AFRICA STANDARD SETTERS CONFERENCE

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COMMENTS MADE BY ALEX WATSON TO DELEGATES ON EDUCATION IMPLICATION OF ADOPTING IFRS

These comments are made in the knowledge that participants are from diverse backgrounds and consequently will have diverse interests in the linkage between IFRS and education. Some of you may be directly involved in education, like me – in which case, the points I am about to raise are probably issues that you have considered. Others may be involved in professional or other bodies and may have some influence in the way in which the educational approach is followed in your constituency. There may be some of you who are from countries that are considering moving onto IFRS – in which case, I hope that the comments I make will assist in making the transition smoother and may also add to the arguments for moving towards IFRS. I am also aware that there are a number of Southern African countries that either have or are considering moving to a professional qualification route. This could incorporate your candidates writing substantially the same professional examination as is written by South African candidates and, therefore, may find it useful to understand a bit more about the education process in South Africa. I hope that my comments will give you some food for thought, irrespective of your connection with the education process in your constituency.

It may help to explain my background as it may give some context to my opinions. My day job is teaching IFRS, which I have been doing at the University of Cape Town since 1982, during which period I have been involved in many of the accounting education projects and processes of the South African Institute of Chartered Accountants (SAICA). In my spare time I am involved in the promotion and development of IFRS in my capacity as the chair of the Accounting Practices Committee, which is the SAICA body that provides feedback to the IASB on their discussion papers and exposure drafts. It also serves as the technical advisory committee to the body that is currently responsible for the issuing of IFRS as a standard in South Africa. The point that I am making is that I am experienced in both education and IFRS developments and I would like to share with you some of my reflections on the inter-connection between the two.

The education model in South Africa involves the majority of the students studying for a minimum of 4 years at university doing professionally orientated courses – the syllabus of which is largely dictated by the material that is covered in the qualifying examinations set by SAICA, which is written within a few months of candidates completing their university studies. The examinations are written in an open-book format and essentially cover the IFRS that have been issued, irrespective of whether or not they are effective in practice. My comments are largely geared to educating candidates for professional qualifying examinations – the educational aspects for qualified accountants of dealing with changes to IFRS or the conversion of existing accounting knowledge to the requirements of IFRS are different, although some of the same concepts will apply.

I believe that the key to financial accounting education is the conceptual framework. A framework based approach to accounting education has many advantages irrespective of the level of the students
and, probably, even irrespective of whether or not IFRS is the reporting framework that forms the core of the technical material that is examinable.

There may be an element of discomfort in placing too much emphasis on the Framework at the moment as a result of the IASB project to revise the Framework, which is being developed in different phases. I do not think that that should be a deterrent, as the key considerations are not likely to change significantly enough to lead to a different conclusion, although the terminology used may differ.

Probably the most important reason for a conceptual framework-based educational approach is that students who develop their accounting knowledge with reference to the Framework will have knowledge that is more enduring, an important attribute given the length of students’ professional working lives. I also believe it makes it easier to cope with future changes, an important consideration given the rapid pace at which the IASB is issuing new documents. The core principles in the standards, which specify the recognition and derecognition as well as measurement and presentation principles in the standards, should be linked to the appropriate aspects of the Framework, usually the qualitative characteristics and definition of elements, particularly the asset definition. For example, it should not be necessary to lecture intangible assets as a separate topic. The requirements of the standard can be explained by demonstrating why the application of the qualitative characteristics may cause the requirements for intangibles to differ from those for property, plant and equipment. Unless the students understand the principles that apply in the standards in the context of the Framework, they may find the volume of standards and their requirements overwhelming and there is also the risk that they will develop less trust in the requirements thereof.

A fair question is if standards keep changing so often, does that mean that the replaced version of the standard was wrong? A student who has a strong understanding of the conceptual framework will understand that individual standards apply the principles of the framework and at different times practical considerations and cost/benefit trade-offs may give rise to different applications of those principles. Students who do not understand the requirements of specific standards in relation to the conceptual principles are in danger not only of having their knowledge obsolete in a very short period of time, but also of having less faith in the value of the standards that are being applied subsequently.

