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# **What is the way forward for IASB's research programme under the evidence-supported approach? Some analyses and comments based on the 2015 Agenda Consultation**

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# What is the way forward for IASB's research programme under the evidence-supported approach? Some reflections based on the 2015 Agenda Consultation

## Introduction

The IASB's Research Programme was introduced in response to the 2011–2012 Agenda Consultation. The launch of this programme was a key part of adopting an evidence-supported approach to standard setting. Evidence-informed decision-making was set out as the appropriate way of working in all phases (research projects, standard-setting projects, maintenance and implementation projects). In particular, "...research should be targeted to provide evidence about the need for change before the IASB starts a standards-level project" (IASB, 2015, p. 8).

In the 2015 Agenda Consultation request for views, the evidence-supported approach is presumed to persist and stakeholders are only asked questions within the limits of this structure. As this is the first agenda consultation following the explicit move towards evidence-supported standard setting, we will in this paper initially discuss the IASB's application of this approach so far. Next, we will focus more closely on the research phase and analyse how stakeholders prioritised among the research projects. This part will be based on the Agenda Consultation comment letters submitted to the IASB. Finally, we will provide research-based comments on the five research projects given the highest priorities among the stakeholders responding to the 2015 Agenda Consultation. This part of the paper is based on the EAA's comment letter to the Agenda Consultation.

## Evidence-supported standard setting

Standard setting informed by evidence is potentially difficult and the IASB uses careful wording when describing the change towards this approach: "The IASB is moving to a more evidence-supported standard-setting process through the whole of the development cycle for Standards" (IASB, 2016). There is good reason to be careful as many of the key terms involved are subject to different interpretations. About ten years ago, Willem Buijink (Professor of Accounting at the University of Tilburg) published a paper (Buijink, 2006) suggesting that financial reporting and disclosure regulation around the world is not, arguably, evidence-based, i.e., the regulation was not based on the *current best scientific evidence* available about accounting and auditing.

One observation made by Buijink (*ibid.*) was that the regulators do not "...appear to use existing empirical scientific evidence in the design of regulation" (pp. 297-298). In general, this observation would not seem to hold to the same extent today, but the term "scientific" raises important concerns. In IAS 38, research is defined as "...original and planned investigation undertaken with the prospect of gaining new *scientific* or technical knowledge and understanding" (emphasis added). However, in the IASB's presentations of its own research-related activities, and use of evidence, the word "scientific" is avoided (e.g., web pages on research centre and research projects at ifrs.org). This appears to be linked to the IASB's broad definition of evidence which includes academic research, studies conducted by, for example, stakeholder-associated organisations, and practice (e.g., fieldwork). There is good reason to involve stakeholders and to relate closely to practice, but what will be the value of evidence that is not collected by using scientific methodology? Let's first think about how this issue is dealt with in medicine, the role model for evidence-based decision-making.

In the field of medicine, evidence-based decision-making have been applied over several decades, and adopting the same approach in another field, having little experience, will involve considerable challenges. In a recent paper by Wright et al. (2016), the authors investigate how physicians apply the evidence-based approach in practice, and then identify potential challenges when using the same approach in another field (management teaching). Wright et al. find that the physicians use three strategies in order to learn to apply evidence-based decision making: (i) embedding the normative foundation of evidence in problem-solving routines, (ii) role modelling being a reflective research consumer, and (iii) creating teachable moments through lived experience of research. Scientific evidence is used a source of authority, and doctors must learn not to draw premature conclusions but to always rule out other possible diagnoses based on the existing literature (the normative foundation of evidence). In addition, the physicians need to be open to learn about new scientific research findings (the reflective research consumer). This rigorous use of scientific evidence is, arguably, a consequence of socialization into the scientific method as a way of knowing and a belief in the generalizability and objectivity of research evidence (Wright et al., 2016, p. 196; Makari, 2009). At the same time, observations of practice are of key of importance in medicine, where a patient is a whole person who cannot simply be reduced

to a number of symptoms and diagnoses in textbooks and journals. The dual approach of using scientific evidence while still observing the whole patient in her/his context seems to require learning from senior colleagues and lived experience.

Next, let's consider a different field, auditing, where the term "evidence" is often used (e.g., Napier, 2002). Audit evidence refers to observations from practice that will support or contradict whether management assertions are compliant with the prevailing accounting regulation. Thus, in contrast with medicine, observations in practice represent what is considered evidence for the auditor's judgement whereas the regulation represent a normative foundation. The role of scientific evidence appears to be rather limited in this context; e.g., collecting audit evidence is a quite different process compared to conducting a scientific study.

