
Chapter 1 International GAAP

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Chapter 1 International GAAP

1 WHY INTERNATIONAL FINANCIAL REPORTING STANDARDS MATTER

With globalisation has come the increasing integration of world markets for goods, services and capital – with the result that companies that traditionally were reliant on their domestic capital markets for financing now have substantially increased access to debt and equity capital both inside and outside their national borders.

Yet – perhaps not entirely surprisingly – the world of financial reporting has historically been slow to respond reflecting, no doubt, a widespread nationalism in respect of countries' own standards.

Undoubtedly, one of the main advantages of a single set of global accounting standards is that it would enable the international capital markets to assess and compare inter-company performance in a much more meaningful, effective and efficient way than is presently possible. This should increase companies' access to global capital and ultimately reduce the cost thereof. Thus the request for global standards came both from regulatory bodies and from preparers of financial statements. As early as 1989 the International Organisation of Securities Commissions (IOSCO), the world's primary forum for co-operation among securities regulators, prepared a paper noting that cross border security offerings would be facilitated by the development of internationally accepted standards. For preparers, greater comparability in financial reporting with their global peers had obvious attractions.

Notwithstanding these anticipated benefits it is only since 2000 that there has been a realistic prospect of such global standards and that has come about largely as a result of bold action by the European Commission.

The European Commission announced in June 2000 that it would present proposals to introduce the requirement that all listed European Union (EU) companies report in accordance with International Accounting Standards by 2005. This requirement – which was adopted in an EU Regulation in 2002¹ – has changed fundamentally not only the face of European financial reporting, but global reporting as well.

Although the EU is almost certainly the International Accounting Standards Board's (IASB's) most significant single constituency for the time being, there are also a number of other economically developed countries that either have already adopted

– or will be adopting – International Financial Reporting Standards (IFRS) as their primary system of GAAP. Notable examples are Australia, which adopted IFRS effective 2005, Canada, which replaced Canadian GAAP with IFRS from 1 January 2011 onwards for ‘publicly accountable enterprises’, and Japan where, in June 2009 the Business Accounting Council (a key advisory body for the Financial Services Agency) approved a roadmap for the adoption of IFRS in Japan, subject to a final decision in 2012. Significantly also, countries such as Brazil, China, India and Russia have made significant progress towards the adoption of IFRS, whilst countries such as South Africa have already aligned their national standards with IFRS.

The European Commission’s decision to adopt IFRS as the basis of financial reporting for all listed EU companies coincided also with the restructuring of the former International Accounting Standards Committee and the formation on 1 April 2001 of the present day IASB. Since then, the IASB and the US Financial Accounting Standards Board (FASB) have become increasingly committed to the convergence of IFRS and US GAAP. This is evidenced by the October 2002 Norwalk Agreement and the February 2006 Memorandum of Understanding between the FASB and the IASB, both of which are discussed in section 3 below.

Beyond convergence between IFRS and US GAAP there is the prospect of adoption of IFRS in the US. In November 2007 the SEC voted unanimously to remove the requirement for a reconciliation to US GAAP from financial statements prepared in accordance with IFRS issued by the IASB.

In August 2008 the SEC approved for public comment its ‘roadmap’ relating to the eventual use of IFRS by US companies. The proposed ‘roadmap’ anticipates mandatory reporting under IFRS beginning in 2014, 2015 or 2016 depending on the size of the company. The SEC’s proposed roadmap is discussed more fully at 3.2.4 below.

In May 2011, the SEC staff issued a paper to describe one possible approach for incorporation of IFRS into the US financial reporting system, assuming that the SEC decides it is in the best interest of US investors. The approach would establish an endorsement protocol for the FASB to incorporate newly issued or amended IFRS into US GAAP. During a defined transition period (e.g. five to seven years), differences between IFRS and US GAAP would be eliminated through ongoing FASB standard setting.

This approach is one of several possible ways to incorporate IFRS into the US financial reporting system, and the SEC has not yet decided whether to move ahead with incorporation.

Although we believe that investors and the capital markets, as well as companies themselves, would benefit from a single set of high quality global accounting standards, the SEC staff’s approach recognises the challenges in making a wholesale US shift to IFRS. The staff’s proposals would move the US forward towards closer convergence with IFRS and, significantly, a commitment to not create further differences.

The fall-out from the 2007 – 2010 financial crisis created a strong underlying political pressure towards convergence of global accounting standards. Comments on the need to achieve this are a regular feature of communications from the G20.

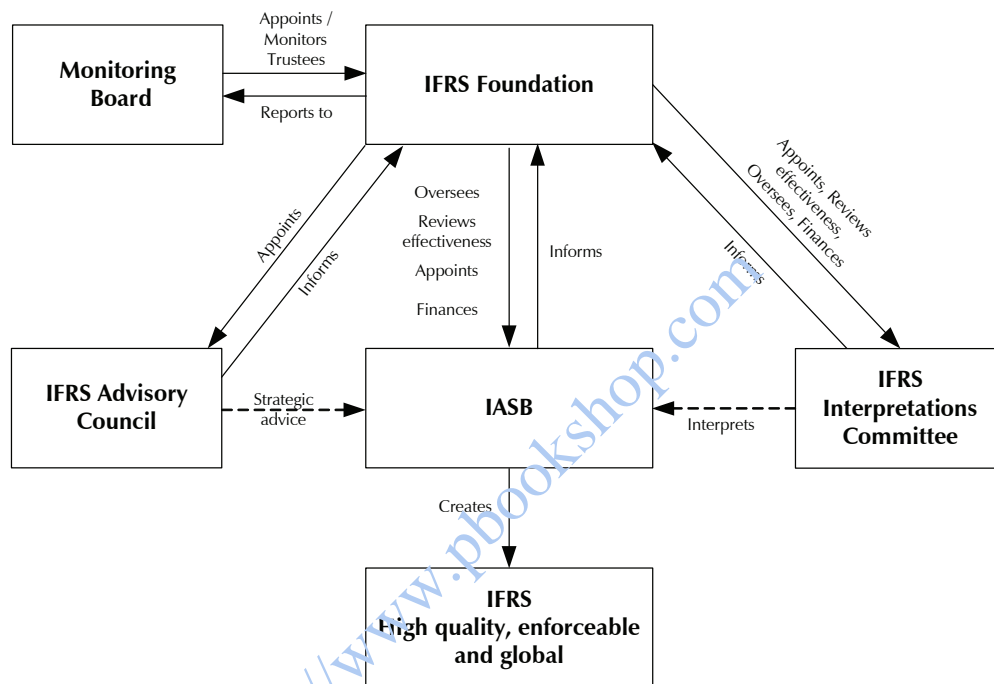
Thus global financial reporting has ceased to be characterised by numerous disparate national systems to the point at which there are today essentially only two – IFRS and US GAAP. Furthermore, there is a strong possibility that IFRS eventually will become the global financial reporting standards.

This chapter discusses the way IFRS is set, the status of convergence with US GAAP, the current agenda of the IASB and adoption of IFRS around the world.

2 THE IFRS FOUNDATION AND THE IASB

2.1 The standard setting structure

The diagram below illustrates the current structure within which standards are set by the IASB. The various elements of the structure are discussed further below.



Unless indicated otherwise, references to IFRS include the following:

- International Financial Reporting Standards – standards developed by the IASB
- International Accounting Standards (IAS) – standards developed by the International Accounting Standards Committee (IASC), the predecessor to the IASB
- Interpretations developed by the IFRS Interpretations Committee or its predecessor, the Standing Interpretations Committee (SIC)
- International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SMEs) – a stand-alone standard for general purpose financial statements of small and medium-sized entities (as defined).

2.1.1 The IFRS Foundation

The governance of the organisation primarily rests with the Trustees of the IFRS Foundation (Trustees) who, in turn, act under the terms of the IFRS Foundation Constitution (the Constitution).² It is a requirement of the Constitution that, in order to ensure a broad international basis, there must be:³

- six Trustees appointed from the Asia/Oceania region;
- six Trustees appointed from Europe;
- six Trustees appointed from North America;
- one Trustee appointed from Africa;
- one Trustee appointed from South America; and
- two Trustees appointed from any area, subject to maintaining overall geographical balance.

The appointment of Trustees to fill vacancies caused by routine retirement or other reasons is the responsibility of the remaining Trustees but subject to the approval of the Monitoring Board as discussed in 2.1.2 below. The appointment of the Trustees is normally for a term of three years, renewable once.⁴

The Constitution requires that the Trustees should comprise individuals that, as a group, provide an appropriate balance of professional backgrounds, including auditors, preparers, users, academics, and officials serving the public interest. Two of the Trustees will normally be senior partners of prominent international accounting firms. To achieve such a balance, Trustees are selected after consultation with national and international organisations of auditors (including the International Federation of Accountants), preparers, users and academics. The Trustees are required to establish procedures for inviting suggestions for appointments from these relevant organisations and for allowing individuals to put forward their own names, including advertising vacant positions.⁵

The Constitution provides that 'all Trustees shall be required to show a firm commitment to the IFRS Foundation and the IASB as a high quality global standard-setter, to be financially knowledgeable, and to have an ability to meet the time commitment. Each Trustee shall have an understanding of, and be sensitive to the challenges associated with the adoption and application of high quality global accounting standards developed for use in the world's capital markets and by other users.'⁶

The Trustees are responsible also for appointing the members of the IASB, IFRS Interpretations Committee (the Interpretations Committee) and IFRS Advisory Council (the Advisory Council).⁷ In addition, their duties include the following:⁸

- assuming responsibility for establishing and maintaining appropriate financing arrangements;
- reviewing annually the strategy of the IFRS Foundation and the IASB and their effectiveness, including consideration, but not determination, of the IASB's agenda;

- approving annually the budget of the IFRS Foundation and determining the basis for funding;
- reviewing broad strategic issues affecting financial reporting standards, promoting the IFRS Foundation and its work and promoting the objective of rigorous application of IFRS (the Trustees are, however, excluded from involvement in technical matters relating to accounting standards);
- establishing and amending operating procedures, consultative arrangements and due process for the IASB, the Interpretations Committee and the Advisory Council;
- approving amendments to the Constitution after following a due process, including consultation with the Advisory Council and publication of an exposure draft for public comment;
- exercising all powers of the IFRS Foundation except for those expressly reserved to the IASB, the Interpretations Committee and the Advisory Council; and
- publishing an annual report on the IFRS Foundation's activities, including audited financial statements and priorities for the coming year.