For those countries that are considering a move to IFRS, a way to smooth the transition is to ensure that all financial reporting education is conceptually based. If students, who will be the future preparers, auditors and users of financial statements, understand the principles and concepts of the framework, the switch from the way in which those principles are applied in the country-specific requirements and in the IFRS is not likely to require an ‘unlearning’ of existing knowledge. This is probably also the most effective way of handling the educational implications of a dual reporting framework i.e. IFRS and a country-specific application. If the country specific GAAP is based on the IASB’s framework, highlighting the differences together with an explanation of the cost/benefit or practical considerations that gave rise to the difference is a way of minimising the impact of the differences while reinforcing the key principles. Even in the unlikely event that country specific GAAP is based on a substantially different framework, it is far easier to explain the differences behind two frameworks than it is to re-educate on each specific area of GAAP.
As the IFRS standards are principle based, there are not specific rules for each application that will be encountered. That creates problems for educators, students and their assessors. Educationally, the right approach is to focus on explaining the core principles of a standard and the factors that preparers should consider in applying those principles. This is not easy from an educator’s perspective – students want to know what the answer is and they feel vulnerable if they reach a different conclusion. One of the challenges is to help students develop the confidence in their understanding of the conceptual framework and the way in which a specific financial reporting standard applies for them to be able to challenge suggestions of inappropriate reporting. We need to develop users, preparers and assurance providers who have the skills to question the way in which the accounting standards are being applied – and to do that in a conceptual and principle based manner.

The challenge of getting educators to deliver material, in whatever form, on a basis that emphasises the conceptual principles, as opposed to the rules, that could be used to apply those principles and the mechanisms for applying those rules should not be underestimated. Students prefer to get told how to do something than to develop their own approach based on their understanding of the principles. The system in place encourages giving students that guidance – students like a format for tackling different applications, and as most lecturers are evaluated by students, there is a temptation to indulge them. It is also much easier to mark a question when every student has tackled their workings in the same manner. I do believe that those who are responsible for quality assessments of education providers should be looking at the solutions that students prepare for their examinations – where the format of most students is substantially similar, that probably indicates that the emphasis of the education process is on the mechanics of getting to an answer rather than the principles underpinning that topic. As an aside, I also believe that academics should be evaluated on their students’ ability to perform in subsequent courses or external examinations and not on their popularity with students.

The ability to exercise judgment and take responsibility for decisions is a necessary component of being a professional. One of the roles of the education of accountants is to develop the ability of future accountants to exercise judgment – the principle-based nature of the standards is a useful tool for doing that. This does require that those that are responsible for the setting of examination papers have the skills and inclination to set the type of question that tests the ability to exercise judgement, and that markers understand what is being assessed and have the skills to deal with a number of different approaches.

One of the particular challenges for educators at the earlier stages of accounting education is to understand the implications of preparing students for financial reporting as opposed to being bookkeepers. The emphasis on planning the overall curriculum for students is to enable them to provide decision-useful information to outside providers of capital. To do this, students need to know what type of decisions capital providers will be making and what type of information they will need in order to make those decisions. Students therefore need to be exposed to a wide variety of different issues that impact on the ability to make decisions, which must include at least some micro and macro economics. It is essential that students’ ability to deal with the judgements required in making decisions is identified early on in their development – there is an important role for bookkeepers in the world, but if you want to attract the right people to the financial reporting and assurance profession, it is essential

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that the ability to use judgement to make decisions is identified early enough in their studies to redirect those that do not have those skills to a career path that is more suited to their skills.

Fair value is increasingly used in IFRS, for good reason when one considers the objective of providing decision-useful information. The application of IFRS relies on estimations and that is not only in relation to those instances where an accounting policy requires fair value. Accounting for business combinations, doing impairment testing, recognising provisions and calculating depreciation are examples where estimates are used in applying the principles required. In most of these cases, estimation requires a valuation exercise - those who will be responsible for preparing financial statements need to have a good understanding of valuation theory and how to audit fair values. Countries that are in the process of adopting IFRS will have to ensure not only that their students are getting sufficient exposure to valuation principles, but more importantly that students understand the linkages between the other courses that they are doing and the financial reporting process. An ongoing challenge for educators is to assist the students to understand how the knowledge that they have applied in other courses has broader application – and the decision-usefulness focus of IFRS and the increased usage of estimates and other fair value aspects in IFRS makes this an even greater imperative. The increasing use of the business model in making accounting decisions also necessitates a broad business education for accounting students.