This brings us back to what we mean by evidence in the field of standard setting – is it scientific evidence (cf., normative foundation in medicine), observations of practice (cf., audit evidence) or something in between (e.g., surveys conducted by stakeholder-associated organisations)? As referred to earlier, IASB applies a very broad definition, including basically kinds of evidence. The above discussion shows that this broad use of the term "evidence" is likely to cause confusion as it does not distinguish between scientific evidence used for developing the normative foundation (the standards) and observations in practice. In addition, the IASB approach is problematic with regard to the reliability of the evidence used. Independence and methodological rigour in the collection and analysis of data, and in theoretical reasoning, is at the heart of scientific research. In fact, audit methodology has similar ideals when it comes gathering and analysing audit evidence. However, standard-setting is a political process where different stakeholders will sometimes have an interest in finding "evidence" in support of their own opinions. Consider the following quotation from the IFRS website (IASB, 2016, emphasis added):

"Evidence-supported decision-making simply involves using evidence to give the IASB more confidence that it is making the *best* decisions. It also allows those affected by the decisions to see that the IASB has demonstrable evidence that is consistent with, or supports, the contentions and views held by the IASB."

The quotation indicates that the evidence-supported standard-setting is primarily about gaining legitimacy for the (political) process. However, the interpretation of what is the "best" decision will be quite different when the evidence is scientific compared to when it is not. The pressure from politicians, industries, and separate companies can be very strong, and this is actually a strong argument of giving only scientific evidence the status of evidence, as in medicine. How would a regulator in the field of medicine deal with all the pharmaceutical companies claiming to have the best medicine without requiring scientific evidence? The use of non-scientific sources may actually undermine the legitimacy of the evidence-supported approach.

The second observation in Buijink (2006) is that it appears that "...accounting researchers do not produce sufficient results and findings that are usable by regulators". One reason for this relates to the switch in accounting research around 1970, from deductive, analytical reasoning with normative implications towards the new tradition of positive accounting research which refrains from drawing policy conclusions (cf. Francis, 2004). As this tradition relies heavily on empirical research, much of the analytical reasoning underlying the standards developed by, for example, the IASB and the FASB over the past decades, have been developed by the standard-setters themselves (the paper by the FASB project managers Johnson & Petrone, 1998, is a good example, presenting the analytical reasoning underlying current standards on business combinations). Another reason, somewhat related to first one, concerns academics' strong incentives to focus on research that can be published in highly ranked journals (cf. Cole, 2014, p. 32). In the field for financial reporting, these journals have a strong focus on empirical work. Third, as with all scientific research, there are limitations in scope and reliance on assumptions and proxies, which, in the financial reporting area, may make standard-setters question the value of this research (cf. the reflective research consumer in medicine).

In sum, there are good reasons for the IASB to separate scientific evidence from other sources of information during the evidence-supported standard-setting process. The academic community must consider whether better alignment between publishing incentives and standard-setting can be achieved. This is important in order to become more relevant to standard-setters' work. It should be acknowledged that the IASB offers many opportunities for academics interested in such a development (IASB, 2016).

### **IASB's Research Programme – 2015 Agenda Consultation**

The research programme is at the core of applying the evidence-supported approach. In the past, a potential project could move from the preproposal stage into the standard-setting phase without a sufficient amount of

background research (Cole, 2014, p. 29). In the new structure, there is a relatively low hurdle for a project to be added to the research programme, and predetermined steps (assessment stage, development stage) before reaching the standard-setting phase. The agenda consultation plays an important role in this process as stakeholders are there given a chance to influence the allocation of resources and priority of projects.

We analysed the 113 comment letters submitted to the 2015 Agenda Consultation which included relative rankings of the importance of research projects (IASB, 2015, questions 2 and 3). The comment letters are publically available on [www.ifrs.org](http://www.ifrs.org). We categorised the commentators into eight groups: (1) Industrial firms (preparers) and their organisations; (2) Financial firms (preparers) and their organisations; (3) Investors and investor/analyst organisations; (4) Academics; (5) Accounting firms; (6) Professional bodies in accounting and auditing; (7) National accounting standards boards and similar organisations; (8) Regulators, stock exchanges and similar organisations. We recorded each commentator's relative rankings of the 17 research projects (9 at assessment stage, 5 at development stage and 3 inactive). The instruction in the request for views (IASB, 2015) was to assign the relative rankings "high", "medium" and "low". We have transformed the three ranking levels into numbers (High=3, Medium=2; Low=1) and calculated average scores. We also measure the percentage of respondents in each commentator group that provided a ranking of each of the projects. Table 1 shows the average ranking scores and percentage of respondents in each commentator group that provided a ranking. The results are presented by commentator group and by research project.

