

1 INTRODUCTION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

THE NEED FOR A COMMON SET OF ACCOUNTING AND FINANCIAL REPORTING STANDARDS

With the rampant rise of globalization, one would find it rather difficult to disagree with Thomas L. Friedman, the author of the world-renowned book, *The World Is Flat*, who said that right around the year 2000 we entered a new stage of globalization (a whole new era that he refers to as Globalization 3.0) which, according to him, is shrinking (figuratively, of course) the size of the world from small to tiny. Some people believe that this magical phenomenon of globalization has led to the emergence of a global village that we all live in.

With such a robust wave of globalization surging through the world, businesses across the globe cannot remain unaffected by it no matter how hard they try. With the advent of the World Wide Web and the knocking down of trade barriers across national boundaries through global initiatives such as the setting up of the World Trade Organization (WTO), international trade between businesses across the globe has become quite simple and attractive.

If we agree with the old adage, "accounting is the language of business," then business enterprises around the world cannot afford to be speaking in different languages to each other while exchanging and sharing financial results of their international business activities and also reporting the results of business and trade to their international stakeholders. As one school of thought believes, since business enterprises around the world are so highly globalized now and need to speak to each other in a common language of business, there is a real need for a single, universal set of accounting standards that would unify the accounting world and, more important, solve the problem of diversity of accounting practices across borders.

Historically, countries around the world have had their own national accounting standards (some countries have treasured these for whatever reason, most likely due to the pride of national sovereignty). However, with such a compulsion to be part of the globalization movement, wherein businesses across national boundaries are realizing that it is an astute business strategy to embrace the world as their workplace and marketplace, having different rules (standards) of accounting for the purposes of reporting financial results would not help them at all; rather, it would serve as an impediment to the smooth flow of information. Businesses, therefore, have realized that they need to talk to each other in a common language.

The adoption of accounting standards that require high-quality, transparent, and comparable information is welcomed by investors, creditors, financial analysts, and other users of financial statements. It is difficult to compare worldwide financial information without a common set of accounting and financial reporting standards. The use of a single set of high-quality accounting standards would facilitate investment and other economic decisions across borders, increase market efficiency, and reduce the cost of raising capital. International

Financial Reporting Standards (IFRS) are increasingly becoming the set of globally accepted accounting standards that meet the needs of the world's increasingly integrated global capital markets.

WHAT ARE IFRS?

IFRS are a set of standards promulgated by the International Accounting Standards Board (IASB), an international standard-setting body based in London. The IASB places emphasis on developing standards based on sound, clearly stated principles, from which interpretation is necessary (sometimes referred to as *principles-based standards*). This contrasts with sets of standards, like U.S. generally accepted accounting principles (GAAP), the national accounting standards of the United States, which contain significantly more application guidance. These standards are sometimes referred to as rules-based standards, but that is really a misnomer as U.S. standards also are based on principles—they just contain more application guidance (or rules). IFRS generally do not provide bright lines when distinguishing among circumstances in which different accounting requirements are specified. This reduces the chances of structuring transactions to achieve particular accounting effects.

According to one school of thought, since IFRS are primarily principles-based standards, the IFRS approach focuses more on the business or the economic purpose of a transaction and the underlying rights and obligations instead of providing prescriptive rules (or guidance). IFRS provides guidance in the form of principles.

This significant difference in approach to standard setting between IFRS and U.S. GAAP is the main reason that the length of the text of the IFRS is less than that of U.S. GAAP. U.S. GAAP extends more than 20,000 pages of accounting literature as opposed to IFRS, which is approximately 2,000 to 3,000 pages in length.

