1 RESEARCHING IFRS IMPLEMENTATION PROBLEMS

OVERVIEW

This book is designed to provide readers with guidance regarding the application of international financial reporting standards that extends beyond that which is immediately obvious from an understanding of the IFRS concepts. Although there are Concepts and Examples sections in each of the chapters that provide summarized versions of the relevant IFRS issues, the primary focus of this book is to provide information about ancillary topics that allow one to implement IFRS, such as accounting policies and procedures, controls, and the construction of financial reporting footnotes. Presently, there are few or no authoritative sources for these IFRS implementation topics. Instead, the sections of this chapter devoted to each implementation topic list some organizations that can provide additional information, as well as key publications that summarize or discuss related topics, including identification of each cited book's author, publisher, and date of publication. But first, we address the IFRS hierarchy of accounting standards and rules, followed by the general approach for researching IFRS-related issues.

The IFRS Hierarchy

International financial reporting standards (IFRS) are standards and rules for reporting financial information, as established and approved by the Financial Accounting Standards Board (IASB). IASB succeeded the International Accounting Standards Committee (IASC), which promulgated International Accounting Standards (IAS), in 2001. The extant IAS have the same status as the more recently issued IFRS and, in this book, all will be referred to as IFRS, for simplicity. Interpretive literature (SIC and IFRIC) issued by bodies of IASB and its predecessor are also considered in the discussions in this book.

The IASB inherited the IASC's *Framework for the Preparation and Presentation of Financial Statements* (the *Framework*). Like the other current conceptual frameworks established by Anglo-Saxon standard setters, this derives from the US GAAP conceptual framework, or at least those parts completed in the 1970s. The

Framework states that "the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions." The information needs of investors are deemed to be a paramount concern, and if financial statements meet their needs, it is presumed, and likely, that other users' needs would generally also be satisfied.

The *Framework* holds that financial statement users need to evaluate the reporting entity's ability to generate cash as well as the timing and certainty of its generation. The financial position is affected by the economic resources controlled by the entity, its financial structure, its liquidity and solvency, and its capacity to adapt to changes in the environment in which it operates.

The qualitative characteristics of financial statements are *understandability, relevance, reliability,* and *comparability.* Reliability comprises representational *faithfulness, substance over form, completeness, neutrality,* and *prudence.* It suggests that these are subject to a cost/benefit constraint and that, in practice, there will often be a trade-off between characteristics. The *Framework* does not specifically include a "true and fair" requirement, but says that application of the specified qualitative characteristics should result in statements that present fairly or are true and fair. IAS 1, *Presentation of Financial Statements,* states that financial statements are to present fairly the financial position, financial performance, and cash flows of the reporting entity and that the achievement of a fair presentation requires the faithful representation of the effects of the reporting entity's transactions, other events and conditions. IAS 1 most recently has been substantially revised in 2007, for mandatory application by 2009. Among the changes imposed are the elimination of the term "balance sheet" (replaced by statement of financial position), and the adoption of a requirement for presentation of a statement of comprehensive income, largely modeled on the approach long in use under US GAAP.

Of great importance are the definitions of assets and liabilities. According to IASB, "an asset is 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." A liability is 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 future benefits." Equity is simply a residual arrived at by deducting the liabilities from assets. Neither asset nor liability is recognized in the financial statements unless they have a cost or value that can be measured reliably—which, as the *Framework* acknowledges, means that some assets and liabilities may remain unrecognized. However, with the ever-expanding use of fair value measurements, and the greatly expanded availability of information from a wide array of sources, including that found via the Internet, there will be a continuing decline in the incidence of "off-balance-sheet" transactions or events, and of those recognized at other-than-current fair values.

The asset and liability definitions have, in the past, not been central to financial reporting standards, many of which were instead guided by a "performance" view of the financial statements. For example, IAS 20 on government grants has been severely criticized, and has been targeted for either revision or elimination, in part because it allows government grants to be treated as a deferred credit and amortized to earnings. Deferred credits do not meet the *Framework* definition of a liability. Similarly, IFRS 3 requires that, where negative goodwill is identified in a business combination, this should be released to the income statement immediately; IAS 22 treated it as a deferred credit, which does not meet the criterion for recognition as a liability.

Both FASB and IASB now intend to analyze solutions to reporting issues in terms of whether they cause any changes in assets or liabilities. The revenue recognition project that both are pursuing is perhaps the ultimate example of this new and rigorous financial position perspective. This project has tentatively embraced the view that where an entity receives an order and has a legally enforceable contract to supply goods or services, the entity has both an asset (the right to receive future revenue) and a liability (the obligation to fulfill the order) and it thus follows that, depending on the measurement of the asset and the liability, some earnings could be recognized at that point. This would be a sharp departure from existing IFRS, under which executory contracts are almost never formally recognized, and never can be the basis for recognition of earnings.

