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**Ambiguities in Accounting and their Impact on Regulatory Arbitrage**

A Study on the Anchoring of the Rights and Obligations Approach in the IASB’s Conceptual Framework

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**Abstract:** The revision of the asset and liability definitions is at the core of the International Accounting Standards Board’s (IASB) efforts to reflect more truthfully the economic substance of the underlying business transactions. In the IASB’s revised Conceptual Framework (CF) from 2018, the board redefined assets and liabilities in terms of rights and obligations, thereby explicitly abstaining from a notion of indivisible balance sheet items. This alteration lays the conceptual foundation for carving out pieces of an item in accounting standards, enabling the removal of arbitrary bright line tests, and, eventually seeks to tackle regulatory arbitrage. Drawing upon 18 expert interviews as well as a document analysis, this study sheds light on the process that led to the anchoring of the rights and obligations model in the IASB’s CF. Using literature on ambiguities in accounting as a theoretical frame, this study goes on to show that removing ambiguities in the asset and liability definitions creates new ambiguities and additional discretionary leeway in turn. The paper argues that the perpetual cycle of ambiguity reduction and creation in accounting (Davie, 2000) also includes ambiguity shifting between the conceptual basis of financial reporting and accounting standards. By comparing the previous International Accounting Standard (IAS) 17: *Leases*, which followed a physicalist, ownership-based notion of assets, with the revised International Financial Reporting Standard (IFRS) 16, the paper demonstrates that the explicit anchoring of the rights and obligations approach does not fully solve the issue of regulatory arbitrage. Instead, it shifts the playing field for structuring activities from the evasion of precise rules to the bending of interpretations.

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Table of Contents
1 Introduction
2 Literature Review Focusing on the Significance of Ambiguities in Accounting
3 Methods
4 The Elements of Financial Statements in the IASB’s Conceptual Framework
5 The Removal and Creation of Ambiguities in the IASB’s Conceptual Framework and in Accounting Standard Setting
   5.1 Tracing the Removal of Ambiguities in the IASB’s Conceptual Underpinning of Financial Reporting from 2001 to 2018
   5.2 Creating and Shifting Ambiguities in the Revised IASB’s Conceptual Framework from 2018
   5.3 Translating Ambiguities into the Accounting for Leases
6 Discussion and Conclusion
References

Economic, Legal and Social Dimensions of Regulatory Arbitrage


1 Introduction

In March 2018, the International Accounting Standards Board (IASB) published the revised version of its Conceptual Framework (CF), which constitutes the principles-based guideline for the development and revision of International Financial
Reporting Standards (IFRS). For a long time, preparers, users and other stakeholders widely considered the conceptual framework project “as something not deserving of much attention because of its high-level nature and the fact that it is unlikely to have any impact on requirements in accounting standards for some time to come” (ICAS/IFAC, 2014, p. 5). However, the CF is at the heart of the IASB’s “revolution in financial reporting” (IASB, 2012, p. 4), which has striven for a more faithful representation of the “economic substance of the underlying economic phenomenon” (IASB, 2018b, para. 2.32) since 2001. As a cornerstone of this movement, the IASB refined two key elements of financial statements – assets and liabilities – in terms of rights and obligations. In doing so, the board removed ambiguities in the definitions of balance sheet items. While the previous CF, issued by the International Accounting Standards Committee (IASC) in 1989, ambiguously defined assets in such a way that allowed multiple interpretations (Abela, Barker, Sommer, Teixeira, & André, 2014; Booth, 2003), the revised definition of assets limits its scope to a single accounting model, thereby “altering the concepts to advance a particular model of financial reporting” (O’Brien, 2009, p. 273).

Despite this significant conceptual shift, accounting research has left the IASB’s decisions leading up to removing ambiguities in the asset and liability definitions as well as the implications of this important refinement largely unexplored.

By abstaining from a notion of assets as indivisible items, the board has attempted to remove the conceptual grounding for issuing accounting standards that follow an “all-or-nothing” (Dworkin, 1967, p. 25) approach. Particularly, previous lease accounting standards (IAS 17 and the US counterpart Statement of Financial Accounting Standards (SFAS) 13) followed a notion of assets linked to the tangible reality, which either recognized the entire physical asset (leased property) and the corresponding lease liability or nothing at all (e.g., Donegan & Sunder, 1989, p. 211). Along these lines, the resulting sharp demarcation for the classification in finance (‘all’) or operating (‘nothing’) leases forms part of what W. McGregor (former IASB board member) calls “‘cliff-edge’ accounting [that] has no conceptual rationale” (AASB, 2013, p. 36). As accounting practice applied IAS 17

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1 The revision of the conceptual underpinning started as a joint IASB/FASB project in the early 2000s. The two bodies jointly reviewed the Objective of Financial Reporting and the Qualitative Characteristics of Useful Financial Information in 2010. From 2012 onwards, the IASB conducted the project on its own. The CF from 2018 deals with the remaining building blocks (Financial Statements and Reporting Entity, Elements of Financial Statements, Recognition and Derecognition, Measurement, Presentation and Disclosure, Concepts of Capital and Capital Maintenance) and includes updated versions on the Objective of Financial Reporting and Qualitative Characteristics.

2 This interpretation of the IASC’s asset definition includes the recognition of both tangible and intangible items (e.g., patents).
with the bright line tests of SFAS 13 in mind, the lease accounting standard allowed economically similar business transactions to be treated differently and, thus, facilitated “accounting-motivated financial engineering” (Dye, Glover, & Sunder, 2015, p. 266).

Against the backdrop that the previous lease accounting standards were “[c]onceptually and operationally an accounting nightmare” (Reither, 1998, p. 288), the reviewed definitions of assets and liabilities in terms of atomized rights and obligations lay the conceptual foundation for bundling and unbundling of items. This componentization option is a necessary precondition for tackling arbitrary bright lines at the standards level, for example, those included in the flawed lease accounting standards, as it allows a more fine-grained depiction of an entity’s wealth. Along these lines, the IASB’s CF project and the conceptual alterations on the asset and liability definitions in particular, are crucial for revising various accounting standards (IASB, 2012, p. 8; see also ICAS/IFAC, 2014, p. 12), as the framework “sets the direction of travel and it is at the heart of debates about what gets recognised (and what does not)” (ICAS/IFAC, 2014, p. 5; see also McCahey & McGregor, 2013, p. 10). Even though the rights and obligations approach enables componentization of balance sheet items and aims to move “[a]ssets and liabilities that companies have moved ‘off balance sheet’ […] back ‘on balance sheet’” (Tweedie, 2002, p. 13), this paper shows that the CF spawns new complexities and ambiguities, creating, in turn, new opportunities for regulatory arbitrage.

By drawing upon 18 expert interviews and a document analysis, this study traces the process of removing ambiguities from the asset and liability definitions, covering the period from 2001 to 2018 and sheds light on shifts in ambiguities to other arenas. As theoretical basis for the analysis, this paper draws on works on the role of ambiguities in accounting (Hopwood, 1990; McSweeney, 1997) to examine the ambiguity-reducing and ambiguity-creating functions of accounting as a self-perpetuating cycle (Davie, 2000). While “accounting is supposed to reduce

3 SFAS 13, para. 7(d), for example, demanded that the present value at the beginning of the lease term of the minimum lease payment equals or exceeds 90% of the excess of the fair value of the leased property to classify the lease as a finance lease, resulting in recognition of the leased property and the corresponding lease liability. Hence, if the present value remains 89.9% or less, the lease is treated off-balance sheet. Given this precise bright line, financial engineers could structure lease transactions to ensure an off-balance sheet treatment. The same holds true for IFRS applicants, as the classification in operating and finance leases under IAS 17 has been interpreted, in practice, through the numeric guidance set out in SFAS 13. This reference was enabled by IAS 8 (para. 7–12), which explicitly supports using US guidance and accepted industry practices in cases where the IFRS offers none.

4 For example, the IASB’s envisaged revision of IAS 37: Provisions, Contingent Liabilities and Contingent Assets to align the liability definition with the IASB’s CF (IASB, 2020) reflects these broader implications of conceptual changes on accounting standard setting.
ambiguity through its conceptual and technical specificity and precision” (Davie, 2000, p. 316) at one level, the paper illustrates that the anchoring of the rights and obligations model entails new ambiguities at another level, particularly in the conceptually interlinked building blocks of the unit of account and recognition criteria. The paper goes on to show how this conceptual juxtaposition of ambiguity reduction and ambiguity creation is anchored in accounting standards, using the example of IFRS 16: Leases. While removing ambiguities in the asset and liability definitions provides the conceptual rationale for fundamental changes at the standards level, the paper demonstrates that ambiguities, inherent to the rights and obligations approach, were translated into the new accounting standard for leases. By examining this translation process, the study argues that the perpetual cycle of ambiguity reduction and creation (Davie, 2000) also includes ambiguity shifting between the conceptual basis of financial reporting and accounting standards.

