1 INTRODUCTION: THE BACKGROUND AND EVOLUTION OF IFRS, AND A DISCUSSION ON WHY IFRS WOULD HAVE AN IMPACT ON INDUSTRY

At first blush, it would appear that a book on the impact that IFRS would have on industry is needless and unnecessary as all IFRS Standards are principle-based and, irrespective of the nature and peculiarities of a particular industry, the same principles would apply. However, accounting history has shown us that a general principle cannot take into account the accounting nuances of each and every industry. There could be interpretational issues when applying the same principles across all industries. As an illustration, let us take the principle of transfer of risks and rewards required in IAS 18 *Revenue* to recognise revenue on sale of goods. The transfer of risks and rewards could occur at different times for a software product company that sells its goods on the internet and a machinery manufacturer which transports its machinery to the customer's premises at its own risk. In the latter case, the transfer of risks would occur at a different time if the customer bore the risk of transporting the goods to his premises. Since IAS 18 only lays down a principle, determining the timing of transfer of risks and rewards is not very clear from the accounting standard. This gap in IAS 18 would however appear to have been rectified by its successor IFRS 15.

1.1 RULE-BASED VS. PRINCIPLE-BASED STANDARDS

Readers are probably aware that it was an Italian mathematician named Luca Pacioli who invented the double entry system of accounting. Being a mathematician, he was most likely content if the debit mathematically matched the credit. In those days transactions were simple, and cost would have been the basis of most accounting. However, as business flourished, accounting issues did too.

It would appear that actual pressures on the accounting profession to establish uniform accounting standards began to surface after the stock market crash of 1929 in the United States. Some feel that insufficient and misleading financial statement information led to inflated stock prices and that this contributed to the stock market crash and the subsequent depression. The 1933 Securities Act and the 1934 Securities Exchange Act were designed to restore investor confidence. The 1933 act sets forth accounting and disclosure requirements for initial offerings of securities, stocks and bonds. The Financial Accounting Standards Board (FASB) was formed in the United States to develop accounting standards. It was in 1938 that the Committee on Accounting Procedures was formed – this committee issued what would be probably the first set of accounting standards – and issued 51 Accounting Research Bulletins on an eclectic variety of topics including business combinations. Though accountants had something to refer to, with the passage of time, these bulletins attracted a lot of criticism for giving too many options and not dealing with complicated situations and transactions. In June 1973, the International Accounting Standards Committee (IASC) was formed to develop international accounting standards. There seemed to be an unwritten rule that the FASB would formulate accounting standards that would apply only in the United States – a rule that applies even now to a limited extent. Over the years, both the accounting bodies issued numerous accounting standards. In doing so, and maybe unwittingly, they developed standards based on totally different concepts – the FASB developed Standards based on rules while the IASC developed Standards based on principles. As subsequent events would prove, there is a world of difference between these two concepts. Rule-based standards suggest that the quantity of standards is due more to the fact that rules have to be established for different industries, while principle-based standards appear much simpler – just lay down the principle and leave the rest to the user of the standard.

The debate on whether principle-based standards score over rule-based standards has been going on for some time now and will probably continue in the future too. Purely on the basis of historical experience, it can be stated with some authority that both approaches have their pros and cons.

Principles-based standards require more judgment that firms could exploit opportunistically. In 2002, the FASB observed that a principles-based approach could lead to abuse, whereby the principles in accounting standards are not applied in good faith consistent with the intent and spirit of the standards. Ironically, the Enron episode occurred a few months later. Critics were quick to point out that aggressive accounting is likely to be easier to justify (or detect by auditors) under rules-based standards because detailed guidance or thresholds are explicitly stated. It was also felt that principles-based standards might lead to more informative earnings since they allow greater flexibility for firms to choose accounting methods that better reflect their economic realities. Following this reasoning, the SEC and FASB have both indicated a preference for principles-based standards because they allow accounting professionals to operationalise accounting treatments in a manner that best fulfils the objective of each standard and thereby best captures the underlying economic reality. On the other hand, from the perspective of statement preparers and auditors, the principles-based accounting system presents higher uncertainty due to lack of detailed guidance. The risk of being perceived as out of compliance may cause preparers to stray from the desired accounting treatment due to the increased risk of second-guessing.

