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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.

Keywords: comparability, globalisation, pension accounting, comparability framework
1.0 Introduction

The world-wide 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).

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. 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; and 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 (2008c) 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 overemphasis on uniformity or permitting too many accounting options for the same transaction (IASB, 2008c: 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 Figure 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. 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). 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 institutional settings and permits optional accounting treatments may potentially decrease cross-sectional comparability across and within jurisdictions. This research is potentially generalisable to other accounting issues that pose comparability difficulties, such as the classifications and varying optional treatments permitted under AASB 139 Financial Instruments: Recognition and Measurement.

2. A Comparability Framework
The IASB’s Conceptual Framework for Financial Reporting (2010b) identifies \textit{relevance} and \textit{faithful representation} as the two ‘fundamental’ qualitative characteristics for information to be useful for decision-making. Information is relevant if it makes a difference (that is, has predictive value, confirmatory value or both) to the decisions of capital providers (IASB, 2010b: paragraph QC5). Once the relevant economic events to be depicted are decided, these depictions must be faithfully represented. Faithful representation of financial information occurs when the economic event is reported in a way that is complete, neutral, and free from material error (IASB, 2010b: paragraph QC12). Paragraph QC19 complements these fundamental characteristics with the four ‘enhancing’ qualities of \textit{comparability}, \textit{verifiability}, \textit{timeliness} and \textit{understandability} that financial information should possess to distinguish more useful information from less useful information. Such characteristics are considered to be ‘enhancing’ because, individually or collectively, they cannot make financial information useful for decision-making unless that information is relevant and faithfully represented.

Of these fundamental and enhancing qualitative characteristics, our focus is on \textit{comparability}, which is claimed to be an impetus for worldwide convergence with IFRS aimed at entities producing internationally comparable information to capital providers (Nobes and Parker, 2008: 76). Given that the “essence of decision making is choosing between alternatives, … information about an entity is more useful if it can be compared with similar information about other entities …” (IASB, 2010b: paragraph QC20). Thus, comparability does not relate to a single item (IASB, 2010b: paragraph QC21) but is the “quality of the relationship between two or more items of information” rather than the quality of individual items (IASB, 2008c: paragraph QC17). Clearly, the fundamental and
enhancing characteristics of financial information are not independent. Although the IASB conceptual framework eschews the possibility of trade-offs occurring between the qualitative characteristics of information, relevance and faithful representation are not absolute properties of accounting information (Whittington, 2008: p.146). Any such tension may be resolved, in practice, by reference to an overriding principle, such as a “true and fair” view (Alexander, 1999: p. 240).

Comparability is difficult to identify (Zeff, 2007: p. 290), measure and quantify, although variations of measurement exist in the accounting context. Examples of research that attempt to measure comparability include Revsine (1985) and Krisement (1997). This research borrows from information system dynamics and industrial concentrations (using entropy) respectively. Zeff (2007: p. 290, 294) reasons that accounting is an artefact, and, unlike physical objects, it is difficult to perceive and identify “like” and “unlike” things in the accounting context. The debate thus becomes philosophical (Zeff, 2007: p. 294). Empirical research that captures comparability from the point of view of the users of the financial statements suggests that greater comparability of earnings information is associated with more accurate analysts’ forecasts, and less bias and lower dispersion in those forecasts (De Franco, Kothari & Verdi, 2009: p. 3). As such, comparability benefits capital market participants by reducing the cost of acquiring financial information, and increasing the quantity and quality of that information.

Although the comparability debate is likely to escalate in the context of international convergence, Zeff (2007: p. 294) states that the “conundrum of accounting comparability and how it is to be achieved” has not been addressed in the debate; he cautions that enhanced comparability is not a surety (Zeff, 2007: p. 290). In the context
of IFRS, Zeff (2007: p. 294) reduces the argument to whether consistent accounting methods across the globe result in “genuine” comparability or “superficial” comparability. Similarly, the IASB (2008c: paragraph QC18; 2010b: paragraph QC24) warns against “superficial” or surface comparability.

Two issues emerge from the (limited) literature on the concept of comparability that forms the basis of the comparability framework we develop. First, a necessary precondition for comparing two sets of information is that each set faithfully represents the economic event on which the information is reporting; that is, the information is a ‘true’ representation of the underlying economic substance of each event. For users of financial information to be able to compare alternative investments, the same economic circumstances need to be accounted for in the same way (Krisement, 1997: p. 466; Sprouse, 1978: p. 64). By inferring that the underlying economic substance of events must be the same or similar, we acknowledge that this assessment of similarity involves professional judgement (and within certain professional boundaries, contains subjectivity).