This paper contributes to the debate on the conceptual underpinnings in financial reporting by analyzing the reconceptualization of elements of financial statements and by examining how this refinement shifts ambiguities to the issue of the unit of account and recognition criteria. Research on CF projects (Booth & Cocks, 1990; Bullen & Crook, 2005; Hines 1989, 1991; Peasnell, 1982; Robson, 1999; Whittington, 2008) examined the social construction of users in financial reporting (Young, 2006) while more recent studies provide interview-based evidence on the decision-making process in revising the objective of financial reporting (Pelger, 2016) and the qualitative characteristics (Erb & Pelger, 2015). This paper adds to this literature as it traces the path towards the anchoring of the rights and obligations approach since 2001 and reveals how changes in the conceptual framework served as a political tool to legitimate accounting change at the standards level.

In this vein, the paper brings together literature on conceptual frameworks with research that focuses on the political dimension of accounting standard setting processes (Baudot, 2014, 2018; Morley, 2011; Thiemann, 2018; Young, 1994, 2014). While research on the conceptual underpinnings of financial reporting investigated conceptual changes that are “too lofty criteria” (Ohlson et al., 2010, p. 475) to have direct implications for the (re)designing of accounting standards (comp. Erb & Pelger, 2015; Pelger, 2016), it widely neglects the crucial role of further conceptual building blocks and their (direct) impact on accounting standard setting (but see Monson, 2001 on the Financial Accounting Standards Board’s (FASB) CF and SFAS 13). By examining the implications of the transition from IAS 17 to IFRS 16 from a lessee’s perspective, this paper shows how removing

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5 This study focuses on the accounting for leases by the lessee as the lessor accounting requirements under IFRS 16 remain largely unchanged (IFRS 16, para. IN14) due to intense industry lobbying (comp. Friedrich, Kunkel, & Thiemann, 2020).
ambiguities from the definitions of assets and liabilities feeds into accounting standards and affects the playing field of regulatory arbitrage. As such, this paper also adds to the literature on financial engineering in accounting (Biondi et al., 2011; Donegan & Sunder, 1989; Dye et al., 2015; Thiemann, 2014; Thiemann & Lepoutre, 2017), as it demonstrates how issues of regulatory arbitrage are linked to ambiguities in the conceptual underpinnings of financial reporting.

This paper is structured as follows: Section 2 first outlines the role of ambiguities in accounting and discusses the literature on conceptual frameworks of financial reporting in the context of regulatory arbitrage, before explaining the methods used in the empirical analysis in Section 3. Section 4 examines conceptual adjustments in three cornerstones of financial reporting – definitions of elements, unit of account and recognition. In Section 5, the paper traces the process of anchoring the rights and obligations approach in the IASB’s CF, before turning to the creation of ambiguities through the revised definitions of assets and liabilities. By focusing on issues of regulatory arbitrage, this creation of conceptual ambiguities and their translation into accounting standards is then examined through a comparison of the previous IAS 17 with the new lease accounting standard IFRS 16. The final section discusses the findings and closes with an outlook as well as possible opportunities for future research.

2 Literature Review Focusing on the Significance of Ambiguities in Accounting

Hopwood (1990, p. 79) describes accounting as a “paradoxical phenomenon” and emphasizes the tense juxtaposition of technical specificity and conceptual vagueness, which “enables a degree of ambiguity to enter the accounting realm” (ibid.). Despite accounting regulations being full of technical details and precisely defined procedures, “[t]erminology is subject to poor usage and a lack of clarity” (ibid.).

On the one hand, ambiguities allow accounting terminology to be interpreted in a variety of ways. This allows “a certain fluidity to enter into the corporate accounting domain” (Hopwood, 1990, p. 80) and leaves “room for alternative reactions and classifications” (Davie, 2000, p. 315). The ambiguity inherent to accounting expressions is associated with discretion for preparers and auditors. In practice, accounting expressions are interpreted divergently and can be manipulated (Hopwood, 1987, 1990; McSweeney, 1997) to obtain a certain accounting outcome. The combination of multiple interpretations, omissions in accounting regulations and susceptibility for structuring activities “makes the practice of accounting a fertile source of ambiguity” (Davie, 2000, p. 316).
On the other hand, accounting can also be seen as a performance aimed at reducing these ambiguities through conceptual and technical explicitness (Davie, 2000, p. 316). Boundaries and task performance tend to be precisely defined to deal with the inherent vagueness of accounting terminology and ensure a certain degree of order and control over accountants’ behavior. However, removing ambiguities is also a classificatory process, which involves a managerial issue of proper application of technical procedures and practices to delineate between categories. As drawing boundaries is a highly political act in accounting (Thiemann & Friedrich, 2016), Davie (2000, p. 315) emphasizes that ambiguities are part of a dynamic process as “there would be no need for clarity if there were no ambiguities, and there would be no ambiguities if not for the pursuance of specific and conflicting interests”. Davie (2000, p. 316) further argues that drawing boundaries also “produces the ultimate source of indecision and uncertainty”, creating new ambiguities that call for further precision and clarification. In this way, accounting is characterized by a perpetual cycle of ambiguity reduction and ambiguity creation and “conceptual and technical ambiguities merely create and enhance the need for more and more accounting” (ibid., p. 330). The reciprocity between specifications and ambiguities in accounting practice and regulation manifests in the debate of precise accounting rules and vaguely formulated principles (Maines et al., 2003a; Nobes, 2005; Schipper, 2003; Wuestemann & Wuestemann, 2010). Nelson (2003, p. 91) understands rules “to include specific criteria, ‘bright line’ thresholds, examples, scope restrictions, exceptions, subsequent precedents, implementation guidance, etc.”. Rules-based accounting standards contribute to certainty, order, comparability, and enforceability (cf. Wuestemann & Wuestemann, 2010), thereby reducing vagueness, uncertainties and judgment. Notwithstanding their ambiguity-reducing function (Davie, 2000), rules are particularly prone to regulatory arbitrage. Financial engineers purposively exploit “the gap between the economic substance of a transaction and its legal or regulatory treatment” (Fleischer, 2010, p. 3) and creatively redesign transactions, instruments and even organizations (Bens & Monahan, 2008; Robé, 2011; Sunder, 2011) “to make accounting choices that cast their actions in the best possible light” (Donegan & Sunder, 1989, p. 206). In this vein, “accounting resembles a game” (Gerboth, 1987a, p. 97) and rules “facilitate strategic evasion, allowing artful dodging of a rule’s spirit by literal compliance with its technical letter” (Cunningham, 2007, p. 1423). Research studies indicate that “identifying stylized arrangements that fall between the cracks” (Maines et al., 2003b, p. 167) are more likely if standards include quantitative thresholds rather than qualitative principles (Agoglia, Doupnik, & Tsakumis, 2011). Here, national and international regulations for lease transactions are a textbook example of evading precise accounting rules (Biondi et al., 2011; Donegan & Sunder, 1989; Friedrich, 2020 in...
this issue; Imhoff & Thomas, 1988), as they “inadvertently provide preparers with a roadmap for evading regulatory intent” (Dye et al., 2015, p. 270). Several studies provide evidence that precisely formulated accounting standards encourage managers to engage in earnings management by artificially structuring transactions to manage the current-year income of their firms and that auditors are less likely to adjust such attempts (see on SFAS 13 Krische, Sanders, & Smith, 2012; Nelson, Elliott, & Tarpley, 2002, 2003).

As rules are often incomplete and susceptible to actions of regulatory arbitrage, principles-based accounting systems have been hailed for placing the standard’s intent center stage (Maines et al., 2003a; Schipper, 2003; SEC, 2003), as they allow for a dynamic interpretation that adapts to the circumstances of each case. Instead of numerical guidance, principles-based accounting systems focus on the regulation’s spirit. Such accounting systems are predominantly viewed as mitigating structuring activities (cf. Dye et al., 2015) as they underscore the economic substance of the underlying business transaction rather than its form. As such, they ensure a ‘fair’ representation of financial statements (Sunder, 2009).

Nevertheless, principles-based accounting systems also have significant shortcomings, as they too spawn new complexities and ambiguities. The abstractness and inherent openness of principles induce uncertainties (see Braithwaite, 2002 for a critical stance to this prevailing view) and shift discretionary power about acceptable accounting practices to preparers and auditors. Nelson (2003) cites a large strand of empirical literature arguing that imprecise accounting standards allow multiple interpretations and offer room for negotiation, which equips managers with new tools to conduct ulterior and aggressive reporting (see also Donegan & Sunder, 1989; Maines et al., 2003a; Sunder, 2009). Pointing to the weaknesses of ambiguous accounting principles subject to individual interpretation (partly used to achieve desired accounting outcomes), other constituents emphasize the need for preparers’ and auditors’ willingness for unbiased reporting (Maines et al., 2003a; SEC, 1999; Sunder, 2010). For example, Hackenbrack and Nelson (1996) provide evidence that vaguely formulated accounting standards allow auditors to justify either aggressive or conservative reporting decisions, depending on their incentives. Despite these deficiencies, standard setters have increasingly established a more principles-based accounting system over the last 20 years (Camfferman & Zeff, 2015).