One of our roles as IFRS accounting educators is to ensure that students know how to use IFRS effectively. I strongly believe that any examination that requires students to apply the requirements of financial reporting standards should be an open book exam – that implies that the emphasis of questions will be on the application of the principles and not on the memorising of the current requirements.

A development that has made it much easier for students to use standards effectively is the IASC F’s publication of what they refer to as “A Guide through IFRS”, which is essentially a full set of standards but cross referenced to the Basis of Conclusions for an explanation of why the IASB reached a particular decision or an illustrative example on a point, as well as having references to IFRIC interpretations or agenda decisions on particular paragraphs. This is the version that South African students are encouraged to use in examinations. The point was made earlier about the importance of developing students’ ability to make judgements and the understanding of the conceptual framework as the basis for financial reporting. Reading the Basis for Conclusions (BC) is an effective way to develop and reinforce those skills as the BC record the judgment used by the IASB in assessing the extent to which a prescribed treatment meets the objectives of financial reporting as set out in the Framework. The publication of dissenting opinions is useful to demonstrate the importance of being able to exercise judgement, articulate a principal-based opinion and be tolerant of different points of view.

Directing students to the bases for conclusions will assist future preparers to make those hard decisions that are required where the accounting for a transaction is not included in the scope of a current reporting standards and therefore an accounting policy needs to be developed in accordance with the hierarchy as required in terms of IAS 8, the standard that deals with the selection of accounting policies. In an educational environment, the same skills are developed and tested by exposing students to questions that ask them to suggest a suitable accounting treatment for a specific transaction not
covered by a standard. A source of many of my discussion accounting questions is early drafts of IASB
documentations – rate regulated industries and emission schemes are two examples that spring to
mind, where the students were expected to propose a suitable accounting treatment by considering the
requirements of the Framework.

My recommendation is therefore that any country that is using or planning to use IFRS, moves towards
open book examinations where the students have access to the financial reporting standards, and that
the version of the standards that is used is the one developed for educational reporting purposes, namely the
“Guide Through IFRS”. It is worth noting that there is free access to the clean standards on the IASB
webpage – but that implies that the bases for conclusions and illustrative examples are not included, both of which are important teaching aids.

HOW IFRS FOR SMES CAN ASSIST

One of the methods that can be used to prepare students for the challenges of preparing for professional examinations that examine IFRS, particularly where that is done in an open book format, is to use IFRS for SMEs as the teaching material for a more junior course e.g. second year of a four year educational process. The model that we use is to focus on the conceptual framework in first year in conjunction with some basic bookkeeping. This implies that the students should be able to prepare simple financial statements, but also be able to justify the transactions that have been processed in terms of the conceptual framework. In second year, the students are taught the principles as applied in the IFRS for SMEs and are allowed to have a copy of the IFRS for SME handbook with them for their tests and examinations.

This approach has a number of practical and educational advantages. On the educational side, this
implies that the emphasis needs to be placed on the principles that apply to the majority of the companies – and removes the temptation to focus on the exceptions and to some extent more interesting complexities. Most educators want their courses to be interesting and to extend the capabilities of the students – one of the consequences of that is that there is that the exceptions and complexities are emphasized at the expense of the basics. Sticking to the requirements of the IFRS for SMEs forces that discipline and provides for an a more effective scaffolding of students’ knowledge in their more senior years of study.

A more important aspect is that it develops a culture of referring to the standards as the authoritative source in answering questions. Prior to making the second year course an open book exam, students would refer to course notes, text books or “my lecturer said” to answer assignments – answering in terms of the standards is more reliable and develops skills that will enable them to deal with the inevitable changes to standards while they are in practice. The fact that the IFRS for SMEs is written in plain English is a huge plus. Many of our students do not speak English at home and are studying in English. For those who are not as conversant in English and who are not enthusiastic readers, the language and the length of the full IFRS can be daunting. Using the IFRS for SMEs is a useful way to ease them into the requirements of the full IFRS standards, which they are then expected to apply in their third and fourth year of their studies.