The second issue is that accounting methods used to depict each of the economic events are the same and are applied consistently across time for the one firm and between firms at one point in time for the one event. (IASB, 2010b: paragraph QC22). The IASB (2010b: paragraph QC22) draws a distinction between comparability as the outcome or the goal, and the process of comparability, achieved by applying consistent accounting policies and procedures to similar events. Comparability is also different from uniformity because the latter may subsume real comparability and force unlike things to look alike (IASB, 2010b: paragraph QC23). Uniformity can refer to uniformity of accounting
treatment or uniformity of the presentation of accounting information (we focus on accounting treatment).

To the extent that optional accounting treatments for the same economic event are tolerated by accounting standard setters, consistency of accounting method is difficult to achieve. That is, comparability will not automatically result from the use of consistent accounting methods across time for the one firm or between firms at one point in time unless the economic substance for the event being compared is similar, and/or sufficient disclosures are made. If optional accounting treatments (for similar underlying economic substances) are tolerated by standard setters, then different accounting methods for similar economic events will result. For example, pension accounting permits alternative accounting options for AGL so that different accounting methods are used for similar events.

The above dimensions are shown in Figure 1 as a two-way matrix, with the two alternatives for accounting methods (same/different) depicted in the rows, and the two alternatives for economic substance (similar/dissimilar event) displayed in the columns.

(insert Figure 1 about here)

The top left-hand cell of the Figure 1 matrix shows that if similar economic events are treated the same from an accounting perspective, this corresponds to deep comparability. Deep comparability implies that there are no accounting options and as a consequence, similar arrangements are treated the same. In this case, if an IFRS accounting method is applied consistently across and between firms, both inter- and intra-
jurisdictional comparability is achieved. As such, comparability is the outcome and consistency is the means (see IASB, 2010b: paragraph QC22). On the other hand, the bottom left-hand cell of Figure 1 shows non-convergent comparability arises where alternative accounting treatments are permitted to be applied to similar underlying economic events. Some IFRSs permit options to accommodate domestic needs of different countries and so options within international accounting standards are common. For example, IAS 19 Employee Benefits currently permits three options to account for AGL. As a result, if the selected accounting method varies between entities, but the underlying economic events are in substance similar, both inter- and intra-jurisdictional comparability are impeded. It could be argued that note disclosure of the accounting method used alerts users to those differences in accounting treatments, enabling them to take those differences into account in their comparisons (Gordon, 2007: p. 67). However, making such adjustments to the numbers reported in financial statements is not a trivial task for most users. Note that if the chosen accounting method is applied consistently across time for the one firm, then this should assist comparability of information in this limited instance.

The top right-hand cell of the Figure 1 matrix represents the situation where the same accounting method is applied to dissimilar economic events. Applying the same accounting treatment to “substantively unlike things” implies surface comparability that may mask the underlying non-comparability (Schipper & Vincent, 2003: p. 104). Such surface comparability can arise where transactions occurring in two different entities might appear to be similar and are accounted for in the same way, but the underlying economic events fundamentally differ. For example, institutional differences between
jurisdictions may be overlooked so that the same accounting treatment is used across jurisdictions even when the underlying economic circumstances vary. As noted by Zeff (2007: p. 291), differing business, financial and auditing cultures, including varying institutional and regulatory arrangements are impediments to “genuine worldwide comparability”. To this extent, surface comparability reduces inter-jurisdictional comparisons. In this case, consistency of accounting method between firms at one point in time does not assist comparability because the underlying economic substance differs (although comparability for the one firm over time is achievable).

The bottom right-hand cell of the Figure 1 matrix shows the situation where dissimilar economic events are accounted for using different accounting methods. We refer to this as intrinsic differences comparability. For some transactions, apposite accounting treatments of intrinsically different economic events may enhance comparability, although at first glance this may not be obvious. On the other hand, the underlying economic substance and the accounting for these events may be so different between firms that comparability may not be possible, or subject to additional disclosures. Accounting standards that focus on the reporting of management intentions, such as IAS 8 Operating Segments emphasise predictive ability at the expense of comparability (Schipper, 2003: p. 63). In this case, the value offered to users of financial reports by managerial insights is emphasised rather than comparability of segment information, although the two may be achievable. To the extent that intrinsic value is added by the entity-specific disclosures, the decision usefulness objective of financial information is satisfied. Consistency of accounting method first, by the one firm over time and second, between firms at one point in time may contribute to comparability, but
in the latter case it is likely that apposite disclosures would also be required to achieve this.