The IASB *Framework,* in its current incarnation, is relatively silent on measurement issues. The three paragraphs that address this matter merely mention that several different measurement bases are available and that historical cost is the most common. Revaluation of tangible fixed assets is, for example, perfectly acceptable under IFRS. In practice, IFRS employs a mixed-attribute model, based mainly in historical cost, but requiring reference to value in use (the present value of expected future cash flows from the use of the asset within the entity) for impairment and the utilization of fair value (market value) for some financial instruments, biological assets, business combinations, and investment properties.

FASB and IASB currently are revisiting their respective conceptual frameworks, the objective of which is to refine and update them and develop them into a common framework that both can use in developing accounting standards. With concurrent IASB and FASB deliberations and a single integrated staff team, this is truly an international project. A joint discussion paper on certain of these matters was issued in mid-2006, stressing the qualitative characteristics of financial statement information. Other aspects of the multiphase conceptual framework project have since been addressed. An Exposure Draft of the first phase is promised for late 2007, with early-stage exposure literature addressing subsequent parts of this project likely to be forthcoming over the next several years.

The existing *Framework* is used by IASB members and staff in their debate, and they expect that those commenting on exposure drafts will articulate their arguments in terms of the *Framework.* However, it is not intended that the *Framework* can be used directly by preparers and auditors in determining all of their accounting methods. In its 2003 revision of IAS 8, IASB introduced a hierarchy of accounting rules that should be followed by preparers in seeking solutions to accounting problems. This hierarchy says that the most authoritative guidance is IFRS, and the preparer should seek guidance in this way:

1. First, by reference to IAS/IFRS and SIC/IFRIC Interpretations, when these specifically apply to a transaction or condition.
2. In the absence of such a directly applicable standard, judgment is to be used to develop and apply an accounting policy that is relevant to the economic decision-making needs of the users, and is reliable in that the financial statements: represent faithfully the financial position, financial performance and cash flows of the reporting entity; reflect the economic substance of transactions, events and conditions, rather than merely the legal forms thereof; are neutral; are prudent; and are complete in all material respects.
3. If this is not possible, the preparer should then look to recent pronouncements of other standard setters that use a similar conceptual framework to develop its standards, as well as other accounting literature and industry practices that do not conflict with higher-level guidance. US GAAP would be the most useful source for such assistance, in the authors' opinion, since it has the largest volume of detailed applications guidance, and since IFRS were heavily influenced, in their development, by US GAAP standards.
4. Only if that also fails should the preparer look to the IASB *Framework* directly, and attempt to draw inferences regarding specific applications that have not been formally addressed in promulgated standards.

In effect, therefore, if IFRS do not cover a subject, the preparer should look to national GAAP, and the most obvious choice is US GAAP, partly because that is the most complete set of standards and partly because, in the global capital market, US GAAP is the alternative best understood (and use of US GAAP removes reconciliation items on the Form 20-F for foreign SEC registrants, although it is now highly likely that the reconciliation requirement will be dropped by the SEC, assuming foreign private issuers adhere to full IFRS as established by IASB). In any event, given the professed intention that IFRS and US GAAP converge, it would make little sense to seek guidance in any other set of standards, unless US GAAP were also silent on the matter needing clarification.

Researching IFRS

The simplest approach to researching IFRS is to review the Concepts and Examples sections in this book. If this does not yield a sufficiently detailed answer, a more comprehensive source of summarized IFRS information is *Wiley IFRS 2008*. *Wiley IFRS 2008* contains a more comprehensive Concepts section than this book and also begins with a list of authoritative pronouncements as well as the applicable page reference leading to a more complete discussion of the issues within the text. If this approach still does not yield a clear answer to an IFRS problem, readers are invited to review selected IFRS source documents. If these still do not yield a clear answer, it is suggested that readers can inquire of other entities in the same industry how they are handling the issue (if only to identify alternative solutions). If all else fails, use basic accounting theory to resolve the issue, or consult with a technical expert at a public accounting firm.

Researching Accounting Controls

The issue of adequacy of accounting controls is distinct from that of IFRS, but in practice, unless a minimum threshold of control effectiveness has been achieved, there can be no real assurance that IFRS are being applied correctly and consistently.

There is no standard source document itemizing the key control areas related to all types of IFRS. Instead, controls are either described in general terms through the reports issued by various accounting review committees (see discussion of the *COSO Implementation Guide* below) or else entities must infer the correct types of controls to use based on various types of fraud that may occur (several examples are noted below). A good source for controls-related publications is the Institute of Internal Auditors (Web site: www.theiia.org). Several reference books related to this topic are

COSO Implementation Guide

Author: James P. Roth
Publisher: Institute of Internal Auditors
Publication Date: 1995

Financial Crime Investigation and Control

Authors: K.H. Spencer Pickett, Jennifer M. Pickett
Publisher: John Wiley & Sons, Inc.
Publication Date: 2002

