

2015

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Interpretation and Application of

**International
Financial
Reporting
Standards**

Includes summary
of key provisions of
**US GAAP
vs. IFRS®**

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2015 Interpretation and
Application of

**International
Financial
Reporting
Standards**

Asif Chaudhry

Danie Coetsee

Erwin Bakker

Santosh Varughese

Stephen McIlwaine

Craig Fuller

Edward Rands

Nees de Vos

Stephen Longmore

T V Balasubramanian

WILEY

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Published simultaneously in Canada.

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ISBN: 978-1-118-88955-8 (pbk);

ISBN: 978-1-118-88953-4 (ebk);

ISBN: 978-1-118-88952-7 (ebk);

ISBN: 978-1-118-88954-1 (ebk);

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ABOUT THE AUTHORS

Asif Chaudhry, FCCA, CPA (K), MBA, is an audit and technical partner at PKF Kenya and is on the Kenyan Institute's Professional Standards Committee. He has 17 years of experience including 8 years with Deloitte LLP, London. He was assisted by fellow partners Darshan Shah, Salim Alibhai and Patrick Kuria.

Craig Fuller, CA (SA), is a technical manager at PKF International Ltd and serves on PKFI's International Professional Standards Committee. He qualified at PKF Durban before moving to the technical division of PKF (UK) LLP.

Danie Coetsee, CA (SA), is Professor of Accounting at the University of Johannesburg, specializing in financial accounting.

Edward Rands, FCA, is the Risk and Professional Standards partner at PKF Cooper Parry. He leads the firm's technical team, which is responsible for maintaining and updating accounting knowledge and for dealing with complex problems and queries as they arise.

Erwin Bakker, RA, is an audit partner, responsible for national and international audits. He serves as chairman of the IFRS working group of PKF Wallast and is a member of the Technical Bureau of PKF Wallast in the Netherlands.

Nees de Vos, RA (NL), is an auditor at PKF Wallast in the Netherlands. He has worked as an audit manager at PwC where he has gained eight years' public practice experience on audits for large listed companies and large privately owned groups. At PKF Wallast he is responsible for (IFRS) audits and (IFRS) accounting advisory.

Santosh Varughese, CA (Germany), Tax Advisor (Germany), CPA (US), is one of the partners at PKF Germany

(www.pkf.de). He is the head of the IFRS Center of Excellence of PKF in Germany. One of his operative focuses is on audits for large listed companies.

Stephen Longmore, FCCA, is an audit senior manager and IFRS specialist at PKF Cooper Parry. He has led a number of local GAAP to IFRS conversions and previously worked as an audit manager for KPMG.

Stephen McIlwaine, ACA (Chartered Accountants Ireland) is a senior audit manager with Johnston Carmichael LLP (PKF member firm in Scotland). As well as being responsible for the provision of audit, accountancy and advisory services to clients across a range of sectors, he is also a member of the firm's financial reporting technical team, responsible for providing guidance and training on current financial reporting issues across the firm, with a focus on IFRS.

T V Balasubramanian, FCA, CFE, CFIP, is a partner in PKF Sridhar & Santhanam, Chartered Accountants, India and previously served as a member of the Auditing and Assurance Standards Board of the ICAI, India.

Chapter 1

INTRODUCTION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

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INTRODUCTION

The stated goal of the IFRS Foundation and the International Accounting Standards Board (IASB) is to develop, in the public interest, a single set of high-quality, understandable,

enforceable and globally accepted financial reporting standards based upon clearly articulated principles.

There were once scores of unique sets of financial reporting standards among the more developed nations (“national GAAP”). The year 2005 marked the beginning of a new era in global conduct of business, and the fulfillment of a thirty-year effort to create the financial reporting rules for a worldwide capital market. For during that year’s financial reporting cycle, the 27 European Union (EU) member states, plus many others in countries such as Australia, New Zealand, Russia, and South Africa adopted International Financial Reporting Standards (IFRS).

Since then, many countries, such as Argentina, Brazil, Korea, Canada, Mexico, and Russia have adopted IFRS. China has substantially converted its national standards in line with IFRS. All other major economies, such as Japan and the United States, have established time lines to converge with or adopt IFRS in the near future.

2007 and 2008 proved to be watershed years for the growing acceptability of IFRS. In 2007, one of the most important developments was that the SEC dropped the reconciliation (to US GAAP) requirement that had formerly applied to foreign private registrants; thereafter, those reporting in a manner fully compliant with IFRS (i.e., without any exceptions to the complete set of standards imposed by IASB) do not have to reconcile net income and shareholders’ equity to that which would have been presented under US GAAP. In effect, the US SEC was acknowledging that IFRS was fully acceptable as a basis for accurate, transparent, meaningful financial reporting.