The comparability framework shows that in circumstances where deep comparability and intrinsic differences comparability arise, the decision-usefulness objective of financial reporting is more likely to be met than where surface comparability and/or non-convergent comparability are present. These latter two dimensions represent dysfunctional aspects of comparability, potentially reducing the usefulness of comparisons between two or more sets of financial information, especially for comparisons between firms. Therefore dysfunctional comparability should be the focus of standard-setters in their endeavours to eliminate the possibility of such non-comparability arising from application of global accounting standards.

3. Applying the Comparability Framework to Global Pension Accounting

We use pension accounting to apply our comparability framework for two reasons. First, complexities and variations in pension rules and regulations across countries have contributed to the difficulties of developing a universal pension accounting standard that is applicable internationally (Kiosse & Peasnell, 2008: p. 15). Differences in institutional arrangements that affect the sharing of risks between the parties to the pension contract alter the underlying economic substance of the transaction, creating challenges for international accounting standard setters to ensure that similar (dissimilar) underlying economic arrangements are accounted for similarly (dissimilarly). The USA and Australia are selected for analysis because, although the USA and Australia
are similar on many economic and social dimensions, DBP funds in each of the two countries have different origins and institutional arrangements, which leads to significant differences in the economic substance of the pension transaction in these two jurisdictions (Gordon, 2007: Chapter 2). Such differences are likely to explain why, when in the early 1990s the Australian standard-setter attempted to introduce a pension accounting standard that was closely modelled on the originally proposed USA standard, it was unsuccessful (Lambert & Gallery, 1996). Consequently, until convergence with IFRS in 2005, Australia lagged overseas jurisdictions with respect to accounting for pensions.

Second, we are prompted by the IASB’s (2008a) ED comment that current options in (pension) accounting standards for deferring the recognition of employee benefits leads to a lack of comparability. These options were originally included as part of the provisions of the international pension accounting standard IAS 19 and the USA standard SFAS 87 Employers’ Accounting for Pensions (and its preliminary ED). Similarly, Australian pension accounting standards (since 2005) include the deferral options. Thus, it could be said the thinking of the standard setters in each jurisdiction (FASB, AASB and IASB) on pension accounting has been like-minded.

### 3.1 Effects of Social and Institutional Contexts of Pensions on Comparability

Pensions originated in the USA as a type of disability payment for rank and file workers if they suffered workplace injury, and later extended to include a retirement payment (Bateman, Kingston & Piggott, 2001: p.39). In Australia, on the other hand,
pensions were originally considered to be a managerial gratuity largely reserved for senior (office) workers and top management (Ward, 1998: p.12). Since their beginnings, DBP funds in the USA were predominantly non-contributory, where only employers contributed to the plan. By contrast, in Australia most DBP funds are contributory, with both employers and employees contributing (Senate Select Committee on Superannuation, 1991). Consistent with the participatory funding of benefits in Australia, the Superannuation Industry (Supervision) (SIS) Act 1993 requires equal representation between the employer and the employees on the fund’s board of trustees (Gallery, 1999: p. 230), while in the USA, the fund board of trustees is normally appointed by the employer. Table 1 presents some of the key differences between the two countries.

(insert Table 1 about here)

A complex regulatory system was established in the USA to protect the pensions of the ordinary workers (Langbert, 1996). Dating back to 1974, The Employee Retirement Income Security Act (ERISA) and Pension Benefit Guarantee Corporation (PBGC) legislation is a guaranteed benefits system that uses termination insurance to curb opportunistic behaviour by sponsors abandoning under-funded DBPs and associated pension liabilities by enforcing the PBGC lien over the net worth of the sponsoring employer in the event of a plan termination. In contrast, Australian legislation is relatively recent with few provisions applying exclusively to DBPs (Gallery, 1999; Ang, Gallery & Sidhu, 2000: p. 53). Furthermore, there is no system of termination insurance, with Australian policy-makers taking a market-oriented approach of relying on good fund
governance practices, rather than guaranteeing benefits (Roberts & Larkin, 1994). That is, the institutional rules in Australia do not impose a statutory duty upon employers to make up any DBP deficits, and there is no statutory recourse to the sponsoring employer to fund any deficits in the event of fund termination.