Financial Reporting Fraud

Author: Charles Lundelius Jr.
Publisher: AICPA
Publication Date: 2003

Financial Statement Fraud

Author: Zabihollah Rezaee
Publisher: John Wiley & Sons, Inc.
Publication Date: 2002

Fraud 101

Author: Howard Davia
Publisher: John Wiley & Sons, Inc.
Publication Date: 2000

Internal Control Integrated Frameworks

Authors: Coopers & Lybrand
Publisher: AICPA
Publication Date: 1994

Process Development Life Cycle

Author: Albert Marcella Jr.
Publisher: Institute of Internal Auditors
Publication Date: 2001

Researching Accounting Forms and Reports

There is no single book or periodical containing a comprehensive set of forms or reports linked to IFRS. Suggestions for useful forms and reports are presented within this book. An alternative is to review publications describing how to construct these documents. Such information can then be used to design forms and reports based on the specific accounting structures unique to a company. This source book provides information about constructing forms and reports:

Design and Maintenance of Accounting Manuals

Authors: Steven M. Bragg and Harry L. Brown
Publisher: John Wiley & Sons, Inc.
Publication Date: 2007

Some examples of forms and reports can be found in certain of the larger accounting "how to" books, such as

Controllership: The Work of the Managerial Accountant, 7th Edition

Authors: Janice M. Roehl-Anderson and Steven M. Bragg
Publisher: John Wiley & Sons, Inc.
Publication Date: 2004

Researching Accounting Footnotes

Source documents for IFRS will describe the general contents of footnotes to financial statements but rarely give more than a few limited examples. Expanded discussions of disclosures can be found in *Wiley IFRS 2008*. Another option is to access the Web site of the Securities and Exchange Commission at www.sec.gov and review the individual filings of various public companies, which can be accessed through the "Search for Company Filings" option on that Web page. Several hundred foreign private issuers file with the SEC, and most of these present financial statements in conformity with IFRS.

Researching Accounting Journal Entries

Examples of journal entry formats are listed in the Journal Entry sections of each chapter in this book. In addition, you can consult *Wiley IFRS 2008* for the most recent year, which may include different examples of journal entries for a specific topic.

Researching Accounting Recordkeeping

Information about the proper time period over which to retain accounting documents is difficult to find, as are procedures and documentation for organizing and destroying documents. The principal organization concerning itself with these issues is the Association for Information Management Professionals (Web site: www.arma.org), headquartered in Lenexa, Kansas. Its Web site cites a number of books related to records retention.

APPENDIX A

Current International Financial Reporting Standards (IAS/IFRS) and Interpretations (SIC/IFRIC)

(Recent revisions noted parenthetically)

IAS 1	Presentation of Financial Statements (revised 2007, effective 2009)
IAS 2	Inventories (revised 2003, effective 2005)
IAS 7	Cash Flow Statements
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors (revised 2003, effective 2005)
IAS 10	Events After the Balance Sheet Date (revised 2003, effective 2005)
IAS 11	Construction Contracts
IAS 12	Income Taxes
IAS 14	Segment Reporting (superseded by IFRS 8, effective 2009)
IAS 16	Property, Plant, and Equipment (revised 2003, effective 2005)
IAS 17	Accounting for Leases (revised 2003, effective 2005)
IAS 18	Revenue
IAS 19	Employee Benefits (revised 2004)
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	The Effects of Changes in Foreign Exchange Rates (revised 2003, effective 2005; minor further amendment 2005)
IAS 23	Borrowing Costs (revised 2007, effective 2009)
IAS 24	Related-Party Disclosures (revised 2003, effective 2005)
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Consolidated and Separate Financial Statements (revised 2003, effective 2005)
IAS 28	Accounting for Investments in Associates (revised 2003, effective 2005)
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 31	Financial Reporting of Interests in Joint Ventures (revised 2003, effective 2005)
IAS 32	Financial Instruments: Presentation (revised 2003, effective 2005; disclosure requirements removed to IFRS 7 effective 2007)
IAS 33	Earnings Per Share (revised 2003, effective 2005)
IAS 34	Interim Financial Reporting
IAS 36	Impairments of Assets (revised 2004)

IAS 37	Provisions, Contingent Liabilities, and Contingent Assets
IAS 38	Intangible Assets (revised 2004)
IAS 39	Financial Instruments: Recognition and Measurement (amended 2005)
IAS 40	Investment Property (revised 2003, effective 2005)
IAS 41	Agriculture
IFRS 1	First-Time Adoption of IFRS (minor amendment 2005)
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
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 Venturers
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 Enterprise 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
IFRIC 1	Changes in Existing Decommissioning, Restoration and Similar Liabilities
IFRIC 2	Members' Shares in Cooperative Entities and Similar Instruments
IFRIC 4	Determining Whether an Arrangement Contains a Lease
IFRIC 5	Rights to Interest 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
IFRIC 9	Reassessment of Embedded Derivatives
IFRIC 10	Interim Financial Reporting and Impairment
IFRIC 11	IFRS 2: Group and Treasury Share Transactions
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