A BRIEF HISTORY OF THE INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE (IASC)

The International Accounting Standards Committee (IASC), the predecessor of the IASB, was established in 1973 and came into being through an agreement by professional accountancy bodies from Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and Ireland, and the United States. The objective behind setting up the IASC was to develop, in the public interest, accounting standards that would be acceptable around the world in order to improve financial reporting internationally. Over the years, the IASC saw several changes to its structure and functioning. For example, by the year 2000, IASC's sponsorship grew from the original nine sponsors to 152 accounting bodies from 112 countries, that is, all professional accountancy bodies that were members of the International Federation of Accountants (IFAC). Such fundamental changes to the IASC may have helped it achieve the objective for which it was set up: changing the perception of the global standard setters about the international nature of participation in the standard-setting process. As part of their membership in IASC, professional accountancy bodies worldwide committed themselves to use their best endeavors to persuade governments, standard-setting bodies, securities regulators, and the business community that published financial statements to comply with IAS. This also drew the world's attention to the fact that there exists a truly representative international accounting body that could ultimately qualify as a global standard setter and be able to develop a single set of accounting standards that would be acceptable to most, if not all, countries worldwide.

Over the years, the IASC worked hard to achieve the objective of developing accounting standards for the world. However, due to several factors (the most important one, according

to one school of thought, being availability of national accounting standards in certain leading jurisdictions that were quite well developed and recognized by other leading jurisdictions as well) the standards promulgated by the IASC were unable to achieve the status of an international accounting standard setter whose standards were accepted by leading jurisdictions.

A BIRD'S EYE-VIEW OF THE STANDARDS PROMULGATED BY THE IASC AND INTERPRETATIONS COMMITTEE (SIC) THAT ARE STILL IN FORCE

During its existence, the IASC issued 41 standards, known as the International Accounting Standards (IAS), as well as a *Framework for the Preparation and Presentation of Financial Statements*. While some of the standards issued by the IASC have been since withdrawn or superseded (for example, IAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*, was withdrawn and IAS 22, *Business Combinations*, was superseded by IFRS 3, *Business Combinations*), many are still in force. In addition, some of the interpretations issued by the IASC's interpretive body, the Standing Interpretations Committee (SIC), are still in force.

IAS Still in Force for 2009 Financial Statements

- IAS 1, *Presentation of Financial Statements*
- IAS 2, *Inventories*
- IAS 7, *Statement of Cash Flows*
- IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*
- IAS 10, *Events After the Reporting Period*
- IAS 11, *Construction Contracts*
- IAS 12, *Income Taxes*
- IAS 16, *Property, Plant, and Equipment*
- IAS 17, *Leases*
- IAS 18, *Revenue*
- IAS 19, *Employee Benefits*
- IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*
- IAS 21, *The Effects of Changes in Foreign Exchange Rates*
- IAS 23, *Borrowing Costs*
- IAS 24, *Related-Party Disclosures*
- IAS 26, *Accounting and Reporting by Retirement Benefit Plans*
- IAS 27, *Consolidated and Separate Financial Statements*
- IAS 28, *Investments in Associates*
- IAS 29, *Financial Reporting in Hyperinflationary Economies*
- IAS 31, *Interests in Joint Ventures*
- IAS 32, *Financial Instruments: Presentation*
- IAS 33, *Earnings Per Share*
- IAS 34, *Interim Financial Reporting*
- IAS 36, *Impairment of Assets*
- IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*
- IAS 38, *Intangible Assets*
- IAS 39, *Financial Instruments: Recognition and Measurement*
- IAS 40, *Investment Property*
- IAS 41, *Agriculture*

SIC Interpretations Still in Force for 2009 Financial Statements

- SIC 7, *Introduction of the Euro*
- SIC 10, *Government Assistance—No Specific Relation to Operating Activities*
- SIC 12, *Consolidation—Special-Purpose Entities*
- SIC 13, *Jointly Controlled Entities—Nonmonetary Contributions by Ventures*
- SIC 15, *Operating Leases—Incentives*
- SIC 21, *Income Taxes—Recovery of Revalued Nondepreciable Assets*
- SIC 25, *Income Taxes—Changes in the Tax Status of an Entity or Its Shareholders*
- SIC 27, *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*
- SIC 29, *Disclosure—Service Concession Arrangements*
- SIC 31, *Revenue—Barter Transactions Involving Advertising Services*
- SIC 32, *Intangible Assets—Web Site Costs*