In the USA, recourse to sponsoring employers’ assets and penalties imposed on employers for underfunding effectively creates a legal nexus between the employer and the pension fund. This legal nexus, together with the dominance of employers governing DBP funds’ boards, suggests that the fund and employer are part of the same economic entity. In contrast, the absence of statutory obligations for Australian employer entities to make good any shortfall in the DBP funds they sponsor, combined with the sharing of plan governance through equal member and employer board representation, suggests that, in substance, Australian DBP funds are not part of the sponsoring employer’s economic entity.

These varying institutional rules carry implications for pension accounting. In the USA, the pension accounting standard (SFAS 87, replaced by SFAS 158 Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, 2006) requires employer-sponsors to disclose any DBP fund surpluses or deficits, and to, at least partly, recognise in their accounts any DBP deficits. This economic entity approach assumes that the employer remains liable for promised benefits, and an employer’s contribution to the DBP fund merely shifts assets within the economic entity (Miller, 1987). When it was introduced, the international standard IAS 19 similarly required disclosure of any DBP fund surplus or deficit, and allowed the same partial recognition of DBP liabilities in the balance sheet. In Australia, the AASB followed the FASB’s initial approach and
proposed recognition of DBP fund deficits, and in addition, the fund surplus. This proposal met with considerable opposition from the corporate sector and superannuation industry (Ang et al, 2000: p. 41), to which the AASB responded by issuing a standard (AASB 1028 Accounting for Employee Entitlements) with no requirements to recognise pension obligations. Companies were required to provide only limited disclosures about the funding status and contributions paid to the DBP they sponsored.

The Australian standard setter’s attempt to import USA pension accounting innovations is likely to have failed because they did not appreciate the significance of the varying social and institutional arrangements on the accounting for pensions (Ang et al, 2000: p. 53). In the absence of a statutory nexus between the employer-sponsor and the pension fund, it could be argued that Australian companies’ obligation to fund any DBP shortfall is only a constructive and contingent liability. As Napier (2009: p. 238) notes, clearly distinguishing between legal and constructive obligations in the pension context may be difficult, but the employer’s present pension obligation and the proximity of settlement are overriding factors. The appropriate accounting treatment for such a contingent liability (under IAS 37 Provisions, Contingent Liabilities and Contingent Assets and AASB 137) is not to recognise it in the accounts, but to disclose it in the notes. However, when Australia converged to IFRS in 2005, sponsors were required, for the first time, to recognise the net pension position in their balance sheets, even though there is no statutory requirement for sponsors to honour this obligation.

The implication for comparisons between Australian and USA companies, or companies in any other jurisdiction that imposes on them statutory DBP obligations, is that surface comparability is a likely outcome. That is, the underlying pension
arrangements between the two jurisdictions are not “like for like”, so that similar (or the same) accounting method is applied to, in substance, different (pension) transactions. Then, it becomes important to identify the pension liability so that the substantive differences in (pension) rights and obligations are communicated to users (Napier, 2009: p. 247). For example, BHP Billiton Limited has DBP funds operating in Australia, USA, Canada, South America, Europe and South Africa. BHP Billiton Limited is also cross-listed in the USA (as well as the UK). The annual reports filed by BHP Billiton Limited to the Securities Exchange Commission (SEC) in the USA (accessed via Edgar Online) contain almost identical pension disclosures to those pension disclosures reported in Australia as at 30 June 2010. The net pension liability reported in both Australia and the USA as at 30 June 2010 in the consolidated balance sheet of BHP Billiton Limited was US$295 million. Therefore, the same pension liability was reported by BHP Billiton Limited in both jurisdictions yet the nature of the obligation differs. Similarly, Rio Tinto Limited has DBP funds located in the USA and Australia (as well as other countries) and reports a combined deficit of US$3,238m in the Statement of Financial Position in 2010 in both jurisdictions. In relation to the companies’ DBPs that are located in the USA, the pension liability is guaranteed by a 30% lien over the net assets of the sponsor (a legal liability). However, for the companies’ DBPs that are located in Australia, no such statutory backing of pension liabilities exists (a constructive liability). These examples illustrate that, in substance, the companies’ pension obligations differ significantly between Australia and the USA, yet the liabilities are treated as homogenous for reporting purposes.
Our comparability framework (Figure 1) highlights the connection between the economic substance of the transaction (as evident in local institutional rules) and the accounting for the transaction. Accounting for dissimilar arrangements (where the underlying economic substance varies due to legal differences) using the same accounting method is likely to result in surface comparability (refer Figure 1, top right hand cell). To the extent that international accounting standards gloss over the economic substance of transactions or differences in institutional settings, the risk of dissimilar arrangements receiving the same accounting treatment (that is, surface comparability) remains. Given the varying institutional pension arrangements across countries that alter the sharing of risks between the parties to the pension transaction (and therefore the economic substance of the transaction), the regulatory challenge for international accounting standard setters increases.