In accounting systems predominantly based on principles, conceptual frameworks are central devices that provide “a basic structure for organising one’s thinking about what one is trying to do and how to go about it” (Macve, 2016, p. 45). Conceptual frameworks do more than pursue the goal of conceptually defining the boundaries within which standard setters should operate (Ohlson et al., 2010); they also demarcate – from a technical and functional perspective – the boundary
between what is true and false, acceptable and unacceptable, good and bad ac-
counting treatment (Peasnell, 1982; Solomons, 1997; Young, 1994, 2006). Although
counting research strongly criticized the initial series of Statements of Financial
Accounting Concepts (SFAC 1-6) issued by the FASB during the late 1970s and
1980s as well as the IASC’s conceptual framework for their abstractness and
technical and conceptual imperfection (Agrawal, Jensen, Meador, & Sellers, 1989;
experience reveals a problem at the heart of US accounting – with the FASB’s
conceptual framework that encourages and legitimates creative accounting”.
Specifically, this critique referred to the core of the conceptual frameworks, namely
their definitions of assets and liabilities, which have been blamed for their all-
inclusiveness and openness to a wide range of interpretations (Booth, 2003; Bullen
& Crook, 2005; Dopuch & Sunder, 1980; Gore & Zimmerman, 2007; Samuelson,
1996; Solomons, 1986; Williams, 2003).

Besides the functional aspect of conceptual frameworks, a growing strand of
accounting literature points to the central role of ambiguities in conceptual
framework projects (Erb & Pelger, 2015; Pelger, 2016). While Young (2006) in-
vestigates the social construction of users and its connection to the objective of
financial reporting, Zeff (2013, p. 265) states that the objective – decision usefulness – is “[y]et another term with diverse meanings, or at least diverse inter-
pretations”. Pelger (2016, p. 66) demonstrates that the ambiguous wording of
decision usefulness in the IASB’s Exposure Draft (ED) on the CF from 2008 allowed
for multiple interpretations and “contributed to the lack of challenge […] by either
side at this stage”. Hence, ambiguities are crucial for finding consensus among
competing actors in accounting standard setting (Erb & Pelger, 2015).

Along these lines, Erb and Pelger (2015) have traced the process of replacing
the qualitative characteristic of reliability with the more ambiguous principle of
faithful representation in the IASB’s partial revision of the CF in 2010. While
elevating faithful representation facilitates the use of fair value accounting, Erb
and Pelger (2015, p. 34) emphasize that “[t]he material effect of the replacement,
however, remains unclear, given diverse views on the meaning and relevance of
qualitative characteristics even among board members”. Elaborating on ambigu-
ities surrounding the principle of faithful representation and its pursuit to reflect
economic reality, accounting research has stressed that neither current nor
reformed accounting regulation is capable of producing unambiguous represen-
tations (Hines, 1991; McSweeney, 1997). As there is no escape from judgment on
the abstract principle of faithful representation, McSweeney (1997, p. 706) argues that
“the pursuit of the unattainable is nonetheless real and productive”. Besides these
ambiguous, but fundamental principles of financial reporting, Sunder (2011, p.
126) points to the “precision-breadth dilemma” in the context of the definition of words, and stresses that some degree of ambiguity of meaning and words is useful for ensuring that most of the elements are captured by the definition. In the same vein, Schipper (2003, p. 65) emphasizes the necessity of broad asset and liability definitions to avoid any type of threshold issues. Research leaves the conceptual changes to the elements of financial statements and related concepts, such as the unit of account issue and recognition criteria, widely unexplored, however. Analyzing conceptual changes to assets and liabilities and interrelated building blocks as set out in the revised IASB’s CF from 2018 is essential as those building blocks directly impact accounting standard setting, whereas the objective of financial reporting as well as qualitative characteristics are both rather overarching building blocks from which to guide and revise standards.

Furthermore, although conceptual frameworks are of central importance in accounting, literature on the political economy of accounting standard setting (Baudot, 2014, 2018; Fogarty, Hussein, & Ketz, 1994; Morley, 2011; Thiemann & Lepoutre, 2017; Young, 1994, 2014) largely neglects the crucial role of conceptual framework projects for any fundamental and incremental (Djelic & Quack, 2003) accounting change. Hines (1989) has pointed to the political and strategic dimension and Horngren (1994, p. 106) argued that a “conceptual framework can help policymakers” “if it provides a common language, methods of analysis and constraints” (ibid., p. 107). In a similar vein, Miller (1990, p. 23) stresses that the unanimous vote of the FASB to adopt the asset/liability view “contains much that would lead to substantial reform in accounting practice” as the question on the elements of financial statements represents a “pivotal issue” (ibid., p. 26), enabling “significant change in the status quo” (ibid., p. 23, italics in the original). Chakravarthy (2014) provides empirical evidence that, in the period after the FASB’s issuance of the initial series of SFACs in 1985, the Financial Accounting Foundation preferably selected FASB members, advocating the asset and liability approach in the development of accounting standards. The study shows that this change to the institutional composition fostered the FASB’s transition to the asset and liability language in accounting standard setting, as it reduced the level of disagreement among board members on this issue. While Morley (2011, p. 179) points out that conceptual frameworks may become an obstacle for accounting change and stresses that “[w]hat might have been considered a force for change at

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6 While stressing the importance of the definition of words such as assets and liabilities, Sunder (2011) points to the difficulty of writing ‘good’ definitions, as they are subject to the precision-breadth dilemma. He argues that “[t]he more precise a definition is, fewer of the unwanted elements would qualify but more of the wanted elements would be left out” (Sunder, 2011, p. 126), whereas “[t]he reverse is true of expansive definitions” (ibid.).
one point in time, now acts as a reminder of the radical thinking of a long gone era”, Friedrich et al. (2020) show that accounting professionals may also exploit the subordinate role of conceptual framework projects to gradually implement substantial accounting reform.

Relying on literature on ambiguities in accounting, this paper aims to reveal linkages between conceptual frameworks and the political economy of accounting standard setting. Specifically, it traces the process leading to the rights and obligations approach in the IASB’s CF and seeks to understand how ambiguities are translated from the conceptual to the standards level and how this process affects regulatory arbitrage.

3 Methods

To accomplish this task, this paper combines a document analysis and interview data. The paper starts by comparing the definitions of assets and liabilities in the IASC’s CF from 1989 with the refined notions in the IASB’s CF from 2018 to demonstrate conceptual adjustments. This comparison is combined with a hand-selected document analysis of what constitutes assets and liabilities. Here, relevant materials released from accounting standard setters and its technical staff who were either directly involved in the drafting of the relevant passages or indirectly dealt with the elements of financial statements through their work in related projects (e.g., leases or provisions) are of particular interest. Sources for this review include publicly available documents from the IASC/IASB/FASB and market regulators (e.g., the Securities and Exchange Commission (SEC)) that focus on developing and revising the conceptual basis for accounting standard setting. The analysis also includes speeches as well as agenda papers, discussion papers, exposure drafts, final accounting standards (especially leases) or frameworks and the corresponding Basis for Conclusions.

In addition, 18 semi-structured expert interviews (Glaeser & Laudel, 2010) were conducted. The interviews serve as a (case-centric) tracing of the process which eventually led to the redefinition of assets and liabilities in the IASB’s CF. While case-centric process-tracing approaches acknowledge that “the social world is very complex, multifactored, and extremely context-specific” (Beach & Pedersen, 2013, p. 13), the interviews provide background information to give “the best possible explanation of a given phenomenon” (ibid.). In the context of applying process-tracing methods, I used elite interviewing (cf. Tansey, 2007) to validate the accuracy of information that has previously been collected from the document analysis and to gain “new information that will advance the research process” (ibid., p. 766). Elite interviewing provided insight into the activities surrounding
the conceptual framework project in general and the redefinition of assets and liabilities in particular. In such a vein, the change in the notions of financial elements can be contextualized as part of a larger process. The document analysis led to the first set of interviewees and “one person leads to another which in turn leads to another” (Myers & Newman, 2007, p. 14). This snowballing technique helped to identify the elite group of experts that were involved in this process.

The interviews were conducted from December 2018 to September 2019 predominantly with standard setters at the IASC/IASB, its technical staff and representatives of the European Financial Reporting Advisory Group (EFRAG) who were either directly or indirectly involved in the framework revision or related projects (particularly leases). In addition, a member of the Australian Accounting Research Foundation (AARF), an auditor from a Big Four accounting firm and a member of the Institute of Public Auditors in Germany (IDW) with specialization in the framework project and related matters were also interviewed. A generic description of the interviewees’ professional affiliation is given in Table 1.