**THE BIRTH OF THE INTERNATIONAL ACCOUNTING
STANDARDS BOARD (IASB)**

With tremendous pressure on the IASC to transform itself into a truly global standard-setting body by addressing some of the serious concerns of established standard setters around the world (grievances were time and again quoted in the international media as serious shortcomings of the IASC), in the year 2001, fundamental changes were made to strengthen the independence, legitimacy, and quality of the international accounting standard-setting process. In particular, the IASC Board was replaced by the International Accounting Standards Board (IASB) as the body in control of setting international accounting and financial reporting standards. This significant structural change to the manner in which the IASC functioned for several years since its inception was brought about as a result of the recommendations of the Strategy Working Party, which was specially formed to take a fresh look at the then-existing IASC's structure and strategy. One dramatic change in the structure and functioning of the Board that is worthy of mention was the replacement of part-time volunteer board members who sat on the IASC Board with, for the most part, full-time IASB board members.

Based on the recommendations of the Strategy Working Party a new constitution was adopted effective July 1, 2000. Under these new rules of governance of the international standard-setting body was born the IASC Foundation. The name of the organization that comprises both the IASB and its Trustees is the International Accounting Standards Committee Foundation (IASC Foundation). The objectives of the IASC Foundation, as stated in its Constitution, are

- a. *To develop, in the public interest, a single set of high-quality, understandable, and enforceable global accounting standards that require high-quality, transparent, and comparable information in financial statements and other financial reporting to help participants in the various capital markets of the world and other users of the information to make economic decisions;*
- b. *To promote the use and rigorous application of those standards; and*
- c. *In fulfilling the objectives associated with (a) and (b), to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies; and*
- d. *To bring about convergence of national accounting standards and International Financial Reporting Standards to high-quality solutions.*

At its first meeting in 2001, the IASB adopted all outstanding IAS and SIC issued by the IASC as its own standards. Those IAS and SIC continue to be in force to the extent they are not amended or withdrawn by the IASB. New standards issued by the IASB are known as IFRS. New interpretations issued by the International Financial Reporting Interpretations

Committee (IFRIC) are known as IFRIC Interpretations. When referring collectively to IFRS, that term includes IAS, SIC, IFRS, and IFRIC Interpretations.

GOVERNANCE AND STRUCTURE OF THE IASC FOUNDATION, IASB, IFRIC, AND THE SAC

IASC Foundation and the Trustees

The governance of IASC Foundation rests on the shoulders of the Trustees of the IASC Foundation (the IASC Foundation Trustees or, simply, the Trustees). The Trustees comprise 22 individuals who are chosen from around the world. In order to ensure a broad international representation, it is required that six Trustees are appointed from North America, six from Europe, six from Asia/Oceanic region, and four from any part of the world, subject to establishing overall geographical balance.

The Trustees are independent of the standard-setting activities (which is the primary responsibility of the Board members of the IASB). The Trustees, on the other hand, are responsible for broad strategic issues, such as

- Appointing the members of IASB, the IFRIC, and the Standards Advisory Council (SAC);
- Approving the budget of the IASC Foundation and determining the basis of funding it;
- Reviewing the strategy of the IASC Foundation and the IASB and its effectiveness including consideration, but not determination, of the IASB's agenda (which if allowed may impair the Trustees' independence of the standard-setting process);
- Establishing and amending operating procedures, consultative arrangements and due process for the IASB, the IFRIC, and the SAC;
- Approving amendments to its constitution after consulting the SAC and following the required due process;
- Fostering and reviewing the development of the educational programs and materials that are consistent with the objectives of the IASC Foundation; and
- Generally, exercising all powers of the IASC Foundation except those expressly reserved for IASB, the IFRIC, and the SAC.

Lastly, in order to enhance public accountability of the IASC Foundation, while maintaining the operational independence of the IASC Foundation and the IASB, the Monitoring Board, a new body, was created in 2009. The Monitoring Board comprises capital market authorities (e.g., representatives of institutions such as the International Organization of Securities Commissions [IOSCO], the U.S. Securities and Exchange Commission [SEC], and the European Commission) and its responsibilities include participating in the appointment of the Trustees of the IASC Foundation, advising the Trustees in the fulfillment of their responsibilities, and holding meetings with the Trustees to discuss matters referred by the Monitoring Board to the IASC Foundation or the IASB.