This easing of US registration requirements for foreign companies seeking to enjoy the benefits of listing their equity or debt securities in the US led, quite naturally, to a call by domestic companies to permit them to also freely choose between financial reporting under US GAAP and

IFRS. By late 2008 the SEC appeared to have begun the process of acquiescence, first for the largest companies in those industries having (worldwide) the preponderance of IFRS adopters, and later for all publicly held companies. However, a new SEC chair took office in 2009, expressing a concern that the move to IFRS, if it were to occur, should perhaps move more slowly than had previously been indicated.

It had been highly probable that nonpublicly held US entities would have remained bound to only US GAAP for the foreseeable future, both from habit and because no other set of standards would be viewed as being acceptable. However, the body that oversees the private-sector auditing profession's standards in the US amended its rules in 2008 to fully recognize IASB as an accounting standard-setting body (giving it equal status with the FASB), meaning that auditors and other service providers in the US could now issue opinions (or provide other levels of assurance, as specified under pertinent guidelines) on IFRS-based financial statements. This change, coupled with the promulgation by IASB of a long-sought standard providing simplified financial reporting rules for privately held entities (described later in this chapter), has probably increased the likelihood that a broad-based move to IFRS will occur in the US within the next several years.

The impetus for the convergence of historically disparate financial reporting standards has been, in the main, to facilitate the free flow of capital so that, for example, investors in the United States will become more willing to finance business in, say, China or the Czech Republic. Having access to financial statements that are written in the same "language" would eliminate what has historically been a major impediment to engendering investor confidence, which is sometimes referred to as "accounting risk," which adds to the already existing risks of making such cross-

border investments. Additionally, the permission to list a company's equity or debt securities on an exchange has generally been conditional on making filings with national regulatory authorities, which have historically insisted either on conformity with local GAAP or on a formal reconciliation to local GAAP. Since either of these procedures was tedious and time-consuming, and the human resources and technical knowledge to do so were not always widely available, many otherwise anxious would-be registrants forwent the opportunity to broaden their investor bases and potentially lower their costs of capital.

The historic 2002 Norwalk Agreement—between the US standard setter, FASB, and the IASB—called for “convergence” of the respective sets of standards, and indeed a number of revisions of either US GAAP or IFRS have already taken place to implement this commitment. The aim of the Boards was to complete the milestone projects of the Memorandum of Understanding (MoU) by the end of June 2011.

Although the Boards were committed to complete the milestone projects by June 2011, certain projects such as financial instruments (impairment and hedge accounting), revenue recognition, leases, and insurance contracts were deferred due to the complexity of the projects and obtaining consensus views. The converged standard on revenue recognition was finally published in May 2014. Details of these and other projects of the standard setters are included in a separate section in each relevant chapter of this book.

Despite the progress towards convergence described above, the SEC dealt a blow to hopes of future alignment in its strategic plan published in February 2014. The document states that the SEC “will consider, among other things, whether a single set of high-quality global accounting standards is achievable,” which is a significant reduction in

its previously expressed commitment to a single set of global standards. This leaves IFRS and US GAAP as the two comprehensive financial reporting frameworks in the world, with IFRS gaining more and more momentum.

The MoU with FASB (and with other international organizations and also jurisdictional authorities) has been replaced by a MoU with the Accounting Standards Advisory Forum (ASAF). The ASAF is an advisory group to the IASB consisting of national standard-setters and regional bodies. FASB's involvement with the IASB is now through ASAF

With the convergence projects ending, the IASB has started with a new agenda consultation process on the future work program of the IASB. The IASB has started working on the new conceptual framework and included rate-regulated activities as a major project.

ORIGINS AND EARLY HISTORY OF THE IASB

Financial reporting in the developed world evolved from two broad models, whose objectives were somewhat different. The earliest systematized form of accounting regulation developed in continental Europe in 1673. Here a requirement for an annual fair value statement of financial position was introduced by the government as a means of protecting the economy from bankruptcies. This form of accounting at the initiative of the state to control economic actors was copied by other states and later incorporated in the 1807 Napoleonic Commercial Code. This method of regulating the economy expanded rapidly throughout continental Europe, partly through Napoleon's efforts and partly through a willingness on the part of European regulators to borrow ideas from each other. This "code law" family of reporting practices was much developed by