The IFRS Foundation has developed four principles for a funding system. Those principles are that it should be:⁹

- Broad based;
- Compelling;
- Open ended; and
- Country specific.

The Trustees have sought to establish national funding regimes consistent with these principles in a number of countries. In 2010, the major funders of the IFRS Foundation were the international accounting firms, the US, Japan and Germany.¹⁰

2.1.2 The Monitoring Board

A frequent criticism of the IASB and of the IFRS Foundation has been of its lack of 'accountability' and apparent lack of responsiveness to the concerns of its constituents. This criticism has increased as the level of international acceptance of IFRS has grown.

The Trustees have recognised this concern. In a 2008 consultation paper on the Constitution they noted that they understood that the IFRS Foundation's unique structure makes demonstrating public accountability more challenging than it would be for a national standard setter, which normally reports to national regulators, governments or parliaments.¹¹

The response to these concerns was the creation of a Monitoring Board to provide a formal link between the Trustees and public authorities. This relationship seeks to replicate, on an international basis, the link between accounting standard-setters and those public authorities that have generally overseen accounting standard-setters.¹²

The responsibilities of the Monitoring Board are to:

- Participate in the process for appointing Trustees and approve the appointment of Trustees;
- Review and provide advice to the Trustees on the fulfilment of their responsibilities – there is an obligation on the Trustees to report annually to the Monitoring Board;
- Meet with the Trustees or a sub-group thereof at least annually. The Monitoring Board has the authority to request meetings with the Trustees or separately with the chair of the Trustees and with the chair of the IASB to discuss any area of the work of the Trustees or the IASB.¹³

At the time of writing, the Monitoring Board comprises:

- (a) a member of the European Commission;
- (b) the chair of the IOSCO Emerging Markets Committee;
- (c) the chair of the IOSCO Technical Committee;
- (d) the commissioner of the Japan Financial Services Agency;
- (e) the chair of the US SEC; and
- (g) as an observer, the chair of the Basel Committee on Banking Supervision.¹⁴

The Charter of the Monitoring Board notes that the Monitoring Board's mission is:

- To cooperate to promote the continued development of IFRS as a high quality set of global accounting standards;
- To monitor and reinforce the public interest oversight function of the IFRS Foundation, while preserving the independence of the IASB. In that regard;
 - To participate in the selection and approval of the Trustee appointments;
 - To advise the Trustees with respect to the fulfilment of their responsibilities, in particular with respect to regulatory, legal and policy developments that are pertinent to the IFRS Foundation's oversight of the IASB and appropriate sources of IFRS Foundation funding; and
- To discuss issues and share views relating to IFRS, as well as regulatory and market developments affecting the development and functioning of these standards.¹⁵

To support the effective operation of the Monitoring Board, in April 2009 a Memorandum of Understanding was agreed between the Monitoring Board and the Trustees. The Memorandum of Understanding sets out how the oversight process will work in practice.

When the Trustees originally proposed the Monitoring Board, a number of commentators expressed concerns that it could threaten the independence of the IASB and lead to greater 'political interference' if the Monitoring Board began to influence specific decisions. More recently, concerns about political interference in standard setting have increased because of the way that both the FASB and IASB were seen to react to political pressure during the 2007 – 2010 financial crisis. This goes to the heart of a very difficult balancing exercise. Most observers want the Trustees and

the IASB to be responsive to constituents' concerns but they also support the principle of 'independent standard setting' – how does one achieve both?

Regarding the role and influence of the Monitoring Board, the Trustees were satisfied that because its role was restricted to oversight of the Trustees' fulfilment of their responsibilities there was no risk to the independence of the IASB. Furthermore the preservation of the independence of the IASB is, as noted above, part of the mission of the Monitoring Board. However, the Memorandum of Understanding provides a wide remit for the Monitoring Board, including the following statement:

'The IASCF [now the IFRS Foundation] Monitoring Board may refer accounting issues to, and will confer regarding these issues with, the Trustees and the IASB Chair.

- i. The Trustees will work with the IASB to ensure these issues are addressed in a timely manner.
- ii. If the IASB determines that consideration of the issue(s) identified by the IASCF Monitoring Board is not advisable or that the issue(s) cannot be resolved within the time frame suggested by the Monitoring Board, the Trustees should:
 1. call on the IASB to undertake all reasonable efforts to consider issues(s) in a manner that is consistent with the public interest, taking account the protection of investors;
 2. call on the IASB to explain its position through the Trustees regarding the IASB's position on the issue(s); and
 3. promptly notify the IASCF Monitoring Board of the IASB's position.¹⁶

To assess whether the three-tier structure of the IFRS Foundation is best achieving its goal of increasing accountability whilst maintaining independence, the Monitoring Board initiated a review of the governance structure supporting the development of IFRS in April 2010. As part of this review, the Monitoring Board issued the *Consultative Report on the Review of the IFRS Foundation's Governance* in February 2011 requesting views on the following key areas:

- Composition and structure of the IASB, Trustees and Monitoring Board
- Oversight, roles and responsibilities of the Trustees and Monitoring Board

However, the fundamental question of the review continues to be whether the current governance structure effectively promotes the standard-setter's primary mission of setting high quality, globally accepted standards. A package of recommendations resulting from the governance review is expected to be issued in the second half of 2011.

In addition, in April 2011 the Trustees issued their *Report of the Trustees' Strategy Review* (Strategy Review). The Strategy Review sets out recommendations in the following areas:

- The IFRS Foundation's mission
- Governance
- The standard-setting process
- Financing the IFRS Foundation.

The review of the Monitoring Board focuses primarily on the institutional aspects of governance such as composition and roles of the Monitoring Board, the IASB and the Trustees. The Strategy Review places more emphasis on the operational aspects of governance, such as due process. Both reviews are aimed at ensuring the IFRS Foundation's governance balances independence and accountability appropriately to facilitate the development of high quality and truly global standards.

2.1.3 The International Accounting Standards Board (IASB)

At the time of writing the IASB comprises 15 members, however the Constitution requires that this should be increased to 16 by no later than 1 July 2012. Up to three members may be part time and the remainder full time. The members of the IASB are appointed by the Trustees.¹⁷ The main qualifications for membership of the IASB are professional competence and practical experience.¹⁸

The Trustees are required to select IASB members so that the IASB as a group provides an appropriate mix of recent practical experience among auditors, preparers, users and academics.¹⁹ Furthermore, the IASB is, in consultation with the Trustees, expected to establish and maintain liaison with national standard-setters and other official bodies concerned with standard-setting in order to assist in the development of IFRS and to promote the convergence of national accounting standards and IFRS.²⁰

By July 2012 the IASB will normally be required to comprise:

- (a) four members from Asia/Oceania;
- (b) four members from Europe;
- (c) four members from North America;
- (d) one member from Africa;
- (e) one member from South America; and
- (f) two members appointed from any area, subject to maintaining overall geographical balance.²¹

The responsibilities of the IASB are listed in Article 37 of the Constitution. Its primary role is to have complete responsibility for all IASB technical matters including preparing and issuing IFRSs (other than interpretations) and exposure drafts, each of which is required to include any dissenting opinions; and final approval of and issuing interpretations developed by the Interpretations Committee.²²

Approval by at least nine members of the IASB is required for the publication of an exposure draft, and IFRS (which includes an IAS or final interpretation of the Interpretations Committee), if there are fewer than 16 members of the IASB. If there are 16 members that approval is required by at least 10 members.²³ Other decisions of the IASB, including the publication of a discussion paper, require a simple majority of the members of the IASB present at a meeting that is attended by at least 60% of the members.²⁴ The IASB has full discretion over its technical agenda and over project assignments on technical matters. It must, however, consult the Trustees on its agenda, and the Advisory Council on major projects, agenda decisions and work priorities. In addition, the IASB is required to carry out public consultation every three years in developing its technical agenda.²⁵

2.1.4 The IASB's Due Process Handbook

The Trustees set up a committee – the Trustees' Due Process Oversight Committee (the Committee) – with the task of regularly reviewing and, if necessary, amending the procedures of due process in the light of experience and comments from the IASB and constituents. The Committee reviews proposed procedures for the IASB's due process on new projects and the composition of working groups and ensures that their membership reflects a diversity of views and expertise. The 'Due Process Handbook' (the Handbook) for the IASB describes the consultative arrangements of the IASB. The Trustees approved the Handbook in October 2008, and it was updated in December 2010.²⁶

The procedures described in the Handbook address the following requirements:²⁷

- transparency and accessibility;
- extensive consultation and responsiveness; and
- accountability.

In order to gain a wide range of views from interested parties throughout all stages of a project's development, the Trustees and the IASB have established consultative procedures to govern the standard-setting process.²⁸

The IASB's standard-setting process comprises the following stages, with the Trustees having the opportunity to ensure compliance at various points throughout the process:²⁹

- Stage 1: Setting the agenda;
- Stage 2: Project planning;
- Stage 3: Development and publication of a discussion paper;
- Stage 4: Development and publication of an exposure draft;
- Stage 5: Development and publication of an IFRS; and
- Stage 6: Procedures after an IFRS is issued.