**{Insert Table 1 about here}**

Table 1 shows some interesting observations. For the *assessment stage projects*, the following observation can be made:

- The two most highly ranked projects are "Goodwill and Impairment" (2.61) and "Primary Financial Statements" (2.55). Almost all groups find "Goodwill and Impairment" to be a highly important project (2.50-3.00) except for the financial firms (2.14). With regard to "Primary Financial Statements", industrial firms (2.10), financial firms (2.00) and regulators (2.20) find it to be of medium importance, whereas the other groups assign very high rankings (2.53-3.00).
- With regard to the project "Definition of a Business", financial firms and the national accounting standard-setters assign low relative importance (1.75 and 1.92, respectively), whereas higher rankings are assigned by regulators (2.80), and also the other groups (2.33-2.75).
- With regard to the "Discount Rates" project, the accounting firms find this to be less important (1.71), whereas most other groups view it as rather important (2.17-3.00).
- No group finds "Income Taxes" to be of high importance (1.33-2.00).
- With regard to "Polluting Pricing Mechanisms" there strong opponents among the financial firms (1.00) and industrial firms (1.33) and a few, but convinced, proponents among investors and academics (3.00).
- "Post-employment benefits" receive medium scores from all groups except from a couple of investors that find it really important (3.00 in average score). The same pattern applies to "Provisions, Contingent Liabilities and Contingent assets" and "Share-based Payment".

For the *development stage projects*, the following observation can be made:

- The most highly ranked project is "Disclosure Initiative – Principles of Disclosure" (2.93) which is very highly ranked by all groups. In addition, the project "Financial Instruments with Characteristics of Equity" is highly ranked by all groups (2.50-3.00) except the industrial firms (1.56). "Business Combinations under Common Control" has a high average score of 2.55 and is particularly emphasised as important by the accounting firms, their professional bodies, and the regulators.
- "Dynamic Risk Management" is regarded to be of medium importance, except for the financial firms who find it very important (2.83). The "Equity Method" project is also viewed to be of medium importance, with some exception for the accounting firms (2.57) and the academics (2.50).

Finally, with regard to the inactive projects, the “Extractive Industries/Intangible Assets/Research and Development” received, on average, medium importance (1.76), whereas “Foreign Currency Translation” and “High Inflation” received low average scores (1.45 and 1.30, respectively).

In summary, the five research projects with average scores above 2.5 and where more than 50% of the commentators have made rankings, are “Disclosure Initiative – Principles of Disclosure” (2.93 – 81%), “Primary Financial Statements” (2.55 – 68%), “Financial Instruments with Characteristics of Equity” (2.67 – 69%), “Business Combinations under Common Control” (2.55 – 57%), and “Goodwill and Impairment” (2.61 – 68%).

In an attempt to contribute to the evidence-supported work of the IASB, we summarise each of these projects below in terms of relevant issues and important extant research, from an academic perspective.

### **Disclosure Initiative – Principles of Disclosure (development stage)**

The IASB’s Disclosure Initiative focuses on the issue of what should be disclosed in terms of materiality, aggregation and format and the main objective is to develop a disclosure standard bringing together the principles for the structure and contents of financial statements.

Recent research on disclosure on this topic mainly involves two areas of research, the usefulness of (narrative) disclosures and the usefulness of non-GAAP measures. The former include the information content and usefulness of narrative disclosures depending on the location in the financial report, the level of detail, the readability of the information, and the demand for the disclosure. Research on non-GAAP measures focuses on the reasons for and the extent of abuse of non-GAAP reporting (Jennings and Marques, 2011; Badertcher, 2011; Barth et al., 2012; Christensen et al., 2014; Curtis et al., 2014; Baumker et al., 2014; Bentley et al., 2015; Malone et al., 2015; Isidro and Marques, 2015).

Overall, most studies find that narrative disclosures are used by investors and make a difference (Rennekamp, 2012; Kravet and Muslu, 2013; Campbell et al., 2014; Merkley, 2014; Hope et al., 2015; Mayew et al., 2015). However, one recent study suggests that there might be a point where information overload reduces usefulness among financial analysts (Impink et al., 2016). Research finds that narrative disclosures are best placed together in a prominent place in the annual report (Campbell et al., 2014; Hope et al., 2015). We also note that companies do provide detailed useful disclosure when it is needed (Merkley, 2014; Hope et al., 2015). A disclosure standard providing principles for disclosure would be an improvement and is of high importance. Although, Impink et al. (2016) find that there is limit to how much disclosure investors can cope with which concur with the European Securities and Markets Authority (ESMA) concerns about the risk of disclosure overload (ESMA, 2015, p. 7; Cairns, 2015, pp. 189-190).