International Accounting Standards Board (IASB)

The IASB is responsible for standard-setting activities, including the development and adoption of IFRS. The Board usually meets once a month and its meetings are open to the public—in person and via the Internet.

The IASB shall comprise 14 members appointed by the Trustees; 12 full-time members and 2 part-time members. With recent amendments to the constitution of the IASC Foundation, the size of the IASB is to be increased from 14 to 16 members by 2012.

Stringent criteria have been laid out in the IASC Foundation constitution for the appointment of IASB Board members. They are

- Demonstrated technical competency, knowledge of financial accounting and reporting, and ability to analyze,
- Effective communication skills,
- Awareness and understanding of the global economic environment,
- Ability to work in a congenial manner with other members and show respect, tact, and consideration for one another's views and the views of the constituents, and
- Capability to take into consideration varied viewpoints presented, weighing the evidence presented in an impartial manner, and arriving at well-reasoned and supportable decisions in a timely fashion.

The Board members, who are appointed for a term up to five years, renewable once, are chosen from a mix of backgrounds, including auditors, preparers of financial statements, users of financial statements, and academics. The members of the IASB are usually individuals who possess professional competence, high levels of technical skills, and have diversity of international business and market experience; possessing such personal attributes would normally ensure that the Board members are able to contribute to the development of high-quality, global accounting standards.

The IASB has the complete responsibility for all IASB technical matters including preparation and issuing of IFRS and Exposure Drafts that precede issuance of the final standards (i.e., the IFRS).

IFRS Issued by the IASB to December 31, 2009

IFRS 1, *First-Time Adoption of International Financial Reporting Standards*

IFRS 2, *Share-Based Payment*

IFRS 3, *Business Combinations*

IFRS 4, *Insurance Contracts*

IFRS 5, *Noncurrent Assets Held for Sale and Discontinued Operations*

IFRS 6, *Exploration for and Evaluation of Mineral Resources*

IFRS 7, *Financial Instruments: Disclosures*

IFRS 8, *Operating Segments*

IFRS 9, *Financial Instruments*

IFRS for SMEs**

***In July 2009, the IASB promulgated the much-awaited IFRS for Small and Medium Enterprises (SMEs). It provides standards applicable to private entities (those that are not public accountable as defined in this standard).*

Standards Advisory Council (SAC)

The Trustees appoint the members of the Standards Advisory Council (SAC). The primary responsibility of the SAC is to provide advice to the IASB on agenda decisions and priorities in the IASB's work. The SAC provides a forum for organizations and individuals who have an interest in international financial reporting and who have diverse geographical and professional backgrounds.

The SAC shall comprise 30 or more members. Members are appointed for a three-year renewable term. Currently, the membership of the SAC includes chief financial and accounting officers from some of the world's largest corporations and international organizations, leading financial analysts and academics, regulators, accounting standard setters, and partners from leading accounting firms.

International Financial Reporting Interpretations Committee (IFRIC)

The Trustees appoint the members of the International Financial Reporting Interpretation Committee (IFRIC). The IFRIC is the IASB's interpretive body and is in charge of developing interpretive guidance on accounting issues that are not specifically dealt with in IFRS or that are likely to receive divergent or unacceptable interpretations in the absence of authoritative guidance. The Trustees select members of the IFRIC keeping in mind personal attributes such as technical expertise and diversity of international business and market experience in the practical application of IFRS and analysis of financial statements prepared in accordance with IFRS.

The IFRIC shall comprise 14 voting members. The Trustees, if they deem fit, may also appoint nonvoting observers representing regulatory bodies, who shall have the right to attend and speak at the meetings of the IFRIC. A member of the IASB, the Director of Technical Activities or another senior member of the IASB staff, or another appropriately qualified individual, shall be appointed by the Trustees to chair the IFRIC. The IFRIC shall meet as and when required, and 10 voting members present in person or by telecommunication shall constitute a quorum. Meetings of the IFRIC (and the IASB) are open to the public but certain discussions may be held in private at the discretion of the IFRIC. It is important to note that an IFRIC Interpretation requires the IASB's approval before its final issuance.