Prior research that directly tests the effect of principles-based versus rules-based accounting standards on accounting quality has been conducted mostly in experimental settings. Evidence from these experimental studies generally supports the notion that principles-based standards improve accounting quality over rules-based standards. For example, in their experiments Agoglia, Doupnik, and Tsakumis (2011) find that CFOs are less likely to report aggressively under a principles-based standard than a rules-based standard.

The end of Enron signalled the beginning of a period in which the world started looking differently at the entire circle of accounting – accounting standards, accounting regulators and auditors. It was felt that having a single set of accounting standards would be the way to go forward – however idealistic that may sound. Both the International Accounting Standards Board (IASB, which succeeded the IASC) and the FASB decided to do something about it.

1.2 THE NORWALK AGREEMENT

Memorandum of Understanding

THE NORWALK AGREEMENT

At their joint meeting in Norwalk, Connecticut, USA on September 18, 2002, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) 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, both the FASB and IASB pledged to use their best efforts to (a) make their existing financial reporting standards fully compatible as soon as practicable, and (b) to coordinate their future work programmes to ensure that once achieved, compatibility was maintained.

To achieve compatibility, the FASB and IASB (together, the "Boards") agree, as a matter of high priority, to:

(a) undertake a short-term project aimed at removing a variety of individual differences between U.S. GAAP and International Financial Reporting Standards (IFRSs, which include International Accounting Standards, IASs);
(b) remove other differences between IFRSs and U.S. GAAP that will remain at January 1, 2005, through coordination of their future work programmes; that is, through the mutual undertaking of discrete, substantial projects which both Boards would address concurrently;
(c) continue progress on the joint projects that they are currently undertaking; and,
(d) encourage their respective interpretative bodies to coordinate their activities.

One of the defining features of rule-based standards is that they prescribe rules depending on the peculiarities of the industry. US GAAP has a bunch of standards that are specific to certain industries. The codification of US GAAP has the following under the heading "Industry."

Topic	*Industry*
905	Agriculture
908	Airlines
910	Contractors

915	Development Stage Entities
920	Entertainment
930	Extractive Activities
940	Financial Services
952	Franchisors
954	Health Care Entities
958	Not-for-Profit Entities
960	Plan Accounting
970	Real Estate
980	Regulated Operations
985	Software
995	US Steamship entities

Subsequent to the Norwalk Agreement, with all accounting standards issued by both the IASB and the FASB, there has been an attempt to develop them based on common principles. There are, however, still some differences between the standards pronounced by both the regulators. This is to be expected as it would be well nigh impossible to expect one-size-fits-all accounting standards due to the fact that local accounting regulations, practices and cultures differ from country to country. As long as the overall principles between the two sets of standards are not radically different, we can acknowledge that some semblance of uniformity has been achieved.

However, this does not resolve the rule-based vs. principle-based debate since all rule-based standards issued by the FASB are still being used. As in all things where there are two diametrically opposite views, it would appear that the ideal solution would be an equal balance between the two – the mid-path so to speak.

The IASB seems to have found that balance. After IFRS 3, the following standards were issued by the IASB:

IFRS 4 *Insurance Contracts*
IFRS 5 *Non-current assets held for sale*
IFRS 6 *Exploration and Evaluation of Mineral Resources*
IFRS 7 *Financial Instruments – Disclosures*
IFRS 8 *Operating Segments*
IFRS 9 *Financial Instruments*
IFRS 10 *Consolidated Financial Statements*
IFRS 11 *Joint Arrangements*
IFRS 12 *Disclosure of Interests in Other Entities*
IFRS 13 *Fair Value Measurement*
IFRS 14 *Rate Regulated Entities*
IFRS 15 *Revenue from Contracts with Customers*

It would appear that the IASB too is moving towards industry specific standards in cases where it is felt that the existing accounting standards are not elaborate enough to meet the requirements of the Framework to International Accounting Standards. IFRS 4 *Insurance Contracts* and IFRS 6 *Exploration and Evaluation of Mineral Resources* are industry specific. IFRS 14 focuses only on regulatory deferral accounts.

