change has been too quick (Bolton, 2006, 6). Therefore, adequate interpretation and enforcement of IFRSs will continue to be an issue in the future.

[5] The Big 4 multinational accounting firms include Deloitte Touche Tohmatsu, KPMG, PricewaterhouseCoopers and Ernst and Young.