It is important to note that the IASB's due process requirements are separated into mandatory and non-mandatory steps. The following due process steps are mandatory:

- developing and pursuing the IASB's technical agenda;
- preparing and issuing IFRSs and exposure drafts, each of which is to include any dissenting opinions;
- establishing procedures for reviewing comments made within a reasonable period on documents published for comment;
- consulting the Advisory Council on major projects, agenda decisions and work priorities; and
- publishing bases for conclusions with IFRSs and exposure drafts.³⁰

The steps specified in the Constitution that are 'non-mandatory' include:³¹

- publishing a discussion document (e.g. a discussion paper);
- establishing working groups or other types of specialist advisory groups;
- holding public hearings; and
- undertaking field tests (both in developed countries and in emerging markets).

If the IASB decides not to undertake any of the non-mandatory steps defined by the Constitution, it is required by the Constitution to state its reasons (known as the 'comply or explain' approach). Explanations are normally made at IASB meetings, and are published in the decision summaries and in the basis for conclusions with the exposure draft or IFRS in question.³²

Although not mandatory, the IASB conducts public meetings and roundtables to ensure that it has appropriate input from its constituents.

There was criticism of the IASB during its attempts to respond to the 2007 – 2010 financial crisis for its failure to follow due process. This criticism relates to a failure to issue an exposure draft (in the case of the October 2008 amendment to IAS 39 – *Financial Instruments: Recognition and Measurement* (IAS 39) dealing with reclassification of financial assets) and more generally for only providing a short period for constituents to respond to proposals rather than the more normal three months. As a consequence a 'fast track' process was developed. Under this process, if the matter is exceptionally urgent, the exposure draft is short, 'and the IASB believes that there is likely to be a broad consensus on the topic, the IASB may consider a comment period of no less than 30 days, but it will set such a short period only after formally requesting and obtaining prior approval from 75 per cent of the Trustees'.³³

2.1.5 The IFRS Advisory Council (the Advisory Council)

The Advisory Council (whose members are appointed by the Trustees) provides a forum for geographically and functionally diverse organisations and individuals with an interest in international financial reporting to:

- Give advice to the IASB on agenda decisions and priorities in the IASB's work;
- Inform the IASB on the views of the organisations and individuals on the council on major standard-setting projects; and
- Give other advice to the IASB or the Trustees.³⁴

The Advisory Council comprises 'thirty or more members, having a diversity of geographical and professional backgrounds, appointed for renewable terms of three years'.³⁵ The chair of the Council is appointed by the Trustees, and may not be a member of the IASB or a member of its staff.³⁶ The Advisory Council normally meets at least three times a year, and its meetings are open to the public. It is required to be consulted by the IASB in advance of IASB decisions on major projects and by the Trustees in advance of any proposed changes to the Constitution.³⁷

In June 2011, the Trustees announced the following changes to Advisory Council membership:

- Inviting regional standard-setting bodies to join, instead of national standard-setters currently serving
- Seeking further participation from the academic community, other internationally recognised professional bodies with an interest in financial reporting not currently represented, and the small and medium sized entity community
- Adding greater participating from developing markets and other economies committed to IFRS adoption

In addition, in future years, membership will be for one, two or three years, to achieve an orderly rotation of membership.³⁸

2.1.6 The IFRS Interpretations Committee (the Interpretations Committee)

For IFRS to be truly global standards consistent application and interpretation is required. 'The mandate of the Interpretations Committee is to review on a timely basis widespread accounting issues that have arisen within the context of current IFRSs and to provide authoritative guidance (IFRICs) on those issues.'³⁹

The Interpretations Committee assists the IASB in improving financial reporting through timely identification, discussion and resolution of financial reporting issues within the framework of IFRS. It has 14 voting members. The chair, who is appointed by the Trustees, is a member of the IASB, the Director of Technical Activities or other appropriately qualified individual. The chair does not have the right to vote. The Trustees may appoint representatives of regulatory organisations, who have the right to attend and speak at meetings but not the right to vote.⁴⁰ Currently, the European Commission and IOSCO have observer status. The quorum for a meeting is ten members, and approval of draft or final interpretations requires that not more than four voting members vote against the draft or final interpretation.⁴¹

The Interpretations Committee meets six times a year. All technical decisions are taken at sessions that are open to public observation. It reviews newly identified financial reporting issues not specifically addressed in IFRS or issues where unsatisfactory or conflicting interpretations have developed, or seem likely to develop in the absence of authoritative guidance, with a view to reaching a consensus on the appropriate treatment.⁴² The IASB approves and issues interpretations. Entities that prepare their financial statements in accordance with IFRS are required to comply with issued interpretations.⁴³

2.1.7 The IASB's 'Annual Improvements Process'

During 2007, the IASB adopted an annual process to deal with 'non-urgent, minor amendments to IFRSs' (the 'Annual Improvements Process'). Issues dealt with in this process arise from matters raised by the Interpretations Committee and suggestions from IASB staff or practitioners, and focus on areas of inconsistency in IFRS or where clarification of wording is required.

The premise behind the Annual Improvements Process is to streamline the IASB's standard-setting process. If a number of minor amendments are processed together, there will be benefits both to constituents and the IASB. The Interpretations Committee assists the IASB by reviewing and recommending potential amendments to IFRS. 'Annual Improvements' is on the IASB's work plan like its other projects and is subject to the same due process.

In February 2011, the Trustees approved amendments to the Handbook to create enhanced criteria to assess whether a matter should be amended through the Annual Improvements Process.⁴⁴ Although the Handbook has not been updated at the time of writing, the IASB is following these enhanced criteria for *Annual Improvements 2009-2011*.

3 THE IASB'S TECHNICAL AGENDA AND GLOBAL CONVERGENCE

3.1 The IASB's current priorities and future agenda

At the time of writing, the IASB could be described as being at a crossroads. The convergence projects with the FASB, which have consumed a significant effort throughout much of the Board's history, are expected to be completed in 2012. All of the founding Board members have completed their terms and on 1 July 2011, the Board has a new chair, Hans Hoogervorst, and vice-chair, Ian Mackintosh. In addition, the SEC is expected to make a decision later in 2011 on whether and how IFRS should be incorporated into the US financial reporting system. All of these factors will influence the Board's future agenda and are discussed in more detail below.

3.1.1 The IASB's current priorities

The majority of the projects on the IASB's current work plan stem from a Memorandum of Understanding between the IASB and the FASB, which is discussed in more detail in 3.2.2.

In a joint progress report on IASB and FASB convergence work issued in April 2011, the IASB indicated that its work plan for the remainder of 2011 would focus on the revenue recognition, leases, financial instruments and insurance contracts projects. Both boards consider the need for improvements in these areas to be the most urgent and as of July 2011 are targeting them for completion in 2011 and 2012. Annual improvements and the Agenda Consultation 2011 (which is discussed in more detail in 3.1.2) are also active projects on the IASB's agenda.

The IASB has deferred projects on financial statement presentation, financial instruments with characteristics of equity, emissions trading schemes, liabilities, income taxes and the conceptual framework until late 2011. It will review these projects as part of its agenda consultation process.

The IASB's current work plan is available on its website under the 'Standards development' tab, 'Workplan for IFRSs'.

3.1.2 Agenda consultation 2011

As discussed in 2.1.3, the Constitution requires that that the IASB carry out public consultation every three years in developing its technical agenda. This process commenced on 26 July 2011 when the IASB issued a Request for Views on the strategic direction and overall balance of its future agenda.

The IASB proposed the following strategic foundation for setting its future agenda:

- A more diverse IFRS community will potentially lead to new issues
- A more complex market environment will create new challenges in financial reporting
- The new and amended IFRS that have been issued in 2011 or are expected to be issued in 2012 will place pressure on preparers to implement the changes and users to understand the key differences; preparers and users may want a period of calm before additional significant projects are added to the agenda.

The Request for Views also highlights that the strategy of the future agenda should not only focus on the development of new IFRS, but should also emphasise the need to perform post-implementation reviews of issued IFRS and targeted narrow scope improvements to existing IFRS.

The post 2011 agenda will be heavily influenced by the progress actually made on existing projects in 2011. Furthermore any decision the SEC makes in 2011 on the role of IFRS in the US can also be expected to have an influence on the post 2011 agenda. The background and status of US adoption of IFRS is discussed in more detail in 3.2.4.

3.1.3 New IASB leadership

2011 marked the retirement of Sir David Tweedie from the IASB. David Tweedie led the IASB since its inception in 2001 and was hugely influential in its development.

Effective 1 July 2011, Hans Hoogervorst became the chair of the IASB. Mr. Hoogervorst brings a regulatory background to the Board having served most recently as chair of the executive board of the Netherlands Authority for the Financial Markets and the IOSCO technical committee. He was also co-chair of the Financial Crisis Advisory Group (FCAG) to the IASB and chair of the IFRS Foundation Monitoring Board.

Also effective 1 July 2011, Ian Mackintosh became vice-chair of the IASB. He has played an active role in standard setting since 1983 serving as chair of the UK Accounting Standards Board, deputy chair of the Australian Accounting Standards Board and chair of its Urgent Issues Group. Among other roles, Mr. Mackintosh also served as manager, financial management, South Asia at the World Bank.