Guidelines were prepared for each interview and adapted to the interviewee’s specific expertise. Although semi-structured interviews start with a set of prepared questions, the conversation develops into a lively dialog and allows interviewees elaborate at will and mind additional aspects. This openness helps to “gather rich detail about key elites’ thoughts and attitudes on central issues” (Tansey, 2007, p. 766). Each interview included questions on the political economy of the IASB’s conceptual framework project, ambiguities in accounting as well as the impact of the rights and obligations approach on future standard setting. In total, 16 phone interviews and two face-to-face interviews were conducted.7 Notetaking was permitted during the two off-the-record interviews, while the other 16 interviewees agreed to having the interview recorded, which was transcribed afterwards. The duration of the interviews ranged between 40 and 116 min. Anonymity was guaranteed as this allows interviewees to express their personal views and to speak openly and unconstrained while avoiding any potential downsides in their professional lives.8

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7 Ten interviews were solely conducted by the author and eight interviews together with another person as part of a joint research project.
8 Note that all interviewees expressed their personal views and interview data should not be regarded to reflect the general and official opinion of their affiliation.
Macve (1981, p. 9) has stressed that “[t]he role of a ‘conceptual framework’ is to provide a structure for thinking about what is ‘better’ accounting and financial reporting”. Hence, when standard setters strive for a major reform of financial reporting, they must reconsider the “coherent system of interrelated objectives and fundamentals that prescribes the nature, function, and limitations of financial reporting” (Johnson, 2004, p. 4) by addressing the fundamental but demanding conceptual questions of accounting: What is the asset or the liability? How big is the asset and how broad is the liability? What belongs on balance sheet and what should be left off? (comp. Gerboth, 1987b; Johnson, 2003). A conceptual framework should answer those crucial questions.
up front and provide direction and structure for standard setters in reforming accounting in such a way that it more faithfully reflects the economic reality.

The IASC’s CF from 1989 defined an asset as “a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise” (IASC, 1989, para. 49a). A liability, on the other hand, was defined as “a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits” (ibid., para. 49b). The vagueness of the IASC’s terminology allowed multiple interpretations of the term ‘asset’, such as indivisible (physical) items, future economic benefits (i.e., the ultimate inflow or outflow per se), and even componentized rights (Booth, 2003; G4+1, 1996, pp. 4–7; IASB, 2014a, p. 3; Teixeira in Abela et al., 2014, p. 260). The similarly vague definition of the term ‘liability’ provided corresponding room for interpretation. This resulted in both the capitalization of liabilities that did not meet the definition or non-capitalization of liabilities even though they met the extant definition, such as liabilities arising from operating leases (Hoogervorst, 2016, p. 2) or certain contingent liabilities (see AASB, 2013 for a critical discussion). Against this backdrop, the IASB’s CF from 2018 includes changes in three elemental and interwoven building blocks, namely in the (1) definitions of elements, (2) unit of account and (3) recognition.

1. **Definitions of elements** (What is the asset or the liability?): In the revised asset and liability definitions, the IASB primarily focuses on the existence of potential balance sheet items. The board clarifies that an asset (i.e., the economic resource) neither represents (physical) objects nor the resulting future economic benefits. In essence, an asset is defined as a single right that has the potential to generate economic benefits (IASB, 2018a, para. 4.2) and is linked to the underlying (physical) resource. More precisely, “each of an entity’s rights is a separate asset” (IASB, 2018a, para. 4.11), including, for example, the right to use the underlying object, the right to sell rights or the right to pledge rights over the object (ibid.). A liability is defined as a present obligation to transfer an economic resource and is further specified as a present “duty or responsibility that an entity has no practical ability to avoid” (IASB, 2018a, para. 4.29). Although the modified definitions of assets and liabilities combine accounting jargon with legal terms, namely ‘rights’ and ‘obligations’,

9 The economist I. Fisher ([1906] 1965, p. 20) stressed the legal origins of the term ‘right’, emphasizing that a right “is a term of jurisprudence, and brings economics into contact with the whole subject of legal and custom-sanctioned relations”. At the beginning of the 20th century, Fisher reciprocally linked economics, law and accounting and successively shaped the contemporary notions of assets and liabilities in terms of rights and obligations by economically defining property rights as “the right to the chance of obtaining some or all of the future services of one or more articles of wealth” (Fisher, [1906] 1965, p. 22). In the following decades, Coase, Alchian and
limited to enforceable (legal) rights and obligations. Rather, the IASB stresses the broad and economic notions of both terms (IASB, 2018a, para. 4.7; IASB, 2018b, para. 4.30). Hence, the revised definitions extend the scope of items that qualify as balance sheet positions. In addition, lease arrangements now clearly meet the new definitions of an asset and a liability as a result (see Section 5.3).

(2) **Unit of account** (How big is the asset and how broad is the liability?): The IASC’s CF failed to address the issue of the unit of account, even though it “is a fundamental, pervasive, and yet unresolved, issue in financial accounting and reporting” (Johnson, 2003, p. 1). The revised CF from 2018 finally introduces this issue on the conceptual level. The IASB defines the economic resource as a set of rights over the object, abstaining from physicalizing the assets. Although each single right and obligation qualifies as a balance sheet item, the IASB de facto requires the aggregation of similar items or combination of dissimilar items to a unit of account if that bundle provides more relevant information than the separate disclosure of single assets or single liabilities (IASB, 2018a, para. 4.51a). In other words, an entity would view the entire bundle of rights as the single asset, which consequently represents the unit to be accounted for (IASB, 2014a, p. 3). Furthermore, the IASB states that “describing the set of rights as the physical object will often provide a faithful representation of those rights in the most concise and understandable way” (IASB, 2018a, para. 4.12). In this regard, it may be more appropriate to refer to the underlying item (e.g., car) itself as the asset, rather than to the bundle of rights and obligations related to it. On the other hand, the IASB requires ‘unbundling’, i.e., disaggregating a bundled item, if this provides a more relevant and faithful representation. Componentization is always required if the real economic substance of transactions would be otherwise obscured.

(3) **Recognition** (What belongs on balance sheet and what should be left off?): The unit of account (either as the single right or obligation or the group of rights or the group of obligations) is the object of recognition and is required to meet additional criteria. The IASC’s CF included an ambiguous minimum probability threshold (“sufficiently certain” (IASC, 1989, para. 50, 83)) as well as

Demsetz as well as Furubotn and Pejovich further developed the property rights paradigm by introducing a new economic perspective (new institutional economics), which extends and modifies conventional microeconomics. The current reclassification of assets and liabilities in terms of rights and obligations in the IASB’s CF demonstrates that the reviewed accounting concept draws upon legal thinking and economic reasoning.

10 For liabilities, accountants drew a quantitative bright line (>50%) in their interpretations of this ambiguous terminology according to the wording used in IAS 37 “more likely than not” (IAS 37.16). For assets, IAS 37 requires a higher recognition threshold (“virtual certainty”), however, the term has no clear mathematical measures.
the loose requirement of reliable measurement (exercised at the “reasonable estimate” (IASC, 1989, para. 86)), enabling preparers to arbitrarily interpret the vague recognition criteria in their favor. The revised CF eliminates any type of probability thresholds in the conceptual underpinning and focuses on the principles of relevance and faithful representation (IASB, 2018a, para. 5.7). Here, the board designates the same principles – relevance and faithful representation – as the criteria of recognition, which operationalize the overall objective of financial reporting – decision usefulness.

Figure 1 depicts the hierarchy of conceptual frameworks as well as the interconnectedness of building blocks and highlights the relevant conceptual changes in the IASB’s CF.

All in all, the definitions of assets and liabilities, unit of account and recognition represent three indiscernible components of financial reporting. While the definitions of balance sheet items constitute the logical starting point, the unit of account bridges the conceptual gap between definition and recognition, thereby linking the fundamental level with the operational level. More specifically, “the unit of account refers to the words that are used to describe the item” (Johnson, 2003, p. 4), and thus relates to the specific assets (rights) and liabilities (obligations) according to the definitions. In this way, the unit of account is equivalent to the object of recognition.

The hierarchy in the conceptual framework provides a serial order for standard setters who seek to foster fundamental changes in accounting. Given that the top of the pyramid (decision usefulness) already complies with the conceptual thinking of reform-oriented standard setters at the IASB, any major accounting change would inevitably require approaching the fundamental level (and subsequently the operational level) of financial reporting. Section 5 examines why the IASB revised central building blocks in the CF project and traces the process towards the implementation of the rights and obligations approach from 2001 onwards. It further shows that the revision of central building blocks does not fully remove but rather shift ambiguities to other arenas and, finally, discusses the implications of these changes at the standards level.