3.2 Effects of Accounting Options on Comparability

In contrast to the different approaches taken by national standard setters in their respective jurisdictions (such as the FASB and the AASB), the international accounting standard setters either assume away inter-jurisdictional differences in institutional rules (discussed in the previous section) and/or accommodate optional accounting treatments for the same underlying economic reality. In the past, IFRS typically accommodated local needs by permitting a number of accounting options. For example, International Accounting Standard (IAS) 19 (that closely follows the USA pension accounting standard (SFAS 87, 1985 replaced by SFAS 158)) currently permits a variety of accounting
treatments for AGL, including the “corridor” method. More recently, the IASB (2010a) is proposing that these options be removed so that all changes in the pension asset/liability are recognised immediately. As optional accounting treatments for AGL are removed from IFRS, the incidence of non-convergent comparability should decrease with a concomitant increase in deep comparability. However, if, by removing the options, firms have fewer choices to represent the underlying substance of the pension transaction, then an inadvertent consequence that contributes to the regulatory dilemma may be that surface comparability increases.

Pension accounting standards in the USA and Australia were subject to substantial social and political debate during their development (Francis, 1987; Saemann, 1995; Ang et al, 2000: p. 62). As a consequence, compromises and concessions were especially evident in pension accounting standards in the USA (Daley & Tranter, 1990: p. 15). For example, SFAS 87 and later, SFAS 158, contain accounting concessions and detailed rules to suit local needs. To soften the impact of pension accounting on sponsors’ profit and loss and balance sheets, the controversial accounting concessions introduced by SFAS 87 included the corridor method of accounting for AGL and the “minimum liability”, which required only part recognition of pension obligations.

IAS 19 similarly allows the corridor method and other options to account for AGL. The corridor method is essentially a delayed recognition or smoothing technique for the treatment of AGL designed to reduce the reporting of large unexpected pension expenses. It has been criticised because it is arbitrary and deferred actuarial gains / losses do not comply with the definitions of assets / liabilities (Gordon, 2001: p. 58). Immediate recognition of AGL is also permitted by SFAS 158, provided it is consistent and the
method is disclosed. In addition to the corridor method, these accounting standards also permit alternative treatments of AGL including immediate recognition in the income statement and recognition directly in equity. Both BHP Billiton and Rio Tinto take actuarial losses of US$38m and US$786m respectively arising during the 2010 year to the Statements of Comprehensive Income.

The optional pension accounting treatments for AGL permitted by the international accounting standard setters is likely to result in non-convergent comparability. International accounting standards assume that generic accounting solutions with optional accounting treatments can be applied across jurisdictions, so that the same underlying transactions can be accounted for differently (see Figure 1, bottom left hand cell). To the extent that similar arrangements are accounted for differently between firms, given the available number of options for AGL, cross-sectional comparability of pension disclosures between firms within the one jurisdiction is likely to decrease. A likely outcome is that both intra- and inter-jurisdictional comparability is reduced, and non-convergent comparability is likely to result.

3.3 Implications for Intra- and Inter-jurisdictional Comparability

Using the case of pension accounting and applying it to the USA and Australian contexts, the preceding discussion has highlighted that applying a common standard gives rise to two types of dysfunctional comparability: surface comparability and non-convergent comparability. Institutional rules vary between nations, affecting the substance of the pension transaction, and uniformly applying an accounting standard to
intrinsically different economic events leads to inter-jurisdictional surface comparability. Allowing options in the pension accounting standard adds an additional layer of dysfunctional comparability, which we refer to as non-convergent comparability, limiting both intra and inter-jurisdictional comparability.