The effect the new chair and vice-chair will have on the IASB's agenda is yet to be known, however, upon issuance of the Agenda Consultation 2011 Hans Hoogervorst commented: 'Up until now, the agenda of the IASB has largely been determined by the need to support a first wave of jurisdictions adopting IFRSs and the completion of our programme to improve IFRSs and align them with US GAAP. With this work largely completed, our attention can now turn to new issues that may require our attention.'⁴⁵

With exposure or re-exposure on several projects or phases of projects, the comment period on the agenda consultation and a decision from the SEC all occurring in the second half of 2011, as well as a new IASB chair and vice-chair, it is difficult to foresee what the priorities of the IASB will be for 2012.

3.2 IFRS/US GAAP convergence

'Convergence' is a term used to describe the coming together of national systems of financial reporting and IFRS. Since its formation in 2001, the IASB has made great strides toward achieving global accounting convergence, with the result that the global acceptance of IFRS is rapidly becoming a reality. All listed EU companies are already required to prepare their consolidated financial statements in accordance with adopted IFRSs. Elsewhere, scores of non-EU countries have either adopted or are in the process of adopting or are aligning their national standards with IFRS. For a company to assert compliance with IFRS it is required to apply IFRS 1 – *First-time*

Adoption of International Financial Reporting Standards (IFRS 1). The IASB has therefore established unambiguously the principle that full application of its standards and related interpretations is necessary for a company to be able to assert that its financial statements comply with IFRS (as issued by the IASB). Consequently, it is necessary for countries that align their national standards with IFRS to require the application of IFRS 1 so that companies reporting under those standards can assert compliance with IFRS. In addition, a company that applies IFRS as amended by a local authority cannot assert compliance with IFRS.

3.2.1 Convergence with US GAAP: The Norwalk Agreement

For many years, the co-operation between the IASC/IASB and national standard setters had happened – mostly at an informal level – through a variety of bodies such as the G4+1 and the Joint Working Group of Standard Setters.⁴⁶ In the US, support for convergence grew steadily, and in October 2002 the IASB and FASB issued a memorandum of understanding that marked a significant step towards the two boards formalising their commitment to the convergence of IFRS and US GAAP.⁴⁷

This agreement, referred to as the Norwalk Agreement, was reached at a joint meeting in September 2002, where the Boards each acknowledged their commitment to the development of high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that meeting, the Boards pledged to use their best efforts to (a) make their existing financial reporting standards fully compatible as soon as is practicable and (b) to coordinate their future work programmes to ensure that once achieved, compatibility is maintained.⁴⁸

To achieve compatibility, the Boards agreed, as a matter of high priority, to:

- undertake a short-term project aimed at removing a variety of individual differences between US GAAP and IFRS;
- remove other differences between IFRS and US GAAP that would remain at 1 January 2005, through coordination of their future work programmes; that is, through the mutual undertaking of discrete, substantial projects that both Boards would address concurrently;
- continue progress on the joint projects that they were currently undertaking; and
- encourage their respective interpretative bodies to coordinate their activities.⁴⁹

The Boards agreed to commit the necessary resources to complete such a major undertaking and to start deliberating differences identified for resolution in the short-term project with the objective of achieving compatibility by identifying common, high-quality solutions. The Boards agreed also to use their best efforts to propose changes to US GAAP or IFRS that reflected common solutions to some, and perhaps all, of the differences identified for inclusion in the short-term project during 2003.⁵⁰

3.2.2 Memorandum of Understanding between the FASB and the IASB⁵¹

On 27 February 2006, the FASB and the IASB published a Memorandum of Understanding (MOU) that reaffirmed the Boards' shared objective of developing high quality, common accounting standards for use in the world's capital markets. The MOU was a further elaboration of the objectives and principles first described in the Boards' Norwalk Agreement (see 3.2.1 above).

The Boards agreed that trying to eliminate differences between their respective standards when both were in need of significant improvement was not the best use of resources – instead, new common standards should be developed. Consistent with that principle, convergence work would continue to proceed on the following two tracks:

- first, the Boards would reach a conclusion about whether major differences in focused areas should be eliminated through one or more short-term standard-setting projects, and, if so, would aim to complete or substantially complete work in those areas by 2008; and
- second, the FASB and the IASB would seek to make continued progress on joint projects in other areas they identified where current accounting practices under US GAAP and IFRS were regarded as candidates for improvement (eleven areas were identified in the MOU).

The Boards pointed out that their work programmes were not limited to the items listed in the MOU. The FASB and the IASB would follow their normal due process when adding items to their agendas.

Topics for short-term convergence included the following:

To be examined by the FASB	To be examined by the IASB
Fair value option	Borrowing costs
Impairment (jointly with the IASB)	Impairment (jointly with the FASB)
Income tax (jointly with the IASB)	Income tax (jointly with the FASB)
Investment properties	Government grants
Research and development	Joint ventures
Subsequent events	Segment reporting

Topics that were on the active and research agendas of the IASB and/or the FASB that would be worked on jointly (i.e. the MOU projects) included the following:

Topics on an active agenda	Topics being researched
Business combinations	Derecognition
Consolidations	Financial instruments (replacement of existing standards)
Fair value measurement guidance	Intangible assets
Liabilities and equity distinctions	Leases
Performance reporting	
Post-retirement benefits (including pensions)	
Revenue recognition	

Subsequent to entering into the MOU, the Boards added a joint project on insurance.

Progress on the various projects can perhaps be described as mixed. Certainly progress has been slower than was anticipated and a number of the areas that were to be addressed have proved intractable for the Boards. Nevertheless, the Boards concluded during 2008 that most of the milestones had been reached or were due to be reached during 2008, and as a result there was little guidance on prioritisation of projects on the Board's active agenda.⁵² Given the number of jurisdictions that announced their intention to adopt or converge with IFRS in 2011 and 2012, the chairs of each board agreed to extend the timetable of the existing MOU through to 2011, to better direct their work plans during that period.

These developments took place in the expectation that the SEC would be announcing plans for the adoption of IFRS in the US. In August 2008 the SEC approved for public comment its proposed 'roadmap' relating to the eventual use of IFRS by US companies (see 3.2.4 below). It was clear that the SEC saw the continued progress of the IASB and FASB on convergence as being an important condition for progress on the roadmap.

In September 2008 the Boards published a short memorandum *Completing the February 2006 Memorandum of Understanding: A progress report and timetable for completion*. However, progress against the expectations set out in that memorandum was adversely affected by the time the Boards had to spend from 2008 through 2010 dealing with the implications of the 2007 – 2010 financial crisis. Since then, the Boards have issued three other progress reports, most recently in April 2011. In April 2011, the Boards reported that they are nearing completion of the MOU programme. The short-term convergence projects 'have been completed or are close to completion' and of the other MOU projects, 'only three ... remain for which the boards have yet to finalise the technical decisions – financial instruments, revenue recognition and leasing.'⁵³

3.2.3 SEC Concept Release on allowing US issuers to prepare financial statements in accordance with IFRS

In July 2007 the SEC issued a proposal to accept IFRS financial statements from foreign private issuers (FPIs) without reconciliation to US GAAP, which in turn raised the question as to whether it also should accept financial statements prepared in accordance with IFRS from US issuers. Consequently, in August 2007, the SEC published a Concept Release to obtain information about the extent and nature of the public's interest in allowing US issuers to prepare financial statements in accordance with IFRS for purposes of complying with the rules and regulations of the SEC.⁵⁴

According to the SEC, it had identified at least two market forces that might provide incentives for some market participants to request in the future that the SEC accepts from US issuers financial statements prepared in accordance with IFRS.⁵⁵

First, as a growing number of jurisdictions move to IFRS, more non-US companies will report their financial results in accordance with IFRS. If a critical mass of non-US companies in a certain industry sector or market reports in accordance with IFRS, then there might be pressure for US issuers in that industry sector or market to likewise report in accordance with IFRS to enable investors to compare US issuers' financial results more efficiently with those of their competitors.

Second, as more jurisdictions accept financial statements prepared in accordance with IFRS for local regulatory or statutory filing purposes, US issuers' subsidiaries based in these jurisdictions might be preparing and filing their local financial statements using IFRS as their basis of accounting. If US issuers have a large number of subsidiaries reporting in this manner, then these US issuers – most likely large, multinational corporations – might incur lower costs in preparing their consolidated financial statements using IFRS rather than US GAAP.

The SEC anticipated that not all US issuers would have incentives to use IFRS. For example, US issuers without significant customers or operations outside the US – which might tend to be smaller public companies – might not have the market incentives to prepare IFRS financial statements for the foreseeable future. Additionally, the SEC recognised that there might be significant consequences to allowing US issuers to prepare their financial statements in accordance with IFRS. If the SEC were to accept financial statements prepared in accordance with IFRS from US issuers, then investors and market participants would have to be able to understand and work with both IFRS and US GAAP when comparing among US issuers, because not all US issuers would be likely to elect to prepare IFRS financial statements. On a more practical level, a US issuer might have contracts such as loan agreements that include covenants based on US GAAP financial measures or leases for which rental payments are a function of revenue as determined under US GAAP. Similarly, US issuers might use their financial statements as the basis for filings with other regulators and authorities (for example, local and federal tax authorities, supervisory regulators) that might require US GAAP financial information.

Consequently, the SEC consultation around the Concept Release focused on such matters as:

- Whether market participants believe that the SEC should allow US issuers to prepare financial statements in accordance with IFRS;
- What the effect would be on the US capital markets of some US issuers reporting in accordance with IFRS and others in accordance with US GAAP;
- What effect the change would have on cost of capital;
- Whether comparative advantages would be conferred on those US issuers who move to IFRS versus those that do not;
- What the effect would be on the US capital markets of not affording the opportunity for US issuers to report in accordance with either IFRS or US GAAP; and
- What immediate, short-term or long-term incentives would a US issuer have to prepare IFRS financial statements and what immediate, short-term or long-term barriers would a US issuer encounter in seeking to prepare IFRS financial statements.