IFRIC Interpretations Issued to December 31, 2009

- IFRIC 1, *Changes in Existing Decommissioning, Restoration and Similar Liabilities*
- IFRIC 2, *Members' Shares in Cooperative Entities and Similar Instruments*
- IFRIC 3, *Emission Rights* (withdrawn)
- IFRIC 4, *Determining Whether an Arrangement Contains a Lease*
- IFRIC 5, *Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*
- IFRIC 6, *Liabilities Arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment*
- IFRIC 7, *Applying the Restatement Approach Under IAS 29 Financial Reporting in Hyperinflationary Economies*
- IFRIC 8, *Scope of IFRS 2* (withdrawn)
- IFRIC 9, *Reassessment of Embedded Derivatives*
- IFRIC 10, *Interim Financial Reporting and Impairment*
- IFRIC 11, *IFRS 2—Group and Treasury Share Transactions* (withdrawn)
- IFRIC 12, *Service Concession Arrangements*
- IFRIC 13, *Customer Loyalty Programs*
- IFRIC 14, *IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and Their Interaction*
- IFRIC 15, *Agreements for the Construction of Real Estate*
- IFRIC 16, *Hedges of a Net Investment in a Foreign Operation*
- IFRIC 17, *Distribution of Noncash Assets to Owners*
- IFRIC 18, *Transfer of Assets from Customers*

POPULARITY AND ACCEPTANCE OF IFRS WORLDWIDE

In the last few years, the popularity of IFRS has grown tremendously. The international accounting standard-setting process has been able to claim a number of successes in achieving greater recognition and use of IFRS.

A major breakthrough came in 2002 when the European Union (EU) adopted legislation that required listed companies in Europe to apply IFRS in their consolidated financial state-

ments. The legislation came into effect in 2005 and applies to more than 8,000 companies in 30 countries, including countries such as France, Germany, Italy, Spain, and the United Kingdom. The adoption of IFRS in Europe means that IFRS has replaced national accounting standards and requirements as the basis for preparing and presenting group financial statements for listed companies in Europe, which is considered by many as a major milestone in the history of international accounting.

Outside Europe, many other countries also have been moving toward IFRS. By 2005, IFRS had become mandatory in many countries in Africa, Asia, and Latin America. In addition, countries such as Australia, Hong Kong, New Zealand, Philippines, and Singapore had adopted national accounting standards that mirror IFRS.

Today, IFRS are used in more than 100 countries. A significant number of Global Fortune 500 companies already use IFRS and this number is expected to increase by 2011 with further conversions to IFRS by major global players (most notably, Brazil, Canada, and India) and substantial convergence of local GAAPs in China and Japan to IFRS.

FAVORABLE AND HISTORIC BREAKTHROUGHS IN THE UNITED STATES

In the United States, since 2002, efforts have been underway to converge IFRS and U.S. GAAP; the earliest initiative was in the form of a well-known agreement entered into between the IASB and the U.S. standard setter (the FASB), referred to as the Norwalk Agreement. In the last few years, media reports are replete with news about the U.S. SEC developing an IFRS road map.

In November 2007, in a surprise move that is considered by some as the most significant nod of friendliness and an astounding move toward convergence in recent times, the U.S. SEC opened its doors to IFRS. This defining moment in the fast-tracked race of the IASB has helped gain global acceptance of the SEC's standards. In fact, this is the first time in the history of United States standard setting that a non-U.S. set of accounting standards were allowed to be used for listings on U.S. stock exchanges without requiring mandatory reconciliation to U.S. GAAP. Before this groundbreaking announcement was made by the U.S. SEC, all foreign private issuers (FPIs) were required to reconcile to U.S. GAAP the financial statements that they file with the U.S. SEC if the financial statements were prepared using any standards other than U.S. GAAP. While this exception to file financial statements without reconciliation to U.S. GAAP was made in a limited manner by the U.S. SEC, that is, only in the case of foreign private issuers (FPIs), such an exception to using U.S. GAAP for purposes of listing on the largest capital market of the world is undoubtedly a major breakthrough for the IFRS, the only non-U.S. GAAP standards that can boast of this special treatment.