The problem of non-convergent comparability, where the economic substance of pension arrangements are similar, can be relatively easily addressed in practical terms (but perhaps not so easily in political terms) by eliminating options in the international pension accounting standard. Removing optional accounting treatments for similar transactions would result in deep comparability, both within and between jurisdictions. The problem of surface comparability, where the underlying economic events are different (for example, BHP Billiton Limited’s DBPs in Australia and USA with varying pension promises that are treated the same for reporting purposes), could be dealt with by including specific provisions that reflect institutional differences across or within jurisdictions. In this case, intrinsic differences comparability would be achieved, alerting financial statement users to underlying differences in the economic substance of pension transactions across jurisdictions. The IASB (2008c: paragraph BC2.26) recognises the need to ensure “dissimilar phenomena are presented dissimilarly” in striving to achieve comparability of financial statement information. This basic principle also needs to be reflected in the pension accounting and other standards where economic events that appear to be similar, are in fact intrinsically different.

4. Conclusion
Comparability is a desirable attribute of financial information contained in international and national conceptual frameworks, in that it arguably assists users’ economic decision-making by permitting the evaluation of trends in an entity’s financial performance and position over time, and with other entities. With the convergence of national accounting standards to IFRS, the argument is advanced that enhanced comparability of financial information will result. However, whether adopting IFRS achieves inter-entity comparability within and across national borders is contestable. This is because first, in the accounting context, it is more difficult to assess “like” and “unlike” accounting representations than for physical objects. Second, comparability of financial information is difficult to measure and quantify. Third, comparability depends upon the information being relevant and faithfully represented as a first condition, and then upon the chosen accounting method(s) being consistently applied both across firms and through time. As a result, one possible outcome of financial reporting is a “comparability mirage” that gives the impression that look-a-like economic events are being accounted for the same, but in practice this may not necessarily follow. It is not surprising that the comparability debate in the accounting context has had limited success in articulating how to achieve comparability.

We contribute to the comparability debate by developing a comparability framework that links similar/dissimilar transactions to similar/dissimilar accounting treatments. The framework is applied to global pension accounting. Our comparability framework distinguishes between four types of comparability: surface, deep, non-convergent and intrinsic differences comparability. We show that for pension accounting,
the varying institutional and regulatory frameworks across jurisdictions impede efforts to achieve global comparability by promoting surface comparability.

In addition, the number of accounting options permitted by international accounting standard setters (for example, the optional treatments for AGL) is likely to contribute to non-convergent comparability. The IASB is modifying its approach of issuing accounting standards that contain optional accounting treatments in an effort to reduce non-convergent comparability. For example, recent moves by the IASB (2010a: p. 4) to remove the corridor option for accounting for AGL are likely to reflect the above-mentioned concerns. On the other hand, an unintended consequence of removing choice of accounting treatment may be to create dysfunctional surface comparability as firms have less choice to represent the underlying pension transaction.

Our comparability framework also highlights the difficulties faced by international accounting regulators when inter-jurisdictional differences intervene, and surface comparability is likely. Given that underlying pension transactions typically differ across jurisdictions, in an effort to curb surface comparability the challenge for the international regulators is to outline appropriate accounting treatments for these complex pension transactions in a generic way so that the incidence of risk is accurately reflected in the employer’s financial statements. Referring to the BHP Billiton Limited example earlier, the reporting of pension liabilities in the financial statements should clearly describe the differing risks assumed by the sponsor for DBP funds in the USA (higher risk) compared to DBP funds in Australia (lower risk). Due to the jurisdictional differences concerning the enforcement of the pension obligation, pension disclosures should indicate that the pension obligation in the USA represents a legal liability while
the pension obligation in Australia represents a constructive liability. In this way, users of financial information prepared under IFRS could be made more aware of the varying risks (and shortcomings) of the information provided to them, and apprised of how easily the comparability of financial information can be eroded.

Our analysis acts as a gentle reminder to preparers and users of financial reports of the difficult tasks faced by international standard setters. We contribute to the literature by challenging the general acceptance that convergence to IFRS necessarily enhances comparability of financial information, at least in the case of pension accounting. This is especially critical in light of the varying social and institutional arrangements in place across the globe. In applying global accounting standards, cognisance needs to be given to the multi-faceted way of looking at comparability along the lines of the comparability framework suggested by this paper. The outcomes of this analysis could also be relevant to other accounting issues that the IASB is considering, such as financial instruments.
REFERENCES


Available at


Notes

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 and Zeff, 2006: p. 262).