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On the practical side – the IFRS standards are changed at such a rapid rate that in almost every year students are required to have access to a new set of standards. While the standards are not that expensive considering the work that has gone into them and their length – it is expensive to acquire separate sets for each of their final three years of study. The SMEs standard is published as a standard alone publication that the students acquire in second year, and therefore only need to get two sets of full IFRS.

Another practical advantage of dealing with IFRS for SMEs as part of the educational process is the quality of the educational material freely available on the IASB webpage. There are useful summaries, worked examples, including fairly advanced case studies and guidance given that can be used by educators who have not developed their own material. Attention is also drawn to those aspects where judgement needs to be exercised in complying with the requirements. Provided that candidates have internet access or at least computer access, the appropriate teaching support material is readily available and free.

IMPACT OF IFRS ADOPTION ON EDUCATION MODELS

Different education models are applied in different countries for preparing students to write their professional examinations. Essentially there are three choices, provision by the Institute, by universities or by private service providers. The model in South Africa is that education is provided by universities, with the vast majority of students writing their technical qualifying examination after either a four or five year programme of full-time study.

The model of providing IFRS-driven accounting education through universities, as is currently done in South Africa, does create tensions as a result of the fast pace of change of the IFRS. Most universities consider research output and post-graduate qualifications as the most important factors driving promotion and appointment of academics. For those academics who are responsible for teaching the most technical material and the latest material, it is very difficult to spend sufficient time on one particular topic to produce a thesis of the quality required to get a PhD or even a Masters and still keep up to date with the material to which the students must be exposed. Teaching professional accounting in a research-led university is not a comfortable fit – developments of new ideas in financial reporting generally do not take place in the academic environment and generally do not get communicated through peer reviewed journals. This is problematic as publications in peer-reviewed journals is the primary measure for academic output and is part of the South African university funding model.

Academics are then faced with the choice of researching a specific topic to get published in a journal which is unlikely to make a major contribution to the development of knowledge in their field, but is likely to get them promoted. A far more useful way of influencing the outcome of developments of financial reporting is to monitor what is happening at a standard settling level, provide feedback on proposed changes or even better, get involved in the development of standards at whatever level is possible. Unless there is an understanding of the way in which financial reporting standards are developed, the criteria that are generally used to evaluate academics will result in academics having to make some hard choices about spending time on activities that will help their careers or activities that will help the education of their students and the development of financial reporting standards. The lack

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of understanding of the way in which developments in financial reporting occur and the inflexibility in approach used to evaluate academics causes ongoing tension in university accounting departments and is threatening to undermine the current high quality of our accounting graduates.

One of the suggestions that has been made to address the problems explained above is to take the final year of education out of the university environment and into professional accounting colleges. That may turn out to be the only way to maintain the quality of our accounting graduates if the universities are not prepared to consider the specific challenges of teaching a highly technical syllabus that is constantly changing and adapt their promotion and appointment criteria accordingly. That will result in taking academic leadership out of the universities and into commercial colleges which is likely to water down the quality of the undergraduate teaching quite quickly. In addition, most universities have some form of tutorial system, where more senior students tutor the more junior courses – removing the senior students from the academic environment will make that model, which is highly effective, impossible. There are also challenges involved in offering support courses if the programmes are taken out of a university or college environment offering a broader education.

In some countries, accounting education is conducted through courses offered by the institute of accountants. This model is not considered appropriate in South Africa as the institute is responsible for the examinations – and it would not be appropriate to be both the coach and the referee! This may be a possibility in countries that are not responsible for their own exam setting.

In conclusion, the rapid pace of change in IFRS, the necessity of exercising judgement in applying the standards and the need for professional accountants to be life-long learners are factors that need to be considered in accounting education. In my experience, the most effective way of doing that is to use the conceptual framework as the foundation for teaching.