Non-GAAP measures (the deviations from reported net income) derive from two main sources: transitory items and recurring non-cash items (Bentley et al., 2015; Malone et al., 2015, and Christenson et al., 2015). Companies exclude transitory items to provide a cleaner indication of future earnings and exclude recurring non-cash items since these are commonly already discounted by investors (Barth et al., 2012; Bentley et al., 2015; Malone et al., 2015; Christenson et al., 2015). The latter exclusion is particularly interesting since it is also directly linked to fair value remeasurement requirements under IFRS. Although, these measures are also abused, mainly to meet or beat earnings benchmarks (Isidro and Marques 2015). Furthermore, Christensen et al. (2014) find that sophisticated investors are exploiting less sophisticated investors’ inability to understand recurring expenses excluded from reported non-GAAP performance measures.

Recent research shows that non-GAAP disclosures is regularly used and play an important role in disseminating information. However, the prevalence of opportunistic behaviour also shows a need for regulation. We believe that a reconciliation between the non-GAAP measure and the most comparable GAAP measure could curb this behaviour and this should be a part of the suggested disclosure standard.<sup>1</sup>

### **Primary Financial Statements (formerly performance reporting) (assessment stage)**

There are a number of issues related to primary financial statements such as the purpose of each statement, whether to specify a minimum level of detail, require format and specify metrics, provide examples or not, and whether further clarification of the distinction between profit or loss and other comprehensive income (OCI) is

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<sup>1</sup> Similar to the US model under SEC final rule no. 33-817 Conditions for use of non-GAAP financial measures.

needed. A review of recent research suggests two main areas of research focus, presentation format and the distinction between profit or loss and OCI.

Research on presentation format indicates that the organisation of the income statement matters in the sense that a separation of measurement uncertainty items and/or persistence from other items improves the usefulness (Clor-Proell et al., 2014; Hewitt et al., 2015).

Research also finds that the distinction between profit or loss and OCI adds value to financial reporting users (Goncharov and Hodgson, 2011; Rees and Shane, 2012; Mechelli and Cimini, 2014; Fasan et al., 2014; Brouwer et al., 2014; Lachmann et al., 2015). However, researchers are requesting a further clarification of the distinction between the two (Rees and Shane, 2012; Brouwer et al., 2014). These results may inform IASB if they consider revising the format of the comprehensive income statement.

The primary statements are the most important components of a financial report and therefore highly important and of high urgency for the IASB to focus future efforts on. This is also linked with the wider debate on the importance of financial reporting in the wider context of corporate reporting.

### **Financial Instruments with Characteristics of Equity (development stage)**

IAS 32 includes requirements for the classification of financial instruments between liabilities and equity. These binary classification requirements result in significant practice issues when applied to many financial instruments with characteristics of equity – other than, for example, typical non-redeemable common shares that pay discretionary dividends. The classification of financial instruments as liabilities or equity not only has a significant impact on their balance sheet presentation, but on their measurement and on how they affect an entity's financial performance. However, the increasing complexity of financial instruments is making it difficult to distinguish between liabilities and equity. The underlying conceptual challenges of distinguishing between liabilities and equity arise because of the interaction between: (a) the economic nature of claims against the entity (paragraphs 10-12); and (b) the polarized financial reporting effects of classifying claims as either liabilities or equity (paragraphs 13-18).<sup>2</sup>

The IASB is currently investigating potential improvements to the classification of liabilities and equity in IAS 32, including investigating potential amendments to the definitions of liabilities and equity in the Conceptual Framework and to the presentation and disclosure requirements for financial instruments with characteristics of equity, irrespective of whether they are classified as liabilities or equity. This has been a priority research project on the basis of the views that it received.

Securities that have some equity characteristics and some debt characteristics, or hybrid securities, have been popular for decades and include: certain classes of preferred stock, trust preferred securities, convertible debt securities, debt securities with principal write-down features, and mandatorily convertible/redeemable instruments. The size of the convertibles market alone in 2014 was over \$207.7 billion.<sup>3</sup> Issuers like hybrid securities because they are an attractive, cost-efficient means of raising non-dilutive capital, often with favourable treatment by ratings agencies and regulators. Many hybrids also provide a lower after-tax cost of capital for issuers compared to common stock. Despite the size of the market and the attractiveness to issuers, there is little recent academic literature to guide the discussion.