In December 2007, the SEC held two roundtables; one on IFRS in the US markets and one on the practical issues surrounding the use of IFRS in the US. The roundtables indicated strong support for a single set of high quality globally accepted accounting standards, and a recognition that the rest of the world was already heading in this direction and that the end point would be IFRS not US GAAP.

3.2.4 The proposed Roadmap

In August 2008, the SEC approved for public comment, a proposed roadmap outlining the milestones and conditions that, if met, could lead to the use of IFRS in the US (Roadmap). In the Roadmap, the SEC stated that it expected to make its final decision regarding the mandatory use of IFRS in 2011 based on whether, in the SEC's view, adoption of IFRS is in the public interest and would benefit investors. However, during her confirmation hearings in 2009, SEC Chair Mary Shapiro made it clear that whilst she supported the goal of a single set of global accounting standards she did not feel bound by the proposed Roadmap.

The Roadmap anticipated that IFRS reporting would be phased-in between 2014 and 2016 depending on the size and status of the company. However, at the annual AICPA National Conference on SEC and PCAOB Developments held in December 2010, Mary Shapiro indicated that if a decision is made to move to IFRS, adoption likely would not be required before 2015.

The Roadmap also included the following milestones and conditions:

- **Improvements in accounting standards:** The SEC expects the FASB and the IASB to continue to work together and progress towards convergence of IFRS and US GAAP.
- **Accountability and funding of the IFRS Foundation:** To date, the IFRS Foundation has financed IASB operations largely through voluntary contributions from companies, accounting firms, international organisations

and central banks. The Roadmap would require the IFRS Foundation to develop a funding mechanism that will enable it to remain a stand-alone, private-sector organization with the necessary resources to conduct its work in a timely fashion.

- **Improvement in the use of interactive data (XBRL) for IFRS:** The SEC has invested heavily in XBRL and expects that IFRS information will be capable of being provided to the SEC in interactive data format. The IFRS Foundation has issued a version of an IFRS taxonomy, which the SEC will consider in evaluating the status of this milestone.
- **Improvements in IFRS education and training:** Before making a final decision to move towards IFRS, the SEC will consider the state of preparedness of US issuers, auditors and users, including the extent and availability of IFRS education and training.

The SEC received approximately 200 comment letters, which were submitted by a wide range of constituents including preparers, investors, auditors and academics. Comments varied widely so it is difficult to identify a common thread or whether there is a preference for mandating IFRS in the US. Perhaps inevitably there was general support for the goal of a single set of high quality accounting standards. However many respondents expressed concern at the SEC's approach and felt that the Roadmap did not adequately address the complexity and cost of any transition. A number of respondents argued that the goal might best be achieved through further convergence of US GAAP and IFRS over a 'reasonable' timescale. Many respondents challenged whether the timetable for the completion of the current phase of convergence was achievable without compromising the quality of the resultant standards. Concerns were also expressed about the funding and independence of the IASB and how IFRS standards with less interpretive guidance would operate in the US regulatory environment. The Financial Accounting Foundation (the body which has oversight of the FASB) submitted a response calling on the SEC to conduct a thorough analysis of the issues raised by the Roadmap, including an analysis of possible conversion approaches such as convergence through continued convergence of standards over a longer period.

In February 2010, the SEC reaffirmed its longstanding commitment to the goal of a single set of high-quality global accounting standards and expressed its continued support for the convergence of US GAAP and IFRS. To aid the SEC's evaluation of IFRS use in the US, the staff of the Office of the Chief Accountant is carrying out a comprehensive work plan to address specific factors and areas of concern before the SEC makes its decision on whether, when and how it will further incorporate IFRS into the US financial reporting system for US issuers (the Work Plan). In October 2010, the SEC issued its first progress report on the Work Plan. In connection with its issuance, SEC Chief Accountant James Kroeker commented that the 'staff has invested significant time and effort in executing the Work Plan, and we've made great progress to date'. Issuance of the progress report is an important step in helping the public to understand the magnitude of the project and the SEC staff's progress to date.

In May 2011, the SEC staff issued a paper to describe one possible approach for incorporation of IFRS into the US financial reporting system, assuming that the SEC decides it is in the best interest of US investors. The approach would establish an endorsement protocol for the FASB to incorporate newly issued or amended IFRS into US GAAP. During a defined transition period (e.g. five to seven years), differences between IFRS and US GAAP would be eliminated through ongoing FASB standard setting.

In July 2011, the SEC staff sponsored a roundtable to discuss topics such as investor understanding of IFRS, the impact on smaller public companies, and on the benefits and challenges in potentially incorporating IFRS into the financial reporting system for US issuers. The feedback on the roundtable was mixed. Investors generally supported the goal of a single set of high-quality global accounting standards, but expressed concerns about consistent application, interpretation, regulation and enforcement on a global basis. Participants representing smaller public companies were less supportive, largely on the basis of cost. Many participants, including regulators, expressed some support for the approach outlined in the SEC staff paper discussed above.

These developments have led to a doubt amongst observers that the Roadmap will proceed as originally envisaged. Although the SEC has subsequently indicated continuing commitment to IFRS it remains unclear what decision it will reach in 2011. We believe the approach described in the SEC staff paper could be a practical alternative to full adoption of IFRS as of a specified date and could help bring US GAAP and IFRS closer together. We would support allowing US companies the option to adopt IFRS as issued by the IASB.

3.2.5 The future for convergence

Although one of the ways forward suggested in the US is further convergence of standards over a longer timescale we doubt whether that is a realistic prospect. In July 2009 the Federation of European Accountants (FEE) issued a call for a new approach to setting global financial reporting standards. FEE argued that convergence had delivered many benefits including the elimination of the SEC's reconciliation requirement. However, it believed that there are diminishing returns from convergence due to the rapid increase in complexity with little benefit to users that arise from seeking to eliminate increasingly smaller differences. FEE therefore believed that the IASB should change its strategy to focus on major improvements and simplifications to IFRS and that it should work with standard setters from around the world in doing so. Such a change would lead to a significant reduction in the number of IASB projects.

We suspect that FEE's comments had some resonance amongst the IASB's constituents. For example there was very little enthusiasm for a proposed amendment to IAS 33 – *Earnings per Share*, which was part of the convergence agenda but is no longer on it. There was a similar lack of enthusiasm for a convergence-based proposed amendment to IAS 12 – *Income Taxes*, particularly once the FASB effectively dropped its corresponding project.

It would appear that this issue has been recognised by the Board. Speaking at the American Accounting Association's 2009 annual meeting David Tweedie made the following observations;

'The European Federation of Accountancy Bodies has just talked about how the point has been reached where there have been diminishing returns from convergence with US GAAP, particularly as more and more countries, including major economies such as Japan and India move towards direct adoption of full IFRS, and the IASB should change its strategy and concentrate exclusively on major improvements and simplifications of IFRS for the short term. We think that's wrong. If you're going to have global standards we need the US, but it cannot go on indefinitely ... My view is we must keep going. But to be blunt if the US turns down IFRS or does not even put a date certain – it does not matter when it is to be, 2017 who cares, if they don't commit, I think it will be impossible to continue this after 2011.'

More recently, Ian Mackintosh suggested that future work between the IASB and FASB will depend on the SEC's decision on IFRS. Mr. Mackintosh was quoted as saying 'My personal opinion is that there would be less joint work with the FASB going forward.'⁵⁶

We are therefore at an important point in the search for a single set of high quality international financial reporting standards. All interested parties express their desire for such an outcome, it is to be hoped that continued progress can be achieved.

3.3 The impact of the 2007 – 2010 financial crisis

The 2007 – 2010 financial crisis had a significant impact on the IASB and on the development of IFRS from 2008 onwards. At a basic level the time the Board had to spend discussing issues arising from the crisis caused delays in other projects, but more fundamentally it put pressure on the Board's working relationship with the FASB, it raised again questions about the quality of some of the Board's standards and probably had an impact on the credibility of the Board itself.

There is a detailed description of the chronology of the Board's responses to the 2007 – 2010 financial crisis in Chapter 42 at 5. Rather than repeat that here it is perhaps more useful to consider, at a high level, some of the key events and try to draw out their implications.

The Financial Stability Forum (now the Financial Stability Board) was established to enhance cooperation amongst the various national and international regulatory bodies. In 2008 it raised concerns about the difficulty of valuing financial instruments in markets that had become illiquid. The IASB responded by the appointment of an Expert Advisory Panel, which proceeded to produce valuation guidance. Subsequently the IASB and FASB worked hard to ensure that there was consistency of guidance between IFRS and US GAAP.

Later in 2008 the EU expressed considerable concern that European financial institutions should not be at a disadvantage compared to their US peer group. Eventually, under pressure from the EU, this led to the publication of the reclassification amendment to IAS 39. Differences in guidance between US GAAP and IFRS remained even after those changes.

In October 2008 the FASB and IASB announced the creation of the FCAG. The remit of this group was to consider how improvements in financial reporting could enhance investor confidence in financial markets and to identify significant accounting issues that require the urgent attention of the Boards as well as issues for longer term consideration.

Although the 2007 – 2010 financial crisis has largely passed, at the time of writing, a sovereign debt crisis has emerged in several countries. To date, the FCAG has not taken steps to address this matter. However, in August 2011, Hans Hoogervorst issued a letter to the chair of the European Securities and Markets Authority commenting on the IASB's observations on European companies' accounting for distressed sovereign debt. In his letter, Mr. Hoogervorst observes inconsistencies among companies in Europe in the application of IAS 39 with respect to the accounting requirements for fair value measurement and impairment losses.⁵⁷ While Mr. Hoogervorst's letter provides clarity around the requirements of IAS 39 for measuring fair value and recognising impairment losses, financial statement preparers and their auditors could have benefitted from the IASB's comments on the issue earlier.