5 The Removal and Creation of Ambiguities in the IASB’s Conceptual Framework and in Accounting Standard Setting

Conceptual frameworks constitute “aspirational documents, setting the direction for reform of financial reporting” (McCahey & McGregor, 2013, p. 10). As a
Figure 1: Conceptual Framework for Financial Reporting IASC, 1989 and IASB, 2018.
Source: Author’s illustration, based on Johnson (2004, p. 6). Changes highlighted.
While the pyramid on the left-hand side reflects the IASC’s concepts, the figure on the right-hand side highlights the conceptual changes made by the IASB’s revised CF. On the level ‘fundamental’, the elements of financial reporting – assets and liabilities – have been redefined in terms of rights and obligations and, in this way, reduced ambiguities that surrounded the previous 0-1 dichotomy. In addition, the IASB replaced the qualitative characteristic of reliability with the principle of faithful representation. Both qualitative characteristics (relevance and faithful representation) operationalize the objective of financial reporting (decision usefulness). In the IASB’s revised CF, the same principles – relevance and faithful representation – now guide the recognition of elements on the level ‘operational’. The new building block ‘unit of account’ constitutes an interlocking component that provides a bridge between the fundamental and operational level.
fundamental accounting change requires a shift that “not only modifies models and ideas as in the process of editing and translation but also involves significant co-construction of ‘new,’ common models and ideas” (Baudot, 2014, p. 981), standard setters were urged to accurately review, reorganize and even remove existent concepts. In drafting conceptual frameworks, standard setters strive for an up-front definition of key terms, such as assets and liabilities, to mitigate “inefficient wrangling over their meanings each time a new matter came before the Board” (Gerboth, 1987b, p. 2). Hence, framework revisions should “make a constructive impact on financial reporting practice” (Ohlson et al., 2010, p. 473) as accounting principles and accounting concepts “rule in, and rule out, potential accounting standards that deal with the myriad measurement, recognition, and classification issues” (ibid., p. 475). As a conceptual framework attempts to describe an ideal accounting model, it “provides standard setters with consequential starting points when they attempt to resolve accounting issues” (Ohlson et al., 2010, p. 474), such as flawed accounting standards, prone to regulatory arbitrage. The following subsections outline adjustments to central building blocks in the revised CF, shed light on possible implications of these changes and demonstrate how they eventually translate in the accounting for leases.

5.1 Tracing the Removal of Ambiguities in the IASB’s Conceptual Underpinning of Financial Reporting from 2001 to 2018

The organizational restructuring of the board in 2001, when the IASC handed over its functions to the reform-minded IASB, provided the necessary impetus to undergo urgently needed conceptual cleanup efforts (Interview #11, EFRAG). As the IASC’s CF lacked periodical revision for almost 30 years11, “accounting standard setters [were] faced with basing new standards on outdated and/or incomplete concepts or being forced to effectively draft new concepts within the standards” (McGregor & Street, 2007, p. 45). Expressed another way, the existing framework represented a major obstacle for any fundamental accounting reform, as an IASB board member stresses:

“… it [the conceptual framework project] started because both of us [the IASB and the FASB] were running into problems in standard setting because the framework, the existing framework, really wasn’t up to what we needed it to be.” (Interview #6)

11 However, note the partial revision of the CF in 2010 as part of the IASB’s/FASB’s joint revision project.
This quote demonstrates that revising the conceptual basis was compelling and necessary for the IASB’s goal of more accurately reflecting the economic substance in international accounting standards. Specifically, new conceptual thinking urged the IASB to abstain from the IASC’s pragmatic solutions to standard setting (Cairns, 2001) and to reexamine the concepts fundamental to financial reporting. The revision of the most fundamental elements of financial statements – assets and liabilities – is a crucial device for any accounting change as “the idea that standards are ‘rooted in fundamental concepts’ suggests that standards are ‘rooted in’ definitions” (Dennis, 2018, p. 383). Instead of a comprehensive rewrite of the entire conceptual pyramid (see Figure 1), a member of the FASB’s technical staff and adherent of sound conceptual thinking suggested focusing on “troublesome conceptual issues that reappear time and time again in different standard-setting projects and in a variety of different guises” (Johnson, 2004, p. 6). In particular, redefining elements is an issue “more likely to yield standard-setting benefits in the near term” (ibid.) as it triggers subsequent adjustments in other building blocks on the operational level.

The high-profile collapses of Enron and other corporate scandals in the early 2000s fueled reformers’ attempts to revise the fundamental building blocks of financial reporting (see Herz, 2016, pp. 57–58 for the FASB and Tweedie, 2002 for the IASB). Enron was able to conceal the true economic substance of its business transactions by creatively exploiting prescriptive bright line tests and arbitrary estimation approaches in order to keep liabilities off the balance sheet (c.f. Baker & Hayes, 2004). In the aftermath of these accounting ‘shenanigans’, numerous stakeholders called for a principles-based accounting change based on a refined conceptual framework (FASB, 2002; Maines et al., 2003a; SEC, 2003; Tweedie, 2002). Apparently, the initial board members at the IASB and FASB sought to capitalize on this “real, and possibly a once in a generation, opportunity to develop truly global high quality accounting standards” (Tweedie, 2004, p. 8).

In 2002, the IASB and the FASB jointly signed the Norwalk Agreement and agreed to coordinate their future work programs, which resulted in identifying a series of improvement, convergence and leadership projects (Tidrick, 2002). Two years later, the IASB and FASB officially started working on their joint framework project and insistently stressed that the conceptual underpinning required improvement, not just convergence (Tweedie, 2004, p. 4). In the following years, the boards put increased effort into revising the conceptual basis of financial reporting for a more truthful reflection of an entity’s assets and liabilities. Since 2005, the IASB has repeatedly tried to translate new ideas (e.g., the rights and obligations approach) into a series of revision projects: leases, conceptual
framework, provisions, financial instruments, consolidations, and revenue recognition (IASB, 2012; Interview #6, Standard Setter (IASB); Interview #13, EFRAG). Among others, leases and the conceptual framework were classified as long-term convergence projects that need substantial reform rather than minor amendments, as they “involve breaking new ground” (Dick & Walton, 2007, p. 12). However, reformers at the IASB and FASB were impeded by critics of the IASB’s interest in the rights and obligations approach. These critics argued that the proposed revisions in accounting standards were at odds with the asset and liability definitions in the current CF (Interview #6, Standard Setter (IASB); Interview #7, EFRAG). For example, in the lease accounting project, opponents were concerned about the (artificial) inflation of balance sheets and argued that the lessor’s liability is not a liability according to the IASC’s CF (Interview #7, EFRAG; Monson, 2001). In addition, constituents criticized the proposed recognition of a ‘right to use’ asset for substantially all lease agreements, again arguing that the ‘right to use’ does not meet the asset definition under the existing CF. As the IASC’s definitions of assets and liabilities allowed multiple interpretations, the joint IASB/FASB Lease Accounting Working Group (LAWG) called to “clarify[] their meanings in order to avoid some of the more common misunderstandings and misinterpretations of them” (LAWG, 2007, p. 1). Along these lines, an IASB board member adds:

“[the old IASC’s framework] was the one that was getting in the way because of the definitions of assets and liabilities, which looked at the asset as the cash flows as opposed to the right. The problem was that they [the constituents] weren’t looking at the right as the thing that gave rights to the cash flows. It was that they were trying to look at the cash flows as the asset.”

(Interview #6)

This statement again illustrates the ambiguity concerning the definitions of assets and liabilities and underlines the necessity of accounting reformers eliminating this confusion. This is all the more important, given a similar confusion among standard setters themselves. At a symposium meeting in 2014, a member of the IASB’s technical staff told a story about two board members reading the IASC’s definition of an asset:

“One said it absolutely it means an asset is a physical thing. You can’t divide the thing up [...] The other Board member sitting next to him said, no, it’s a bunch of rights. [...] They were both reading the same words and they came to different conclusions.” (Teixeira in Abela et al., 2014, p. 260, see also Interview #18, Standard Setter (IASB))

Despite these shortcomings of an ambiguous asset definition that led to confusion among constituents, the following quote of an IASB board member stresses the political dimension of ambiguities and emphasizes their benefits for accounting standard setting:
“And I think there always are ambiguities in accounting and often, with particular, I noticed on the IASB of course, it did sometimes help to have a little bit of constructive ambiguity, so people can accept certain assumptions and definitions whether they have a slightly different interpretation of them. And it is not that it does lead to inconsistency but at least it gets them moving together and hopefully eventually they start to understand the subtleties and the differences and that is what has happened with the definition of assets.” (Interview #18, emphasis added)

This statement highlights the strategic use of ambiguities to find consensus among various constituents with divergent understandings of accounting terms. In addition, this statement strikingly shows that ambiguities include a dynamic element. Ambiguities serve as a stimulus for accounting change, as constituents are constantly concerned with the subtleties of terminology. In this way, the definitions of key elements constitute a recurring issue in accounting standard setting, which may result in the removal of ambiguities over time. As the same IASB board member puts it:

“And so I think it’s a process of natural evolution and clarification and elimination of some of the ambiguities that may have been there by accident, may have been there in order to produce compromise between different constituencies who had different views of these things.” (Interview #18, emphasis added)

Given this ‘natural’ tendency towards the removal of ambiguities in accounting standard setting over time, the vaguely formulated definitions of financial elements in the IASC’s CF provided a perpetual impetus for the elimination of alternative interpretations of assets and liabilities at a later stage.