Hopkins (1996) conducted an experiment with buy-side equity analysts and examined the effects of classifying mandatorily redeemable preferred stock (MRPS) under various scenarios, basing the study on psychology research documenting that individuals mentally access their own knowledge base of similar situations when faced with a problem. Grounded in research that issuances of equity are generally associated with stock price drop for the issuer, but that debt issuances are not, the analysts were asked about the stock price reaction to the issuance of MRPS, with the MRPS classified as either debt or equity. The analysts' price judgments were correlated with the location of the MRPS: analysts observing equity classification predicted lower prices than analysts observing debt classification. Other studies corroborate those results, including Maines and McDaniel (2000); Hopkins, Houston, and Peters (2000); and Gramlich, Mayew, and McAnally (2006). Thus, the evidence is fairly clear that classification of securities as debt versus equity matters. Maines and McDaniel (2000) specifically examine whether and how alternative presentation formats affect *non-professional investors'* processing of information and provide evidence that format affects how they weight information.

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<sup>2</sup> <http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/May/AP05A-FICE.pdf>

<sup>3</sup> <https://www.putnam.com/literature/pdf/II853.pdf>

More recently, Gunderson and Swanson (2010) evaluated whether financial statement categorization of trust preferred stock (TPS) influences its market valuation. They find that when TPS is re-classified as a liability, the market values TPS more like a liability compared to when it was reported in the mezzanine. Clor-Proell et al. (2015) experimentally test whether disclosure of the features of hybrid instruments, already classified into liabilities or equity, affects users' credit-related judgments. They show that getting the classification right is not as central for experienced financial statement users as they rely primarily on the underlying features of the instrument to make their judgments. In contrast, classification is more important for inexperienced users, with weaker evidence for their use of features. A second follow-up experiment showed that the reliance on features by experienced users generalizes to various features that often characterize hybrid instruments, although they also find that even experienced users vary in their beliefs about which individual features are most important in distinguishing between liabilities and equity.

Bonner et al. (2011) draw on the ideas in mental accounting theory and experimentally investigate whether firm managers have preferences regarding disaggregation in the context of compound financial instruments, which could appear in the financial statements as one aggregate amount or bifurcated into two amounts. The results show that managers have predictable preferences for the presentation of income statement gains and losses from compound financial instruments, but not for their balance sheet presentation. Additional tests indicate that the income statement preferences are driven by how firm managers believe investors will value the firm. This multitude of evidence suggests that financial statement users depend on balance sheet categories and classification may lead to misinterpretation or management opportunism.

In addition to evidence that classification of securities clearly matters to users and affects decisions, other research finds that users do not naively rely on simple liabilities versus equity partitions when examining financial statements. Several studies examine how various financial instruments are correlated with systematic risk or market prices. Other evidence presented by Cheng et al. (2003) and Linsmeier et al. (2007) shows that investors treat securities such as preferred stock differently depending on the financial health of the firm. For example, when insolvency risk is high, investors treat preferred stock as equity, but when it is low, they treat preferred stock as debt.

We believe that it is imperative to resolve the classification issues around IAS 32, however, the improvements of the standard needs to be in full accordance with the final outcome of the *Conceptual Framework* project.

### **Business Combinations under Common Control (development stage)**

Business combinations under common control, including those related to preparations for initial public offerings, are excluded from the scope of IFRS 3 because the combining entities are controlled by the same party. These restructurings and reorganizations are often described as business combinations under common control (BCUCC). Common control combinations are widespread, and examples include combinations between subsidiaries of the same parent; the acquisition of a business from an entity in the same group; and some transactions involving the insertion of a new parent company at the top of a group. BCUCCs are not restricted to combinations between entities that are part of the same group. Entities controlled by the same individual shareholder (or group of shareholders acting together in accordance with a contractual arrangement) are also regarded as under common control (IFRS 3, B3).

It is not simple to define BCUCCs, as they do not represent a homogeneous case and are not easily generalizable. The BCUCCs project was initiated to respond to concerns about the lack of consensus on how BCUCC transactions should be reflected in financial statements prepared under IFRS. While their name is reminiscent of business combinations, the concept of common control is introduced. The distinctive feature of BCUCC is that the acquisition of control takes place inside an existing entity and does not involve a change of the subject that controls it (Biancone, 2013). The entities involved are controlled by the same subject both before and after the transaction. The nature of BCUCC could be defined as the transfer of assets "from one pocket to another pocket" (Pan, 2002). In addition, common control must not be temporary, so as to avoid the circumvention of IFRS 3 through the creation of ad hoc arrangements (Caratozzolo, 2009). The absence of specific requirements, however, has led to a perceived diversity in practice.