Various themes arise from this brief summary. Firstly, standard setting remains susceptible to political pressure and the application of due process together with appropriate governance structures for the standard setters are a key defence against that. Secondly, although the IASB's stated role is not to *ensure* compliance with IFRS, in the absence of a global body with such responsibility the IASB's public comments on urgent reporting matters of global significance could go a long way to doing just that. Thirdly, whilst US GAAP and IFRS remain as separate bodies of standards there remains the risk that at times of stress there will be pressure to converge to the 'weaker' standard, what some have called a 'race to the bottom'. Fourthly, it is important to recognise the limitations of financial reporting as expressed by FCAG in 2009 that financial reporting can only provide a snapshot of performance not perfect insight into the effects of macro-economic developments. Financial reporting is important, there was and is scope for improving standards on financial instruments. However, weaknesses in those standards did not cause the 2007 – 2010 financial crisis as some have claimed and any search for perfection in standard setting is ultimately doomed because of the inherent limitations the FCAG explains. Finally, however it is worth noting that there appears still to be common ground that a single set of high quality financial reporting standards is a desirable goal. It is to be hoped that the IASB is able to deliver that. In that context it is perhaps unfortunate that there are appreciable differences between the FASB's proposals for financial instruments and those being developed in IFRS 9 – *Financial Instruments* – by the IASB.

4 THE ADOPTION OF IFRS AROUND THE WORLD

4.1 Worldwide adoption

Since 2001, there has been a tremendous increase in the adoption of IFRS around the world. The precise way in which this has happened has varied among jurisdictions. This section sets out a brief description of how a number of key jurisdictions in each continent have approached the adoption.

4.2 Europe

4.2.1 EU

On 13 February 2001, the European Commission published a draft EU Regulation⁵⁸ that would require publicly traded EU incorporated companies⁵⁹ to prepare, by 2005 at the latest, their consolidated financial statements under IFRS 'adopted' (as discussed further below) for application within the EU. On 12 March 2002, the European Parliament endorsed this proposal, which was adopted as Regulation No. 1606/2002 of the European Parliament and of the Council of the EU on 19 July 2002 (the Regulation).⁶⁰

An EU regulation has direct effect on companies, without the need for national legislation. However, the Regulation also provides an option for EU member states to permit or require the application of adopted IFRS in the preparation of annual (unconsolidated) financial statements and to permit or require the application of adopted IFRS by unlisted companies. This means that EU member states can require the uniform application of adopted IFRS by important sectors, such as banking or insurance, regardless of whether or not companies are listed.

The Regulation established also the basic rules for the creation of an endorsement mechanism for the adoption of IFRS, the timetable for implementation and a review clause to permit an assessment of the overall approach proposed. The European Commission took the view that an endorsement mechanism was needed to provide the necessary public oversight. The European Commission considered also that it was not appropriate, politically or legally, to delegate accounting standard setting unconditionally and irrevocably to a private organisation over which the European Commission had no influence. In addition, the endorsement mechanism is responsible for examining whether the standards adopted by the IASB satisfy relevant EU public policy criteria.

The role of the endorsement mechanism is not to reformulate or replace IFRS, but to oversee the adoption of new standards and interpretations, intervening only when these contain material deficiencies or have failed to cater for features specific to the EU economic or legal environments. The central task of this mechanism is to confirm that IFRS provides a suitable basis for financial reporting by listed EU companies. The mechanism is based on a two-tier structure, combining a regulatory level with an expert level, to assist the European Commission in its endorsement role.

The recitals to the Regulation state that the endorsement mechanism should act expeditiously in relation to proposed international accounting standards and also be a means to deliberate, reflect and exchange information on international accounting standards among the main parties concerned, in particular national accounting standard setters, supervisors in the fields of securities, banking and insurance, central banks including the European Central Bank (ECB), the accounting profession and users and preparers of accounts. The mechanism should be a means of fostering common understanding of adopted international accounting standards in the EU community.⁶¹

There are three criteria set out in the Regulation on the application of IAS in the EU with which any individual IAS must comply if it is to be adopted:⁶²

- the standard should not be contrary to the principle of true and fair in conformity with accounting directives;
- the standard should be conducive to the European public good; and
- the standard should meet basic criteria as to the quality of information required for financial statements to be useful to users.

These criteria, although wide, do not appear unreasonable or overly burdensome in the light of the substantial power the EU has effectively vested in the IASB. It is important to note that although a standard or interpretation can only be adopted if all three criteria are met, this does not mean that if all three criteria are met a standard or interpretation must necessarily be adopted. However, if a standard or interpretation is not adopted, EU companies are free to apply it, other than in those cases where such application would be in conflict with an accounting standard that has been adopted or with EU law.

Concerns have been expressed on occasions about the speed of the EU endorsement process but to date, apart from the carve out from IAS 39 (refer to Chapter 42), all IASB standards to have gone through the process have ultimately been endorsed albeit a number of Interpretations Committee interpretations have had delayed application dates under the endorsement. However, the discussions in relation to IFRS 8 – *Operating Segments* (refer to Chapter 34) were particularly difficult and as a consequence the EU enacted Regulation 297/2008, which gives the EU Parliament a greater involvement in the endorsement process. Discussions about the adoption of IFRS 9 (the IASB's revised standard on financial instruments) are also likely to be difficult in the future. At present, the process has not started pending finalisation of all aspects of the standard by the IASB. However many of those involved are likely to have strong views on this standard.

The European Commission is advised on IFRS by the European Financial Reporting Advisory Group (EFRAG) and specifically by its Technical Expert Group (TEG). In addition to advising the European Commission on endorsement of IFRS, EFRAG is the mechanism by which Europe as a whole can participate in the global debate on accounting standards and it coordinates European responses to IASB proposals. Enforcement of compliance with IFRS within Europe is still, in the first instance, the responsibility of national regulators. However, the European Securities and Markets Authority (ESMA) – formerly Committee of European Securities Regulators (CESR) – has responsibility for reinforcing cooperation between those regulators. An ESMA database of regulatory decisions taken by EU National Enforcers participating in European Enforcers Co-Ordination Sessions (EECS) has been established, which should further promote consistency of application of IFRS within Europe.

4.2.2 Russia

Since 2004, the Central Bank of the Russian Federation (CBR) has required credit institutions to file financial statements prepared in accordance with IFRS as issued by the IASB. For public reporting purposes, all Russian listed companies prepare

their financial statements in accordance with Russian Accounting Principles (RAP), except for 'A-listed' companies, which are also required to prepare financial statements in accordance with IFRS or US GAAP. Statutory financial statements also are required to be prepared in accordance with RAP.

Since 1998, RAP has been gradually converging towards IFRS. Most of RAP is substantially based on IFRS, although some IFRSs have no comparable RAP standard and some RAP that are based on IFRS have not been updated for recent changes to the comparable IFRS.

On 27 July 2010, with the adoption of the Federal Law 'On Consolidated Financial Statements' (the Law), IFRS was introduced into the Russian legislation for the purposes of consolidated financial reporting by public companies. The Law requires that all credit and insurance institutions, as well as all listed entities, publish annual IFRS consolidated financial statements as described below.

The Law and consequent Government Resolution 107 of 25 February 2011 establish the process of IFRS endorsement in Russia. Individual IFRSs (standards and interpretations) become mandatory starting from the beginning of the calendar year following the year of their endorsement, or from the effective date specified in the IFRS, if it is later. IFRSs can be voluntarily applied after they are endorsed but before their effective date.

The Law allows the following companies to defer the adoption of IFRS until 2015 at the latest:

- Listed companies that prepare consolidated financial statements under internationally recognised accounting principles other than IFRS (e.g. US GAAP);
- Companies with only listed debt securities.

The IFRS endorsement process will begin with an analysis of the Russian language text of an IFRS provided by the IFRS Foundation by an independent expert body. On 7 July 2011, the National Organization for Financial Accounting and Reporting Standards Foundation (NOFA Foundation), a non-commercial organisation, was identified by the Ministry of Finance of the Russian Federation (Ministry of Finance) as the independent body for performing analysis of individual IFRSs' suitability for the Russian financial reporting system. NOFA will advise the Ministry of Finance whether an IFRS should be endorsed as issued by the IASB or whether certain requirements should be 'carved out' to meet the needs of the financial reporting system in Russia. The Ministry of Finance, after consultation with the CBR and the Federal Service for Securities Market, makes the final decision on endorsement and publication of an IFRS.

It is currently expected that the endorsement process for IFRS issued as of 1 January 2011 will be completed by the end of 2011, which would mean that most listed companies will have to file consolidated IFRS financial statements for fiscal years ending 31 December 2012. The endorsement process will continue into 2012 and beyond for all IFRSs issued after 1 January 2011.

4.3 Americas

4.3.1 US

See 3.2 for a discussion of the status of US adoption of IFRS.

4.3.2 Canada

In Canada, the Accounting Standards Board (AcSB) is charged with the responsibility for establishing standards of accounting and reporting for Canadian companies and not-for-profit organisations. The AcSB derives its authority from the Canadian Institute of Chartered Accountants (CICA). The AcSB is supported in its standard setting role by the Accounting Standards Oversight Committee (AcSOC).

In January 2006 the AcSB ratified a new Strategic Plan outlining its direction for financial reporting in Canada. Under this plan the AcSB developed three separate categories of reporting entities in Canada, which are:

- publicly accountable enterprises;
- non-publicly accountable enterprises; and
- not-for-profit organisations.