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.

5 The Occupational Superannuation Standards Act came into effect in 1987, and was subsequently replaced by the Superannuation Industry (Supervision) Act in 1993.

6 Requiring only partial recognition of deficits was a concession to constituents’ concerns that full recognition of the liability would adversely impact the balance sheet, and changes in that liability over time would increase volatility in reported income.

7 Standard setters permit three possible methods to account for actuarial gains and losses in the income statement. Of these alternative accounting treatments, the corridor method is an income smoothing tool aimed at shielding income from volatility due to market movements.

8 SFAS 87 paragraph 32 permitted recognition of AGL outside a 10% corridor (if net cumulative unrecognised AGL exceed the greater of 10% of the projected benefit obligation or 10% of the fair value of plan assets). The minimum amount that an entity should recognise was that part that fell outside the corridor at the end of the previous reporting period, divided by the expected average remaining working lives of the employees participating in that plan. The interval +10% acts as a corridor within which gains and losses are not recognised (Dufresne, 1993: p.2).

9 In a discussion with one of the authors, Ken Peasnell proposed that, as a starting point, the varying levels of risk that attach to pensions across jurisdictions could be addressed as a way to acknowledge that all pension liabilities do not carry the same level of risk. We draw on Ken Peasnell’s idea in proposing how the pension accounting problem might be addressed.
Figure 1: Comparability Framework

<table>
<thead>
<tr>
<th>Accounting method</th>
<th>Economic Substance</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Similar Event</td>
<td>Dissimilar Event</td>
<td></td>
</tr>
<tr>
<td>Same (no options)</td>
<td>Deep comparability</td>
<td>Surface comparability</td>
<td></td>
</tr>
<tr>
<td>Different (including options)</td>
<td>Non-convergent comparability</td>
<td>Intrinsic differences comparability</td>
<td></td>
</tr>
</tbody>
</table>
Table 1: Comparison of the Social Context of Defined Benefit Pension Funds in the USA and Australia (adapted from Ang et al. (2000: p.69) and Gordon (2007: p. 37))

<table>
<thead>
<tr>
<th>Feature</th>
<th>USA</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Genesis</td>
<td>Disability entitlement that later extended to retirement entitlements</td>
<td>Retirement entitlement motivated to avoid fidelity insurance by bondsmen of the bank (for job protection)</td>
</tr>
<tr>
<td>Industries where first introduced</td>
<td>Railways and mining</td>
<td>Banks, insurance and financial institutions</td>
</tr>
<tr>
<td>Early nature of pension arrangement</td>
<td>Dependent upon the benevolence of management but regarded as deferred payment</td>
<td>As a managerial gratuity</td>
</tr>
<tr>
<td>Basis of membership</td>
<td>Generally covered all employees of firms with DBP funds.</td>
<td>Generally limited to senior employees and management</td>
</tr>
<tr>
<td></td>
<td>Plus over 15 additional statutes enacted over the next 30+ years, and Pension Protection Act (2006).</td>
<td></td>
</tr>
<tr>
<td>Funding arrangements</td>
<td>Generally non-contributory (only employers contribute)</td>
<td>Generally contributory (both employers and employees contribute)</td>
</tr>
<tr>
<td>Fund governance structure</td>
<td>Pension plan trustees are usually appointed by the employer</td>
<td>SIS requires equal numbers of employer and member representatives on a pension fund’s board of trustees.</td>
</tr>
<tr>
<td>Statutory insurance guaranteeing benefits of underfunded DBPs that are terminated</td>
<td>Yes - provided through Pension Benefits Guaranty Corporation (PBGC)</td>
<td>No</td>
</tr>
<tr>
<td>Recourse to employers for terminated DBPs that are underfunded</td>
<td>Yes - PBGC 30% lien over firms’ net worth</td>
<td>No</td>
</tr>
<tr>
<td>Funding status</td>
<td>Underfunding is common.</td>
<td>Generally fully funded</td>
</tr>
<tr>
<td>Penalties for failing to meet minimum funding requirements</td>
<td>Penalty tax imposed on sponsoring employers</td>
<td>No statutory penalties imposed on sponsoring employers</td>
</tr>
</tbody>
</table>