As an interpretation of assets and liabilities in terms of rights and obligations was already possible under the IASC’s definition of balance sheet items, the board of reform-oriented standard setters simply needed to refine the definitions, not comprehensively rewrite them. An IASB board member involved in this process further states:

“So it was important when the conceptual framework got opened up again that it’d be explicit. Because there were a number of projects that, not just leases, but insurance as well and also revenue … that hang very much on the interpretation of rights and obligations in contracts. So for all of those projects it was important that the framework be drafted in a way to make that explicitly clear so that there wasn’t going to be any more argumentation about what was and what wasn’t okay in terms of that asset and liability definitions.” (Interview #6, emphasis added)

This quote strikingly shows the need for unambiguously defining financial elements, thereby “contribut[ing] to greater efficiency in the standard-setting process by avoiding the necessity of having to redebate fundamental issues such as ‘what
is an asset?’ time and time again’ (Foster & Johnson, 2001, p. 2). In such a way, the conceptual framework is “a vehicle for facilitating the development of new ideas by the standard setter at a standards level” (McCahey & McGregor, 2013, p. 10). As an IASB board member involved in this process recalls:

“… the answers that the board came up with [the implementation of the rights and obligations approach in standards]; the things that we thought that drove the right answers, the push back we got from constituents was ‘well, you can’t do that because it’s not consistent with the framework’. So we said okay fine, we will have to change the framework.” (Interview #6, emphasis added)

This quote highlights the importance of the conceptual framework in political discussions as constituents used the vague concepts to argue against undesired accounting change. As frameworks provide “the language for evaluating and discussing existing and emerging standards” (O’Brien, 2009, p. 273), an explicit anchoring of the rights and obligations approach would turn this game upside down by equipping standard setters with a rhetorical tool to legitimize and justify accounting change.

In the first phase of the framework revision (completed in 2010), the qualitative characteristic of reliability was replaced with the principle of faithful representation, while the redefinition of assets and liabilities in terms of rights and obligations and the changes to interwoven concepts (e.g., unit of account and recognition) followed in the second phase. In its 2013 Discussion Paper, the IASB suggested adjusting the existing definitions to reinforce what they are intended to mean (IASB, 2013, pp. 8–9). The board clarified that “an asset is a resource (rather than the inflow of economic benefits that the resource may generate)” (ibid., para. 2.10) and “a liability is an obligation (rather than the outflow of economic benefits that the obligation may generate)” (ibid.). In other words, the IASB reduced the pool of possible interpretations by removing the future economic benefits interpretation. In the Discussion Paper, the IASB explicitly stated that “an asset (or a liability) is the underlying resource (or obligation)” (IASB, 2013, p. 7) and the term ‘resource’ should be interpreted as either a right or another source of value (ibid., para. 2.11). Although the IASB listed possible ‘other sources of value’, e.g., knowhow, customer lists, and goodwill (ibid., para. 3.5c), the terminology is ambiguous and provides room for wide interpretations. Furthermore, the IASB’s proposed

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12 The IASB explicitly refrained from the FASB’s definition, which introduces assets as “probable future economic benefits” (FASB, 2008, para. 25). This clear delineation became possible after 2010, when the IASB and FASB ended their joint work on the conceptual framework.

13 For example, respondents to the Discussion Paper raised concerns that “[t]he phrase ‘other sources of value’ is not defined and does little to place boundaries around the concept” (IASB, 2014b, p. 15).
asset definition refers to the ‘underlying resource’, which could lead to confusion as practitioners tended to understand the resource as the physical item (such as a machine) and “subsequently attempt[ed] to identify whether the resource is an asset of the entity” (Barker, Lennard, Nobes, Trombetta, & Walton, 2014, p. 152). Facing the potential threat of renewed ambiguity, in 2014 the IASB tentatively decided that “[a]ssets should be viewed as rights, or bundles of rights, rather than underlying physical or other objects” (IASB, 2014a, p. 3). This decision was adopted in the IASB’s Exposure Draft from 2015 as well as in the final CF from 2018, thereby excluding any alternative interpretation. Narrowing the range of alternatives to a single accounting model eventually removed the ambiguities from the previous asset and liability definitions (see also Figure 2 in Section 5.2). By explicitly anchoring the rights and obligations approach, “the framework was really catching up with the thinking that the board already had at that stage” (Interview #9, Technical Staff (IASB)).

The IASB’s commitment to the rights and obligations model as the predominant accounting model necessarily concerns the issue of the unit of account, because the redefinition now allows items to be atomized in a way that more truthfully reflects the economic substance of the underlying transactions. While it is conceptually impossible to carve up the physical resource itself, the new definition allows rights to be unbundled and rebundled again.14 Confronted with an increasing amount of aggregation and disaggregation issues in the formulation of accounting standards, the unit of account issue became a matter of urgency for the IASB. At the European Accounting Association (EAA) symposium meeting in 2014, R. Barker – academic and member of the EAA Financial Reporting Standards Committee (FRSC) – aptly described the issue of the unit of account: “Whether much that is useful and constructive can be said about the unit of account, I’m actually not sure, but it’s so important in practice that ignoring it doesn’t seem like an option either” (Barker in Abela et al., 2014, p. 271). Given its increasing significance in practice and difficulties related to determining the level of aggregation/disaggregation, the Institute of Chartered Accountants of Scotland (ICAS) and the International Federation of Accountants (IFAC) even define the unit of account as a core building block of the conceptual framework (ICAS/IFAC, 2014, p. 10). Despite awareness from the board and the accounting community about the difficulties

14 The consequent implementation of the rights and obligations model also requires accounting issues to be approached by assessing the underlying source of value, the set of cash flows and the related rights and obligations (Barker in Abela et al., 2014, p. 269) in an analytically distinct process to arrive at the unit (object) of recognition. This assessment entails a procedural logic which, in itself, urges the board as well as IFRS applicants to put an increasing emphasis on the underlying economics of business transactions.
involved in addressing the unit of account issue due to its abstractness, the board was prompted to address it conceptually and to incorporate a new chapter on it in the revised CF. Admittedly, the IASB’s CF only vaguely outlines the unit of account (Barker & Teixeira, 2018), yet the explicit anchoring of the unit of account concept provides more clarity as it bridges the prior conceptual gap between the definitions of elements and the operational level (see Figure 1). Along these lines, a consequent and conceptually consistent implementation of the rights and obligations approach inevitably includes an alignment of recognition criteria to remove ambiguities and related issues of regulatory arbitrage on the operational level.

In the older version, definition, recognition and measurement had not been clearly defined and, for example, probability requirements were embedded in the definition of an asset, resulting in tautologies and inconsistencies. Given these conceptual flaws, the IASB strove to clearly delineate between definitions of elements and recognition requirements on the one hand, and between recognition and measurement issues on the other hand. During this refinement process, the IASB also eliminated any kind of probability and measurement thresholds for recognition. This was driven by the fact that the CF from 1989 included an ambiguous probability threshold, which provided opportunities for regulatory arbitrage (see Section 4). This ambiguity in recognition requirements and resulting divergent interpretations is outlined by a member of EFRAG, who reflected on a conversation with a former IASC standard setter:

“… and he said that with this probable we didn’t really have any things in mind with a particular threshold. It was just that there should be a chance that there would be an inflow. But this probable has been interpreted by many that it should be ‘more likely than not’, for example, that there should be an inflow. So sometimes that has caused diversity in different countries and between different people on when something would meet the definition of an asset.” (Interview #13)

This quote once more illustrates the necessity for standard setters to mitigate the risk of confusion and to limit discretionary leeway. In addition, abstaining from probability thresholds is a step consistent with defining assets and liabilities in terms of rights and obligations. In line with the previously discussed conceptual adjustments, the IASB “downplays the recognition criteria that existed in the previous

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15 Specifically, the IASB only demands that the right has “the potential to produce economic benefits” (IASB, 2018a, para. 4.2). Hence, the right needs to give rise to the chance or privilege to future economic benefits, however, meeting an expectation threshold is no longer required (i.e., expectation that future economic benefits will flow from the asset to the entity).

16 While drafting the G4+1 special report on Future Events, Johnson stressed that the inclusion of probability thresholds would be conceptually inconsistent with viewing the asset as the right to (future) benefits and liabilities as the obligation to (future) sacrifices (G4+1, 1994, pp. 12–13).
version” (Barker in Abela et al., 2014, p. 270) and adopts the qualitative characteristics of relevance and faithful representation as new recognition requirements.