For publicly accountable enterprises, the AcSB has adopted IFRS as Canadian GAAP for fiscal years beginning on or after 1 January 2011. From that date forward, Canadian GAAP for publicly accountable enterprises is IFRS as issued by the IASB, with the following exceptions:

- Entities with rate-regulated activities have the option to defer their changeover to IFRS by one year to 1 January 2012.
- Investment companies and segregated accounts of life insurance enterprises have the option to defer their changeover by two years to 1 January 2013 to correspond with the anticipated completion date for the IASB's *Investment Entities* project.
- Pension plans, and benefit plans that have characteristics similar to pension plans, will follow the accounting standards for pension plans issued by the AcSB as of 1 January 2011, rather than IAS 26 – *Accounting and Reporting by Retirement Benefit Plans*.

The term 'publicly accountable enterprises' encompasses public companies and some other classes of enterprise that have relatively large or diverse classes of financial statement users. Canadian publicly accountable enterprises that are registered with the US SEC continue to be permitted to apply US accounting standards rather than IFRS. SEC registered Canadian entities operating in industries dominated by US entities tend to favour US accounting standards over IFRS. Recently, securities regulators have indicated that they will consider permitting the use of US standards by Canadian entities that are not SEC registered. This possibility may prove attractive to rate-regulated entities in particular.

For non-publicly accountable enterprises and not-for-profit organizations the AcSB has developed new bases of accounting that are derived from Canadian rather than

International Standards, although IFRS is also available for use by those entities on a voluntary basis.

The adoption of IFRS in Canada for publicly accountable enterprises means that the AcSB has effectively ceased to make final decisions on most matters affecting the technical content and timing of implementation of standards applied to publicly accountable enterprises in Canada. The AcSB's plans for incorporating new or amended IFRS into Canadian standards include reviewing all IASB documents issued for comment. As part of this process, the AcSB will seek the input of Canadian stakeholders by issuing its own exposure draft of the IASB proposals, together with a document highlighting the key elements of the IASB proposals that are particularly relevant to Canadian stakeholders. In addition, the AcSB may perform outreach activities such as public roundtables. Any changes to IFRS must be approved by the AcSB before becoming part of Canadian GAAP.

While the AcSB retains the power to modify or add to the requirements of IFRS, it intends to avoid changing IFRS when adopting them as Canadian GAAP. Accordingly, the AcSB does not expect to eliminate any options within existing IFRS. As issues relevant to Canadian users of financial information arise in the future, the AcSB will work to resolve them through the Interpretations Committee or the IASB. In the event that a resolution by the Interpretations Committee or IASB is not possible the AcSB will stand ready to develop additional temporary guidance.

In late 2009, AcSB formed its IFRS Discussion Group to provide a public forum to discuss the application of IFRS in Canada and to identify matters that should be forwarded to the Interpretations Committee for further consideration. The Group does not interpret IFRS or seek consensus on its application in Canada. It meets in public four times per year and has generated several suggestions for the Interpretations Committee's agenda.

4.3.3 Brazil

Local accounting standards in Brazil (CPCs) have been converged with IFRS since 2010 and public companies regulated by the 'Comissão de Valores Mobiliários' (CVM) are now also required to make a formal statement of compliance with IFRS as issued by the IASB in their financial statements. The only exception is for homebuilding companies, which are temporarily permitted to continue to apply IAS 11 – *Construction Contracts* – rather than IAS 18 – *Revenue* – under IFRIC 15 – *Agreements for the Construction of Real Estate*.

Banks are regulated by the Brazilian Central Bank, which continues to require preparation of financial statements under its pre-existing rules. However, larger banks have also been required to prepare financial statements in accordance with IFRS since 2010, which must be made publicly available. Insurance companies are required to adopt the local CPCs, and hence IFRS, in 2011.

Non-public companies outside financial services are required to apply the CPCs. Smaller non public companies are permitted to apply an equivalent of IFRS for SMEs.

4.4 Asia

4.4.1 China

4.4.1.A Mainland China

The developments in IFRS have been playing an important role in the development of accounting standards and practices in China. The Ministry of Finance (the MOF) – through its Accounting Regulatory Department – is responsible for the promulgation of accounting standards. In 1993, the MOF started a work programme to develop a set of *Accounting Standards for Business Enterprises*. Before 2006, China had promulgated and implemented *Accounting Standards for Business Enterprises – Basic Standard*, with 16 specific standards, as well as *Accounting System for Business Enterprises*, *Accounting System for Financial Institutions* and *Accounting System for Small Business Enterprises* which are applicable to various business enterprises.

Representatives of the China Accounting Standards Committee (CASC) – which falls under the Accounting Regulatory Department of the MOF – and the IASB met in Beijing in November 2005 to discuss a range of issues relating to the convergence of Chinese accounting standards with IFRS. At the conclusion of the meeting, the two delegations released a joint statement setting out key points of agreement, including the following:

- The CASC stated that convergence is one of the fundamental goals of its standard-setting programme, with the intention that an enterprise applying Chinese accounting standards should produce financial statements that are the same as those of an enterprise that applies IFRS; and
- The delegation acknowledged that convergence with IFRS will take time and how to converge with IFRS is a matter for China to determine.

In February 2006, the MOF issued a series of new and revised *Accounting Standards for Business Enterprises* (ASBE), which included the revised *Basic Standard*, 22 newly-promulgated accounting standards and 16 revised accounting standards. The new and revised ASBE was effective from 1 January 2007 for listed companies. Other companies are also encouraged to adopt it. In April 2010, the MOF issued the *Road Map for Continual Convergence of the ASBE with IFRS* (the Road Map), which requires the application of ASBE by all listed companies, some non-listed financial enterprises and central state-owned enterprises, and most large and medium-sized enterprises. The Road Map also states that ASBE will continue to maintain convergence with IFRS.

ASBE, to a large extent, represents convergence with IFRS, with due consideration being given to specific situations in China. ASBE covers the recognition, measurement, presentation and disclosure of most transactions and events, financial reporting, and nearly all the topics covered by current IFRS. Most of ASBE is substantially in line with the corresponding IFRS, with a more simplified form of disclosures. However, there are ASBE that do not have an IFRS equivalent, such as that on non-monetary transactions and common control business combinations, and there are certain standards that restrict or eliminate measurement alternatives that

exist in IFRS. For example, the ASBE on investment property permits the use of the fair value model only when certain strict criteria are met. Whilst ASBE is not identical to IFRS, the substantive difference from IFRS is that the ASBE on impairment of assets prohibits the reversal of an impairment loss for long-lived assets in all situations.

4.4.1.B Hong Kong

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the principal source of accounting principles in Hong Kong. These include a series of Hong Kong Financial Reporting Standards, accounting standards referred to as Hong Kong Accounting Standards (HKAS) and Interpretations issued by the HKICPA. The term 'Hong Kong Financial Reporting Standards' (HKFRS) is deemed to include all of the foregoing. While HKFRS has no direct legal force, it derives its authority from the HKICPA, which may take disciplinary action against any of its members responsible, as preparer or as auditor, for financial statements that do not follow the requirements of the pronouncements.

In 2001, the HKICPA Council mandated a strategy of achieving convergence between its accounting standards and IFRS issued by the IASB. HKFRS was fully converged with IFRS with effect from 1 January 2005. The HKICPA Council supports the integration of its standard setting process with that of the IASB.

Although the HKICPA Council has a policy of maintaining convergence of HKFRS with IFRS, the HKICPA Council may consider it appropriate to include additional disclosure requirements in an HKFRS or, in some exceptional cases, to deviate from an IFRS. Each HKFRS contains information about the extent of compliance with the equivalent IFRS. Where the requirements of an HKFRS and an IFRS differ, the HKFRS is required to be followed by entities reporting within the area of application of HKFRS. However in practice, exceptions to IFRS are few and relate to certain transitional provisions.

4.4.2 Japan

In 2007, an agreement between the Accounting Standards Board of Japan (ASBJ), and the IASB, known as 'The Tokyo Agreement', was announced. The Tokyo Agreement advanced the gradual convergence of Japanese GAAP and IFRS, which had been taking place for a number of years. Following the initial convergence projects under this agreement, in 2008 the European Commission accepted Japanese GAAP in its markets as part of its process to accept certain GAAP as equivalent to IFRS for listing non-EU companies in a European 'regulated market' (as defined by the European Commission). Further convergence of Japanese GAAP has continued as new standards are issued or expected to be issued. Since adoption of IFRS is being considered for consolidated financial statements only, this convergence process is expected to continue as Japanese GAAP is used by Japanese companies in their standalone financial statements.

In June 2009, the Business Advisory Council (BAC) a key advisory body to the Financial Services Agency approved a roadmap for the adoption of IFRS in Japan and

the relevant related matters have subsequently been incorporated into the regulation for consolidated financial statements. The key points of this roadmap are:

- Option of voluntary adoption of IFRS from fiscal years ended after 31 March 2010 for companies with global financial or operating activities; and
- Decision on the mandatory adoption of IFRS to be made in 2012.

In June 2011, the BAC announced that if mandatory application of IFRS were to be decided, a period of five to seven years would be given for preparing for adoption. This is a longer period than proposed in the roadmap. A number of Japanese companies have already taken, or are planning to take, the option to apply IFRS voluntarily.