Bonacchi et al. (2015) analyse a choice that parent firms face under IFRS: whether to account a BCUCC at fair value or historical cost. They provide evidence that firms would use fair value when they believe it would help them issuing public debt. Although most BCUCCs do not materially change the composition and the market value of the parent firm's assets and liabilities, they can significantly reduce accounting leverage of the parent

firm if recorded at fair value. Bonacchi et al. (2015) find that parent firms are more likely to record BCUCCs at fair value when their pre-BCUCC leverage is high and when they have net worth covenants on their debt. These firms are likely to issue new public debt following the BCUCC.

The scarce and fragmentary literature, not to mention the lack of clear consensus on the topic, contributes to the prevailing concerns on how to account for BCUCCs. Fiume et al. (2015) assess the possible and various accounting methods and identify the most suitable, accredited and consistent techniques.

### **Goodwill and Impairment (assessment stage)**

The IASB 2015 Agenda Consultation document acknowledges mixed views about the relevance and cost-effectiveness of the existing requirements for the initial and subsequent measurement of goodwill. It also identified the need for improvements to impairment testing for goodwill and other non-current, non-financial assets. Both FASB and IASB are currently evaluating the issues described in 8A and several Staff papers have already been produced (Agenda Paper 13, Agenda Paper 18).

Research based on archival data has generated mixed results as regards the decision usefulness of financial information related to goodwill and impairment. With regard to goodwill at acquisition, a study by Shalev (2009), based on US data, finds that preparers seek to avoid transparency in their financial reporting when the acquisition premium is to a higher extent allocated to goodwill and argues that this is consistent with a behaviour where acquirers downplay ‘bad news’ for investors by trying to hide overstatement of goodwill in the purchase price allocation in order to avoid amortisation. In a more recent study, Shalev et al. (2013) find that CEOs whose compensation packages rely more on earnings-based components are more likely to over-allocate the purchase price to goodwill.

With regard to goodwill impairment tests, a review paper by Barone et al. (2016), reports that major standard setters, i.e. FASB and IASB, support the impairment-only approach because impairment test provides users of financial reports with a measure of goodwill that reflects firms’ underlying economic value and investment opportunities. A line of argument suggests that managers will use estimates related to the impairment tests to convey private information on future cash flows. In line with this idea, Lee (2011) finds that goodwill’s ability to predict future cash flows has improved since the FASB adopted SFAS 142. For example, a number of studies based on archival data have also found an increase in harmonisation following the adoption of standards featuring impairment.

Bayerlein and Al Farooque (2012) found that in Australia, Hong Kong and the UK all exhibited low levels of ownership concentration, extensive shareholder/outside rights, extensive disclosure requirements and strong legal enforcement following the adoption of IFRS 3 and IAS 38, information on goodwill impairment became more comparable. In contrast, another line of argument suggests that managers will adapt the timing of goodwill impairment charges in accordance with their private incentives and several empirical studies report results supporting this view (e.g., Ramanna and Watts, 2012; Gu and Lev, 2011; Li et al., 2011; Jarva, 2009; Zang, 2008). For example, on the basis of a study of 870 firms implementing SFAS 142, Zang (2008, p. 38) writes: “The findings are consistent with the strategic reduction of the goodwill impairment by management to avoid the violation of debt covenants and with the notion that new managers take a big bath so they can report higher earnings in the future”. A study by Hamberg et al. (2011) suggests that goodwill impairments under IFRS 3/IAS 36 will be considerably lower than the corresponding sum of goodwill amortisations and impairments under the preceding IFRS accounting regime. More recently a study by Hamberg and Beisland (2014) provides empirical support for the use of the model used in the accounting regime preceding the adoption of IFRS 3, i.e., the dual model (IAS 22/IAS 36), where the value decline was divided into two components: (i) goodwill amortisation reflecting the gradual realisation of expected excess returns and (ii) impairment losses in the case of bad outcomes compared to expectations.