In August 2008, the U.S. SEC went a step forward with its acceptance of IFRS and proposed to relax its rules further and permit the use of IFRS by U.S. issuers (i.e., domestic companies in the United States) provided certain *milestones* are achieved leading to mandatory use of IFRS by U.S. issuers starting for fiscal years ending on or after December 15, 2014. The milestones that need to be addressed before mandatory adoption of IFRS in the United States are

- Improvements in accounting standards, in accordance with a memorandum of understanding established between the IASB and FASB;
- Funding and accountability of the IASC Foundation;
- Improvement in the ability to use interactive data for IFRS reporting; and
- Education and training on IFRS in the United States.

According to this road map to convergence, in 2011, the U.S. SEC will assess the progress of these milestones and will decide whether to mandate the use of IFRS for U.S. issuers. If, after assessment, the U.S. SEC is satisfied with the achievements of the milestones, then U.S. issuers may be allowed to make the transition to IFRS as early as 2014.

The other good news is that under this new friendly approach to convergence with IFRS (which some refer to as the sudden urge to merge or converge with IFRS in the United States), more specifically, under the U.S. SEC IFRS road map, limited early use of IFRS has also been permitted for eligible entities; *under this limited exception, certain U.S. issuers may even begin using IFRS soon. However, the final decisions in this regard are yet to be made as of this date.*

THE WAY FORWARD

IFRS are clearly emerging as a global financial reporting benchmark and most countries have already started using them as their benchmark standards for listed companies. With the recent issuance of IFRS for SMEs, a stand-alone set of standards for private entities that do not have public accountability, the global reach of the IASB is further enhanced. However, if these international standards are not applied uniformly across the world due to interpretational differences, then their effectiveness as a common medium of international financial reporting will be in question. If different entities within the region apply them differently based on their interpretation of the standards, it would make global comparison of published financial statements of entities using IFRS difficult. Debate still rages amongst accountants and auditors globally on many burning and contentious accounting issues that need a common stand based on proper interpretation of these standards.

According to one school of thought, IFRS are emerging as the much-awaited answer to the “billion-dollar question” on the minds of accountants, financial professionals, financial institutions, and regulators, that is, *which set of accounting standards would solve the conundrum of diversity in accounting practices worldwide by qualifying as a single or a common set of standards for the world of accounting to follow and rely upon?*

Undoubtedly, for years, U.S. GAAP was leading this much-talked about international race to qualify as the most acceptable set of accounting standards worldwide. However, due to several reasons, including the highly publicized corporate debacles such as that at Enron in the United States, the global preference (or choice) of most countries internationally has now clearly tilted in favor of IFRS as the most acceptable set of international accounting and financial reporting standards worldwide.

With the current acceptance of IFRS in more than 100 countries (and with several more expected to adopt IFRS in the coming years), one can probably argue that IFRS could possibly qualify as an Esperanto of international accounting (*Esperanto* refers to the well-known universal language). However, some people still believe that the race for global acceptance of IFRS is not over yet. While more than 100 countries have adopted IFRS as their national accounting standards, there are some important jurisdictions in the financial world (such as the United States) that have not yet fully accepted IFRS for financial reporting of their domestic companies. Therefore, unless the United States, the largest economic superpower of the world for years now, accepts IFRS as its national GAAP (replacing U.S. GAAP), it may be difficult to call IFRS the world’s standards. There is, however, a strong possibility of the U.S. SEC’s accepting IFRS ultimately. Judging from the amazing change in attitude of the U.S. SEC, which has already allowed use of IFRS by foreign private issuers for filings on U.S. stock exchanges, one may expect—that is, if the SEC’s road map to convergence with IFRS goes through successfully without any glitches—that by the year 2014 (unless the date of convergence is extended further for whatever reason), the world of accounting may be

rejoicing and celebrating under a strong common banner of a global set of accounting and financial reporting standards, namely, the IFRS. Some believe that the idea of a single set of standards for the world may be wishful thinking especially if the U.S. SEC's road map is amended adversely. As things stand presently, however, it may be expected that there is a strong possibility of allowing the use of IFRS in the United States in some form or another.

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