All in all, the revised CF removed ambiguities from the notions of assets and liabilities by explicitly redefining both elements in terms of rights and obligations. As the redefinition of balance sheet items marks the beginning of any substantial reform in accounting, this shift was inevitably accompanied by including the concept of the unit of account as well as excluding ambiguous probability thresholds for recognition in the IASB’s CF. Although adopting a single accounting model eliminated alternative interpretations of assets and liabilities and contributed to clarity, the changes are a double-edged sword as they create new ambiguities in turn.

5.2 Creating and Shifting Ambiguities in the Revised IASB’s Conceptual Framework from 2018

While Section 5.1 demonstrated that the IASB’s CF reduced ambiguities by explicitly adopting the rights and obligations approach, the revised accounting model creates new ambiguities in a self-perpetuating process. Even the term ‘right’ itself is open to interpretation. Given an international application of IFRS with heterogeneous domestic accounting traditions, the IASB’s intended interpretation of an economic resource in terms of an (economic) right may not be self-explanatory. For example, in countries with a strong link between civil law and accounting (e.g., Germany), the term right might be interpreted through the lens of civil law, limiting the scope to enforceable (legal) rights. Aside from this unintentional narrowing of the scope of rights, the ambiguity also allows for an overly broad interpretation, which would include, for example, rights of access to public goods. Even though the IASB excludes as assets these rights available to entities without significant cost (IASB, 2018a, para. 4.9), their recognition would be de facto covered by the IASB’s ambiguous conception of rights in the CF.17 This all-inclusiveness inherent to the rights approach complicates which rights in fact belong to the select group of those recognized, as a member of the IASB’s technical staff emphasizes:

“When I try to define economic rights, I enter a space in which I can recognize everything or nothing. The term ‘economic rights’ is so broad … that it is hard to tell where to draw the line.”

(Interview #8)

17 With this exemption, the IASB limits the pool of potentially recognizable rights and consequently the unit (object) of recognition. On the one hand, this boundary is conceptually inconsistent with the pure idea of the rights and obligations approach through which all externalities should be internalized (Coase, 1937). On the other hand, the line between rights within and outside of the scope is fluid, making these boundaries prone to regulatory arbitrage (see Section 5.3).
As a consequence of this inherent openness of the term ‘right’ in the revised CF, the same interviewee adds:

“The IASB failed to address this in the new CF. This new definition creates more questions than it does answer.” (Interview #8)

As these statements illustrate, the focus on rights fuels the everlasting inclusion-exclusion dilemma “because the ‘boundaries’ of assets are not well defined, that is, the points at which an asset’s existence begins and ends are sometimes rather ambiguous” (G4+1, 1994, p. 54). Even though the IASB further specifies the pool of recognizable rights in accounting standards, as is the case with the ‘right to use’ in IFRS 16: Leases (see Section 5.3), determining the unit of account is the main issue here.

While the IASB now addresses the unit of account issue in its conceptual underpinning, the framework lacks detailed guidance for determining the level of aggregation and decisions about when and to what extent the bundled rights and obligations shall be unbundled. This even holds true on the accounting standards level, which creates discretionary leeway for preparers and their auditors, because determining the object of recognition involves various steps of judgment (ICAS/IFAC, 2014, p. 13). These difficulties regarding the unit of account issue and the aggregation and disaggregation process is further outlined by a member of EFRAG, with long-term expertise in this area:

“Some people think that the unit of account should only have one right attached to it. Other people see units of account as bundles of rights and obligations … Different people think of it differently. Nobody has ever … been able to come up with a clear and agreed approach to what unit of account means. It’s one of the most difficult questions.” (Interview #14)

This quote highlights the lack of a conceptually pure solution to the unit of account issue as well as proper guidance for bundling and unbundling at the application level, creating ambiguities. In addition to the abstract nature of determining the object of recognition, the new recognition criteria (i.e., relevance and faithful representation) are themselves rather ambiguous concepts from which to guide and revise accounting practices and leave significant room for discretion. Along these lines, Barker and Teixeira (2018, p. 154) stress that if the IASB takes the revised CF for standard development “it is difficult to see what accounting would result” and highlight that notwithstanding the IASB’s conceptual refinements “it appears that something conceptual is missing” (ibid.). This "open-ended nature of the Framework" (ibid.) increases the level of subjectivity and uncertainty in financial reporting. An IASB board member underscores this:

“One of the things that is a consequence of the approach that we developed, the conceptual approach, is that it does introduce a degree of subjectivity and it introduces uncertainty. But … isn’t that what business is like? The world is uncertain. Very few decisions can be made as
A large majority of them are in the grey area, because of the uncertainty around the existence of events, the implications of events and the implications of transactions. So, having an accounting model that affirms that you … have knowledge of the future is certainly unrealistic and of very little benefit to those trying to make decisions on a timely basis … It is both sides of the equation; to benefit from a more robust accounting model that provides a better reflection of the economic reality.” (Interview #2, emphasis added)

While the conceptual adjustments allow a more meaningful representation of the economic substance, the quote illustrates that the rights and obligations approach increases subjectivity in financial reporting and that the IASB accepts this increasing level of uncertainty as a given feature of the business world.

Although the conceptual refinements clarify the definitions of balance sheet items, the explicit focus on the rights approach creates new ambiguities, demonstrating the self-perpetuation of ambiguities in accounting. Figure 2 displays a timeline of events in the IASB’s framework project and illustrates the gradual honing of the definitions of assets and liabilities, which again induces new ambiguities inherent to the rights and obligations approach.

The creation of ambiguities is particularly evident with the issue of the unit of account, which requires interpretation by preparers and auditors. These conceptual ambiguities are further translated into accounting standards albeit somewhat weakened. Given this translation of ambiguities into a standards level combined with increasing discretionary leeway, the conceptual adjustments may shift the potential risk of regulatory arbitrage from rule evasion to bending interpretations. The following Section 5.3 illustrates this juxtaposition of ambiguity reduction and ambiguity creation by analyzing the implications of the rights and obligations approach in the accounting for leases in the context of accounting motivated financial engineering.

5.3 Translating Ambiguities into the Accounting for Leases

Redefining the notions of assets and liabilities was a necessary step in legitimizing the translation of the rights and obligations approach into accounting standards, such as the accounting for leases. An example now shows the differences between the previous lease accounting standard IAS 17 and the revised IFRS 16 to examine the translation of the conceptual adjustments in the IASB’s lease regulations. This analysis focuses on the lessee’s perspective and discusses the implications for regulatory arbitrage along the central building blocks – definitions of elements, unit of account and recognition.

Although the previous lease accounting standard, IAS 17, already referred to the right to use the leased item (IAS 17.3), the notion of assets was linked to the
Figure 2: The juxtaposition of ambiguity creation and ambiguity reduction in the IASB’s CF project.
Source: Author’s illustration.
underlying leased property, e.g., a car or machine. Hence, the underlying physical item served as the object to which a set of rights was directly attached.\textsuperscript{18} Under IAS 17, however, this set of rights (unit of account) could not be unbundled “through the simple device of substituting ownership for control as a criterion” (Booth, 2003, p. 318). According to this notion of indivisible ownership, operationalized through the concept of risks and rewards incidental to ownership of leased assets, IAS 17 assumed that the asset was the tangible leased property, resulting in leases being recognized in an all-or-nothing fashion. Given the classification in off-balance sheet operating and on-balance sheet finance leases under IAS 17, the object of recognition (unit of account) was the physical item as a whole in case of the latter. And, even though all lease contracts transfer a right to use, IAS 17 denied recognition if the lease was classified as an operating lease. This classification requirement facilitated a “black magic” (SEC, 2006) in the classification of finance and operating leases, as similar transactions could be treated differently. Despite the ambiguous definition of assets in the IASC’s CF allowing a ‘physicalist’ interpretation of assets in IAS 17, the ownership-centered model induced clear-cut boundaries for the unit of account and its subsequent recognition.

IFRS 16, in contrast, abstains from an ownership-centered model and draws upon a de-physicalist notion of assets in terms of rights. While IAS 17 did not allow the set of rights to be unbundled, the rights and obligations approach in IFRS 16 conceptualizes the set of rights as a loose bundle and allows them to be componentized.\textsuperscript{19} In all lease transactions the lessee obtains a set of rights, which has at its core the right to use the leased asset, potentially augmented by supplemental rights, attached to renewals or purchase options (unspecified/loose unit of account). While IFRS 16 requires the lessee to recognize all lease agreements,\textsuperscript{20} the range of lease rights is rather fluid and the decision over the bundling and unbundling of these rights becomes increasingly subjective, shifting the issue of regulatory arbitrage from the bending of precise rules to the issue of the unit of account.