Barone et al. (2016) also highlight that prior to the implementation of the current standards incorporating goodwill and impairment, IASB members were quite vocal about impairment due to its complexity and practicality (Shoaf and Perez Zaldivar, 2005). Additionally, some members were strongly opposed to impairment and instead favoured amortisation as the correct treatment for goodwill. An example of that can be

found on the recent EFRAG's Discussion Paper (EFRAG, 2014) where the Research Group claims to support the reintroduction of the dual model.<sup>4</sup>

There are several examples from the extant literature relating to issues of impairment. Studies in Australia found that impairment included in IAS 36 added complexity to preparers, and, expectedly, high levels of non-compliance were found two years after IFRS adoption in Australian companies (see Carlin et al., 2008; Carlin and Finch, 2007a; 2007b, 2009). There were also issues associated with the transparency of the information. Studies in other countries, for example, Italy (Pieri, 2010) concur with these findings.

Another stream of literature analyses the impairment option in terms of complexity, cost, subjectivity or comparability and concludes that the accounting treatment introduced by IFRS 3 can be quite complex and subjective (Glaum et al., 2013; Petersen and Plenborg, 2010; Wiese, 2005). There are also cost versus benefit concerns especially for smaller firms.

### **Concluding remarks**

This paper reviews and discusses the application of the evidence-supported approach within the IASB, in particular with regards to the Research Programme. Since the launch of this programme a few years ago, the IASB has moved towards a process where the standard-setting is more informed by evidence, however, the definition of evidence is very broad and does not separate the use of scientific evidence for the normative foundation from the application of this foundation in practice. We argue that there are good reasons for the IASB to separate scientific evidence from other sources of information during the evidence-supported standard-setting process. The academic community must consider whether better alignment between publishing incentives and standard-setting can be achieved. This is important in order to become more relevant to standard-setters' work.

Furthermore, based on the 2015 Agenda Consultation comment letters submitted to the IASB, we focus more closely on the research phase and analyse how commentators prioritised among the research projects. Our analysis shows that five projects stand out as having a high relative ranking on average with a majority support: "Disclosure Initiative – Principles of Disclosure", "Primary Financial Statements", "Financial Instruments with Characteristics of Equity", "Business Combinations under Common Control", and "Goodwill and Impairment". In order to further support the IASB's evidence-informed standard-setting process, we provide research-based comments on these five research projects. This part of the paper is based on the EAA's comment letter to the 2015 Agenda Consultation.

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<sup>4</sup> The objective of the EFRAG (2014) paper is to review, based on prior literature, what are the arguments underlying the debate impairment versus amortisation and goodwill and also what is the empirical evidence supporting arguments favourable or not to the different options.

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**Table 1 Commentators' rankings of the relative importance of different research projects in the 2015 IFRS Agenda Consultation**

Average scores for eight commentator groups (High=3, Medium=2; Low=1).