The saying "the only constant is change" is probably as old as change itself. Technology has filtered into everyone's lives and changed the way they live. A decade ago, buying a bestselling book involved going to your nearest bookstore. Often times, the book was not available and the storekeeper was told to inform you when it arrived. These days, you can order a bestseller online even before it is released to the public. You get it at your doorstep immediately after it is released. You can pay cash after ensuring it has been delivered intact (the only thing you probably can't do is to read it and return it!). From vegetables, electronic gadgets to matrimonial alliances, everything is done at the click of a button. With the rapid changes in technology, it was only a matter of time before bricks-and-mortar companies started to provide an online offering, thereby ensuring parity with the competition.

Accounting standards needed to keep pace with these developments. Both the FASB and the IASB have been quick to issue clarifications whenever any issues are raised on their existing accounting standards. In many ways, it is considered that the five-step approach envisaged by IFRS 15 is not only bringing the revenue recognition standard on par with Chapter 606 of US GAAP but also takes into account the changing revenue recognition landscape in different industries. Many of the 64 illustrative examples in IFRS 15 show the principles of revenue recognition in different industries.

Apart from the new generation industries, such as e-commerce, the traditional manufacturing industries also seem to be changing. Entities are hiving off divisions which they cannot manage profitably – bringing into play IFRS 3 *Business Combinations* – or are outsourcing segments of their manufacturing process that are provided more cheaply by third parties. This would bring into play questions of revenue recognition and in some instances, determining who owns and controls the property, plant and equipment to recognise it under IAS 16.

Entities that engage with the government in public private partnerships invariably enter into service concession arrangements with the government. The erstwhile International Accounting Standards provided limited guidance on how to recognise revenue in such arrangements or whether the right to charge an amount for utilising that public service gave rise to any intangible assets. IFRIC 12 *Service Concession Arrangements* fixes this conundrum.

All IFRS Standards go through a very detailed process before being published. Despite this, a Standard may not be able to provide solutions to specific situations experienced in particular industries. A recent discussion in the IASB focused on whether telecommunication towers owned by tower companies should be reflected as investment property under IAS 40 or property, plant and equipment under IAS 16. The IASB brought out International Financial Reporting Standards Interpretations (IFRIC) and Standard Interpretations Committee (SIC) to resolve such specific issues. In a limited way, IFRIC and SIC are looking at industry-specific issues.

The focus of IFRS on industry-specific standards appears to be further confirmed if one looks at the major projects of the IASB for the future. Re-deliberation is planned on IFRS 4 in Q1 of 2015, and the all-new IAS 17 *Leases* is expected to be issued at the latest by the end of 2015. That apart, a further public consultation on rate regulation is expected to be commenced in Q1 2015.

The twin factors of IFRS evolving, and dynamic changes in the way business is conducted and industries are aligned, will ensure that there will more industry-specific standards that will come out in the future from the IASB.

Some experts aver that IFRS is all about fair value and disclosures. They opine that the extensive disclosures mandated by every IFRS Standard provide ready-made information to competitor to know everything that a competitor needs to know about an entity – the fair value of its assets and liabilities, as well as a detailed breakdown of the amounts paid in a business combination. This is a spin-off effect that IFRS has had on industry – the availability of too much information about an entity. While using these vast amounts of disclosure data can do no harm, misuse of this data can create issues between entities and their competitors. However, it should be stated here that all the accounting accidents that happened over the last decade and more – be it an Enron, WorldCom, Parmalat, Lehmann Brothers or Satyam – suffered from a common shortcoming: the lack of detailed disclosures in the areas of accounting where they deviated from the norms. Accounting regulators feel – and rightly so – that it is better to disclose more rather than less, or only what is deemed essential. In the IFRS era, entities operating in different industries should learn the art of disclosing both good and not-so-good information.

We can reasonably conclude from the above discussion that, irrespective of the basis on which accounting standards have been developed, they will have an impact on specific industries. During the course of writing this book, I found to my pleasant surprise that the industry most impacted by IFRS was the airline industry. They have different types of leases, componentisation of PPE, borrowing costs, impairment, intangible assets such as airport landing rights, revenue recognition dilemmas (customer loyalty programmes) and financial instruments. It would probably not be an exaggeration to state that apart from the industry specific Standards such as IFRS 4 *Insurance Contracts* and IFRS 6 *Exploration for and Evaluation of Mineral Resources* most of the other Standards would apply in some way or the other to the airline industry. This conclusion sets the tone for the remaining chapters of the book.