4.4.3 India

Accounting standards in India are issued by the Institute of Chartered Accountants of India (ICAI) and are 'notified' by the Ministry of Corporate Affairs (MCA) under the Companies Act, 1956 (Companies Act). The MCA had originally issued an IFRS conversion roadmap in which it had proposed a date for IFRS conversion in a phased manner from 2011. The phasing was done based on certain criteria, such as the listing status, net worth and nature of the industry. The MCA had also clarified that companies subject to the IFRS conversion roadmap would not have the option of using 'full IFRS'; rather, they would need to comply with IFRS converged standards that would be issued by the ICAI. This effectively created a separate body of accounting standards known as 'Indian Accounting Standards' (Ind-AS) to be followed by all companies registered under the Companies Act, other than non-listed companies with net worth less than approximately US\$110 million.

At the time of writing, the MCA has notified 35 Ind-AS standards. Further, the MCA has stated that these standards will be applied in a phased manner, after resolving various issues, including tax-related ones. Therefore, Ind-AS may not apply from the dates announced in the original roadmap. At the time of writing, these dates of application are not fixed. Notified Ind-AS contains numerous departures from IFRS. The MCA felt that these departures were necessary to reflect the accounting principles, practices and economic conditions prevailing in India.

The departures from IFRS may be segregated into five broad categories. These categories and some examples in each category are given below:

- Departures from IFRS that result in Ind-AS financial statements not being compliant with IFRS, when the issues addressed in those IFRS apply to an entity. For example, under IFRS, a foreign currency convertible bond is treated as a hybrid financial instrument having liability and derivative components. Under Ind-AS, the derivative component is treated as fixed equity, if the exercise price is fixed in any currency.
- Removal of options available under IFRS. For example, IAS 40 – *Investment Property* – permits both the cost model and fair value model for subsequent measurement of investment properties. Ind-AS 40 – *Investment Property* – does not permit the use of the fair value model.
- Additional options provided in Ind-AS that, if selected, would result in Ind-AS financial statements not being compliant with IFRS when those additional

options under Ind-AS are used by an entity. For example, in addition to the exemption given in IFRS 1, Ind-AS 101 – *First-time adoption of Indian Accounting Standards*, also allows a first time adopter to continue with the previous GAAP carrying value for all its property, plant and equipment at the transition date. This previous GAAP carrying value is used as the deemed cost at the date of transition, after making necessary adjustments for decommissioning liabilities, etc. A similar exemption is also available for intangible assets and investment property.

- Deferment or non-adoption of certain IFRS. For example, the notification of IFRS 4 – *Insurance Contracts*, IFRIC 4 – *Determining whether an Arrangement contains a Lease*, IFRIC 12 – *Service Concession Arrangements* – and SIC-29 – *Service Concession Arrangements: Disclosures* – have been deferred under Ind-AS. The implementation dates for these standards/interpretations have not been announced by the MCA. Further, there is no certainty that these standards/interpretations will be issued without modifications to the IASB version.
- Additional differences may arise between Ind-AS and IFRS if the Companies Act is not amended. For example, the Companies Act permits a company to charge the debenture redemption premium to the securities premium reserve account instead of to the profit or loss account. An amendment to the Companies Act is required to prevent such departures from IFRS being created.

4.5 Australia/Oceania – Australia

The Australian Financial Reporting Council (FRC) is a statutory body established under the *Australian Securities and Investments Commission Act 2001, as amended by the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004*. The FRC is responsible for providing broad oversight of the process for setting accounting and auditing standards as well as monitoring the effectiveness of auditor independence requirements in Australia and providing the Australian Government with reports and advice on these matters. It comprises key stakeholders from the business community, the professional accounting bodies, governments and regulatory agencies.

In July 2002, the chair of the FRC announced that the FRC had formalised its support for the adoption by Australia of international accounting standards by 1 January 2005. In accordance with this strategic directive, the Australian Accounting Standards Board (AASB) issued Australian equivalents to IFRS (AIFRS) on 15 July 2004. Australian Accounting Standards have the force of law for Australian corporations, and therefore the standards issued by the IASB are required to be issued as Australian standards by the AASB. The implementation of AIFRS has achieved the FRC's strategic directive of ensuring that the financial statements of for-profit entities applying AASB standards are also in compliance with IFRS.

In adopting the IASB's standards, the AASB's initial approach was to ensure that compliance with Australian Accounting Standards would permit a company to be in compliance with IFRS. At the time of initial adoption in 2005, in certain AIFRS the AASB permitted only one of certain optional treatments available in the equivalent

IASB standards, and retained a number of specific disclosures from domestic GAAP in addition to the disclosure requirements of IFRS. On 30 April 2007, the AASB issued AASB 2007-4 – *Amendments to Australian Accounting Standards arising from ED 151 and Other Amendments*. This Standard was a result of an AASB decision that, in principle, AIFRS should reflect the exact requirements and wording of IFRS. AASB 2007-4 was effective for reporting periods beginning on or after 1 July 2007, and had the effect of incorporating all remaining IFRS accounting policy options into AIFRS and removing almost all Australian-specific disclosure requirements from AIFRS.

In some cases, existing AASB standards contained commentary that was not included in the equivalent IASB standards. The AASB has removed all this guidance that was not part of the standards, except where the guidance deals with situations that are commonly encountered in the Australian environment but are not catered for in the IASB standards.

In 2007, the Australian Auditing and Assurance Standards Board (AUASB) issued a revised auditing standard requiring the auditor to opine on the entity's compliance with IFRS where it has made the statement under the Australian equivalent of paragraph 16 of IAS 1 – *Presentation of Financial Statements*. This is in addition to the auditor's opinion on compliance with Australian Accounting Standards. In effect, both the reporting entity and the auditor make a statement of dual compliance with IFRS and Australian Accounting Standards.

The AASB plans to continue to work to maintain consistency with the IASB's standards in order that the FRC's strategic directive continues to be met. IFRS also forms the basis for Australian Accounting Standards that apply to not-for-profit private and public sector organisations. In 2010, the AASB introduced a differential reporting system based on the IASB's definition of publicly accountable entities. Non-publicly accountable entities can now adopt Australian Accounting Standards – Reduced Disclosure Regime. These Standards contain the recognition and measurement requirements of IFRS, but have reduced disclosures determined on the principles adopted by the IASB in its development of IFRS for SMEs.

4.6 Africa – South Africa

In 2004, South Africa completed a convergence project and all IFRS in issue at that time were fully adopted, thus removing all differences, except one, between the standards that made up South African GAAP (SA GAAP) and IFRS. After this convergence project, the only remaining difference between companies reporting under SA GAAP and an IFRS reporter would be the legacy effect of different effective dates (between the equivalent IFRS and SA GAAP standards) and the non application of IFRS 1. Since 2004, until early 2011, all standards and interpretations that have been issued by the IASB have been adopted into SA GAAP without change by the South African standard setting body, the Accounting Practices Board (APB).

With effect from periods beginning on or after 1 January 2005 the South African securities exchange, JSE Limited (JSE), required all listed companies to prepare financial statements under IFRS. All listed entities that were not already reporting under IFRS transitioned to IFRS by applying IFRS 1. Non-listed companies in South

Africa continued to use either IFRS, IFRS for SMEs or SA GAAP as the framework for preparing their financial statements.

In addition to the disclosure requirements of IFRS, IFRS for SMEs and SA GAAP, the South African Companies Act and the JSE imposed certain additional disclosure requirements. For example, the JSE requires the calculation of headline earnings per share and the disclosure of a detailed reconciliation of headline earnings to the earnings numbers used in the calculation of basic earnings per share in accordance with the requirements of IAS 33.

Further to these additional disclosure requirements, the APB has also issued its own interpretations on four issues, as a result of the Interpretations Committee deciding not to issue interpretations on what were considered issues specific to the South African environment. These interpretations deal with an additional tax payable when dividends are declared, the meaning of substantively enacted tax rates and tax laws in a South African context, accounting for black economic empowerment transactions (which are not specifically dealt with in IFRS 2 – *Share-based Payment*) and the application of IFRIC 14 – *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* – in a South African environment. While these interpretations are specific to SA GAAP, IFRS reporters in South Africa make use of them as they are based on a framework equivalent to that used for IFRS.

Effective 1 May 2011, different accounting frameworks now apply to different categories of companies. For example, while listed companies are required to use IFRS, other larger companies in South Africa are required to either apply IFRS or IFRS for SMEs. The concept of SA GAAP still remains, but is only permitted to be used by certain categories of companies. In addition, the APB was replaced with the Financial Reporting Standards Council (FRSC) as the new standard setting body in South Africa in the second half of 2011. In light of these changes, the APB made a decision earlier in 2011 to defer approving some of the latest IFRS as part of SA GAAP, pending a final decision on whether to continue to issue SA GAAP standards and interpretations in the future. For categories that generally encompass the smallest companies, these entities are permitted to use IFRS, IFRS for SMEs, SA GAAP, or in certain situations entity specific accounting policies as determined by themselves.

5 SUMMARY

IFRS is now, together with US GAAP, one of the two globally recognised financial reporting frameworks. Although there remains some uncertainty as to what view the SEC will take on the role of IFRS in the US there is strong demand among policy makers and regulators for there to be just one set of high quality accounting standards recognised globally. It therefore continues to seem likely that IFRS will fill that role and truly become 'International GAAP'.

However for there to be a truly International GAAP it is necessary that there is consistent application, interpretation and regulation of those standards to mirror the processes that have traditionally supported national GAAPs. Whilst complete consistency does not exist today, many mechanisms to achieve it are in place. The

Interpretations Committee plays a key role not just through its interpretations but also through its agenda decisions. In the Strategy Review, the Trustees propose a number of ways to help ensure consistent application of IFRS, including working with a network of securities regulators, audit regulators, standard setters and other stakeholders to identify areas of divergence.⁶³ We agree that the IFRS Foundation needs to focus on discouraging local interpretations of IFRS and support the proposals to involve regulators in the process.

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