| Commentator group  | 1     |                | 2     |                | 3     |                | 4     |                | 5     |                | 6     |                | 7     |                | 8     |                | Total       |                |
|--|-------|----------------|-------|----------------|-------|----------------|-------|----------------|-------|----------------|-------|----------------|-------|----------------|-------|----------------|-------------|----------------|
|  | Score | % of responses | Score       | % of responses |
| <b><i>Assessment stage projects</i></b>                          |       |                |       |                |       |                |       |                |       |                |       |                |       |                |       |                |             |                |
| Definition of a Business   | 2.53  | 71%            | 1.75  | 29%            | 2.50  | 15%            | 2.50  | 50%            | 2.75  | 89%            | 2.33  | 82%            | 1.92  | 57%            | 2.80  | 71%            | <b>2.36</b> | <b>59%</b>     |
| Discount Rates   | 2.36  | 52%            | 2.40  | 36%            | 3.00  | 23%            | 2.50  | 50%            | 1.71  | 78%            | 2.17  | 82%            | 2.53  | 65%            | 2.33  | 86%            | <b>2.31</b> | <b>59%</b>     |
| Goodwill and Impairment  | 2.62  | 62%            | 2.14  | 50%            | 2.67  | 23%            | 3.00  | 75%            | 2.75  | 89%            | 2.59  | 77%            | 2.70  | 87%            | 2.50  | 86%            | <b>2.61</b> | <b>68%</b>     |
| Income Taxes   | 2.18  | 52%            | 1.33  | 21%            | 2.00  | 15%            | 2.00  | 75%            | 1.63  | 89%            | 1.72  | 82%            | 1.83  | 78%            | 1.50  | 57%            | <b>1.81</b> | <b>59%</b>     |
| Polluting Pricing Mechanisms                                     | 1.33  | 29%            | 1.00  | 21%            | 3.00  | 8%             | 3.00  | 50%            | 1.71  | 78%            | 1.79  | 86%            | 1.94  | 70%            | 2.00  | 43%            | <b>1.81</b> | <b>50%</b>     |
| Post-employment Benefits   | 1.86  | 33%            | 1.75  | 29%            | 3.00  | 15%            | 1.50  | 50%            | 1.71  | 78%            | 1.82  | 77%            | 1.80  | 65%            | 2.00  | 57%            | <b>1.84</b> | <b>51%</b>     |
| Primary Financial Statements                                     | 2.10  | 48%            | 2.00  | 43%            | 3.00  | 77%            | 3.00  | 75%            | 3.00  | 89%            | 2.53  | 86%            | 2.56  | 70%            | 2.20  | 71%            | <b>2.55</b> | <b>68%</b>     |
| Provisions, Contingent Liabilities and Contingent Assets         | 1.88  | 38%            | 1.60  | 36%            | 2.50  | 15%            | 2.50  | 50%            | 1.71  | 78%            | 2.00  | 77%            | 2.12  | 74%            | 2.40  | 71%            | <b>2.02</b> | <b>56%</b>     |
| Share-based Payment  | 1.71  | 33%            | 1.33  | 21%            | 2.50  | 15%            | 1.67  | 75%            | 1.40  | 56%            | 1.47  | 77%            | 1.47  | 65%            | 1.50  | 57%            | <b>1.54</b> | <b>50%</b>     |
| <b><i>Development stage projects</i></b>                         |       |                |       |                |       |                |       |                |       |                |       |                |       |                |       |                |             |                |
| Business Combinations under Common Control                       | 2.33  | 43%            | 2.67  | 21%            | 2.50  | 15%            | 2.00  | 50%            | 2.75  | 89%            | 2.67  | 82%            | 2.44  | 70%            | 2.67  | 86%            | <b>2.55</b> | <b>57%</b>     |
| Disclosure Initiative – Principles of Disclosure                 | 2.93  | 67%            | 3.00  | 71%            | 3.00  | 54%            | 3.00  | 100%           | 2.89  | 100%           | 2.80  | 91%            | 3.00  | 87%            | 3.00  | 100%           | <b>2.93</b> | <b>81%</b>     |
| Dynamic Risk Management  | 2.00  | 48%            | 2.83  | 86%            | n/a   | 0%             | 2.50  | 50%            | 2.00  | 78%            | 2.06  | 73%            | 2.00  | 52%            | 2.00  | 86%            | <b>2.18</b> | <b>58%</b>     |
| Equity Method  | 1.83  | 57%            | 1.67  | 21%            | 2.00  | 8%             | 2.50  | 50%            | 2.57  | 78%            | 2.44  | 82%            | 2.47  | 74%            | 2.00  | 57%            | <b>2.28</b> | <b>57%</b>     |
| Financial Instruments with Characteristics of Equity             | 1.56  | 43%            | 3.00  | 71%            | 3.00  | 23%            | 2.50  | 50%            | 2.78  | 100%           | 2.86  | 95%            | 2.67  | 78%            | 2.83  | 86%            | <b>2.67</b> | <b>69%</b>     |
| <b><i>Inactive projects</i></b>                                  |       |                |       |                |       |                |       |                |       |                |       |                |       |                |       |                |             |                |
| Extractive activities/Intangible Assets/Research and Development | 1.50  | 19%            | 1.33  | 21%            | 2.00  | 8%             | 3.00  | 50%            | 1.43  | 78%            | 2.00  | 64%            | 1.67  | 52%            | 1.67  | 43%            | <b>1.76</b> | <b>41%</b>     |
| Foreign Currency Translation                                     | 2.00  | 29%            | 2.00  | 21%            | 1.00  | 8%             | 1.00  | 75%            | 1.00  | 78%            | 1.29  | 64%            | 1.73  | 48%            | 1.00  | 29%            | <b>1.45</b> | <b>42%</b>     |
| High Inflation   | 1.57  | 33%            | 1.50  | 14%            | 1.00  | 8%             | 1.00  | 50%            | 1.00  | 67%            | 1.15  | 59%            | 1.55  | 48%            | 1.00  | 29%            | <b>1.30</b> | <b>39%</b>     |
| Number of observations   | 21    |                | 14    |                | 13    |                | 4     |                | 9     |                | 22    |                | 23    |                | 7     |                | <b>113</b>  |                |

Commentator groups: (1) Industrial firms (preparers) and their organisations; (2) Financial firms (preparers) and their organisations; (3) Investors and investor/analyst organisations; (4) Academics; (5) Accounting firms; (6) Professional bodies in accounting and auditing; (7) National accounting standards boards and similar organisations; (8) Regulators, stock exchanges and similar organisations.