As similar or dissimilar contracts are aggregated or disaggregated into a bundle of rights, the question arises as to which contracts form a part of the bundle (unit of account). Specifically, lease and executory contracts (e.g., service arrangements) constitute a similar type of transaction, however, whereas the first is

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18 This set of rights compromised all ownership rights attached to the underlying property.
19 As IFRS 16 enables componentization, the lessor separates a right to use the leased item, receiving a right to cash flows in exchange. This unbundling more truthfully reflects the fact that several parties have some interest in the underlying item.
20 Under IFRS 16, the classification into operating and finance leases remains solely with the lessor.
subject to recognition, the latter is scoped out. Hence, financial engineers may exploit the additional discretionary leeway and unspecified boundaries of the bundle of rights to reclassify in substance lease contracts into service contracts (c.f. Thiemann & Friedrich, 2016). Consider a set of basic car leases, in which the lessee is required to recognize a right to use the car on balance sheet, excluding related off-balance sheet service components (e.g., maintenance or service). The lessee may redesign the contract and bundle the various rights in a portfolio, replacing the right to use a car with the right to use a portfolio of unspecified vehicles. Depending on the subjective assessments of the lessee’s auditor, the magnitude of service components is extended to a level that allows arguing that the entire bundle, including the right to use the asset, represents an off-balance sheet service contract.

As this example demonstrates, the conceptual adjustments provide preparers with new tools (i.e., possibility of bundling and unbundling) and relocate the issue of regulatory arbitrage from the exploitation of precise bright lines to the increasingly subjective demarcation of the unit of account. Hence, resolving ambiguities in the definitions of assets and liabilities simultaneously created ambiguities in terms of ‘what belongs to the unit of account’. In this way, the conceptual refinements do not ultimately answer the question of ‘what belongs on the balance sheet’ but rather change how to answer this question and where the “black magic” (SEC, 2006) happens.

6 Discussion and Conclusion

This paper has analyzed the ambiguity-reducing and ambiguity-creating functions of accounting (Davie, 2000) by examining the redefinition of assets and liabilities in terms of rights and obligations in the IASB’s CF from 2018. It has shown that the CF project was central to fostering changes in accounting by limiting the scope of possible interpretations of financial elements, thereby anchoring the rights and obligations approach as the guiding accounting model. As ambiguities are inherent in the revised accounting model (e.g., the issue of the unit of account), this article demonstrated how ambiguities were translated from the conceptual to the standards level. Furthermore, the paper shed light on how this process of ambiguity shifting affects the playing field of regulatory arbitrage.

As the IASB strove for a more faithful and fine-grained depiction of an entity’s wealth, the anchoring of the rights and obligations approach paves the way for “tough decisions and unpopular standards” (Tweedie, 2002, p. 13). The definitions of assets and liabilities is one of the “crosscutting issues” (Johnson,
As conceptual frameworks “presume, legitimize and reproduce the assumption of an objective world” (Hines, 1991, p. 327) from which to guide and revise accounting practices, conceptual adjustments are a central device to legitimate and justify accounting change. Removing ambiguities from the definitions of assets and liabilities shows that conceptual frameworks serve as a political tool (Hines, 1989; Horngren, 1994; Miller, 1990). This equips standard setters with an ‘objective’ rationale in political discussions at a standards level. By clarifying what assets and liabilities should mean, the IASB establishes a sound conceptual rationale that legitimizes fundamental changes in standard-setting projects, such as leases, thereby mitigating opposition from constituents.

As such, this article contributes to the literature on the political economy of accounting standard setting (Baudot, 2014, 2018; Fogarty et al., 1994; Morley, 2011; Thiemann & Lepoutre, 2017; Young, 1994, 2014) as it shows how standard setters define terms within conceptual frameworks to induce major changes in accounting standards. Clarifying financial elements “contributes to greater efficiency in the standard-setting process by avoiding the necessity of having to redebate fundamental issues such as ‘what is an asset?’ time and time again” (Foster & Johnson, 2001, p. 2) and getting troublesome conceptual questions “out of the way once and for all” (Gerboth, 1987b, p. 2). As “[c]hange is often introduced in new and powerful vocabularies” (Hopwood, 1990, p. 82), the revision process of the IASB’s CF is a “significant event” (McCahey & McGregor, 2013, p. 2). It provides standard setters the “opportunity to put in place something that will have lasting benefit for those involved in and impacted by financial reporting” (ibid., pp. 2–3).

Previous research on the IASB’s conceptual framework project primarily focused on the revision of the objective of financial reporting (Pelger, 2016; Young, 2006) and the qualitative characteristics (Erb & Pelger, 2015) that “are too lofty criteria for the making of accounting standards” (Ohlson et al., 2010, p. 475). While alterations in those areas may primarily represent a shift in wording rather than in substance and are intended to clarify the boards’ understanding (IASB, 2018b, para. 2.26), adjustments to the elements of financial statements are a shift in substance rather than in wording. Although the IASB staff describes the focus on rights as “a slightly simpler definition” (Teixeira in Abela et al., 2014, p. 263) and “a tweak not a major rewrite” (ibid.), this research indicates that anchoring the rights and obligations approach is key to the IASB’s efforts to more truthfully depict the economic substance of business transactions. While this paper only outlines changes to parts of the conceptual pyramid (see Figure 1), exploring linkages to further building blocks (e.g., measurement) or translations of conceptual changes in accounting standards (e.g., IAS 37: Provisions, Contingent Liabilities and
Contingent Assets; IAS 38: Intangible Assets) would be interesting areas of future research.

This paper indicates that the explicit focus on the rights and obligations model forms part of a political agenda to further substance over form in financial reporting. The new accounting model facilitates the elimination of arbitrary bright lines, as it provides the precondition for a continuous balance sheet approach (Donegan & Sunder, 1989; Dye et al., 2015). While the new definitions resolve ambiguities in what an asset and a liability are, the rights and obligations approach creates new ambiguities in turn. As such, the study illustrates that the new accounting model is an expression of the “in-built tendency to self-perpetuation” (Davie, 2000, p. 316) of ambiguities in accounting. The analysis of the anchoring of the rights and obligations approach in the accounting for leases shows that ambiguities, inherent in the revised accounting model, become translated into accounting standards, shifting the playing field of regulatory arbitrage from evading rules to bending interpretations. Due to the increasing significance of the abstract concept of the unit of account, the boundaries of ‘what belongs to the asset’ have become more fluid and auditors and preparers have received additional discretion. Hence, demarcating the asset to be recognized (unit of account) has increasingly become a “zone of strategic choice for corporate management and a basis for a negotiated rather than purely procedural audit function” (Hopwood, 1990, p. 80, emphasis added). Along these lines, the paper adds to the literature on structuring activities in accounting (Donegan & Sunder, 1989; Friedrich, 2020 in this issue; Imhoff & Thomas, 1988; Thiemann, 2018), as it shows the link between the conceptualization of financial elements and how regulatory arbitrage happens.

Given that “conceptual and technical ambiguities merely create and enhance the need for more and more accounting” (Davie, 2000, p. 330), this paper predicts that the unit of account is one of the key issues that will “keep pushing themselves into the standard setting arena” (Abela in Abela et al., 2014, p. 267). Due to the increasing significance of the unit of account at the conceptual and standards level, accountants have called for more precision “rather than leaving it to chance” (ibid.). Notwithstanding its crucial role, the concept of the unit of account is too abstract to be universally defined ex ante, as its meaning is inextricably linked to the respective transaction. Along these lines, Barker and Teixeira (2018, p. 154) assume that the unit of account is one of “that conceptual issues […] worked through at this (lower) [standard’s] level, rather than being guided by, and being consistent with, an overarching conceptual framework”. The unit of account issue fuels the self-perpetuating cycle of ambiguity reduction and ambiguity creation, as newly created ambiguities inevitably require ambiguity-reducing activities in turn through ‘re-refinements’ in accounting standards.
Against the backdrop of the IASB’s increasingly abstract conceptual framework and its broad impact on the formulation of accounting standards, future research could investigate the role of actors and institutions in reducing ambiguity through subsequent interpretation and continual refinement of accounting terminology, concepts and principles. While prior research examined the handling of ambiguities by private standard setting bodies, interpretative committees as well as accounting expert professionals (c.f. Brown, Collins, & Thornton, 1993; Hines, 1989), more research is needed on the role of regulators as interpretative communities (Black, 2002; Ford, 2010; Thiemann & Troeger, 2020 in this issue) in the accounting realm. Given the special court-based system in the European Union and the EU’s aspiration for consistent interpretation and application of IFRS to ensure comparability of financial statements, the judicial branch may also gain importance in interpreting ambiguous accounting terminology. Understanding the role of actors in fields adjacent to accounting (e.g., lawyers and regulatory bodies) is crucial as they could decisively influence the process of accounting self-perpetuation.

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