

**WILEY**

---

# IFRS

**International Financial  
Reporting Standards**

## **WORKBOOK AND GUIDE**

---

- **Practical insights**
- **Case studies**
- **Multiple-choice questions**
- **Illustrations**

**Abbas Ali Mirza    Graham J. Holt    Magnus Orrell**



WILEY

JOHN WILEY & SONS, INC.



**WILEY**

---

# **IFRS**

**International Financial  
Reporting Standards**

**WORKBOOK AND GUIDE**

---



**WILEY**

---

# IFRS

**International Financial  
Reporting Standards**

## **WORKBOOK AND GUIDE**

---

- **Practical insights**
- **Case studies**
- **Multiple-choice questions**
- **Illustrations**

**Abbas Ali Mirza    Graham J. Holt    Magnus Orrell**



WILEY

JOHN WILEY & SONS, INC.

Portions of this book have their origins in copyrighted materials from the International Accounting Standards Board. These are noted by reference to the specific pronouncements, except for certain of the definitions introduced in bold type, which appear in a separate section at the beginning of each chapter. Complete copies of the international standards are available from the IASB. Copyright © International Accounting Standards Board, 30 Cannon Street, London EC4M 6XH, United Kingdom.

This book is printed on acid-free paper. ☺

Copyright © 2006 by John Wiley & Sons, Inc. All rights reserved.  
Published by John Wiley & Sons, Inc., Hoboken, New Jersey  
Published simultaneously in Canada.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, 222 Rosewood Drive, Danvers, MA 01923, (978)750-8400, fax (978)750-4470, or on the Web at [www.copyright.com](http://www.copyright.com). Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, (201)748-6011, fax (201)748-6008, or online at <http://www.wiley.com/go/permission>.

**Limit of Liability/Disclaimer of Warranty:** While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. No warranty may be created or extended by sales representatives or written sales materials. The advice and strategies contained herein may not be suitable for your situation. You should consult with a professional where appropriate. Neither the publisher nor author shall be liable for any loss of profit or any other commercial damages, including but not limited to special, incidental, consequential, or other damages.

For general information on our other products and services, please contact our Customer Care Department within the US at 800-762-2974, outside the US at 317-572-3993 or fax 317-572-4002.

Wiley also publishes its books in a variety of electronic formats. Some content that appears in print may not be available in electronic books. For more information about Wiley products, visit our Web site at [www.wiley.com](http://www.wiley.com).

**ISBN 13: 978-0471-69742-8**

**ISBN 10: 0-471-69742-7**

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

## CONTENTS

<u>Chapter</u>	<u>Title</u>	<u>Page No.</u>
1	Introduction to International Financial Reporting Standards .....	1
2	IASB Framework .....	7
3	Presentation of Financial Statements (IAS 1) .....	12
4	Inventories (IAS 2) .....	20
5	Cash Flow Statements (IAS 7) .....	27
6	Accounting Policies, Changes in Accounting Estimates and Errors (IAS 8) .....	39
7	Events After the Balance Sheet Date (IAS 10) .....	48
8	Construction Contracts (IAS 11) .....	53
9	Income Taxes (IAS 12) .....	62
10	Segment Reporting (IAS 14) .....	75
11	Property, Plant, and Equipment (IAS 16) .....	85
12	Leases (IAS 17) .....	93
13	Revenue (IAS 18) .....	103
14	Employee Benefits (IAS19) .....	110
	Accounting for Government Grants and Disclosure of Government	
15	Assistance (IAS 20) .....	122
16	The Effects of Changes in Foreign Exchange Rates (IAS 21) .....	129
17	Borrowing Costs (IAS 23) .....	138
18	Related Party Disclosures (IAS 24) .....	144
19	Accounting and Reporting by Retirement Benefit Plans (IAS 26) .....	152
20	Consolidated and Separate Financial Statements (IAS 27) .....	159
21	Investments in Associates (IAS 28) .....	166
22	Financial Reporting in Hyperinflationary Economies (IAS 29) .....	172
	Disclosures in the Financial Statements of Banks and Similar Financial	
23	Institutions (IAS 30) .....	177
24	Interests in Joint Ventures (IAS 31) .....	182
25	Financial Instruments: Presentation (IAS 32) .....	187
26	Financial Instruments: Recognition and Measurement (IAS 39) .....	203
27	Earnings Per Share (IAS 33) .....	248
28	Interim Financial Reporting (IAS 34) .....	260
29	Impairment of Assets (IAS 36) .....	264
30	Provisions, Contingent Liabilities, and Contingent Assets (IAS 37) .....	276
31	Intangible Assets (IAS 38) .....	287
32	Investment Property (IAS 40) .....	298
33	Agriculture (IAS 41) .....	306
34	First-Time Adoption of International Financial Reporting Standards (IFRS 1)	314
35	Share-Based Payments (IFRS 2) .....	326
36	Business Combinations (IFRS 3) .....	338
37	Insurance Contracts (IFRS 4) .....	350
38	Noncurrent Assets Held for Sale and Discontinued Operations (IFRS 5) .....	356
39	Exploration for and Evaluation of Mineral Resources (IFRS 6) .....	365
40	Financial Instruments: Disclosures (IFRS 7) .....	371
Index .....		380



# **FOREWORD**

**by the Chairman of IASB**

I and my fellow Board members at the International Accounting Standards Board (IASB) are committed to developing high quality, understandable, and enforceable global accounting standards that meet the demands for comparable and transparent information in the world's capital markets. Recently we completed a work program to develop and issue a stable platform of such standards. Those standards, the International Financial Reporting Standards (IFRS), are now being implemented in a large number of countries around the world. This is a major achievement on the road towards the global acceptance of a single set of accounting standards.

The responsibility for achieving high quality financial reporting, however, does not rest solely with IASB. Our role is limited to providing the set of standards that entities should apply to achieve high quality, comparable, and transparent financial reporting. For IFRS to be properly understood, implemented, and applied in practice, education and training of all relevant parties—including financial statement preparers, auditors, regulators, financial analysts, and other users of financial statements as well as accounting students—is essential.

This book should be a helpful tool in this regard. The approach of the book is to discuss core concepts and other key elements of the standards and to provide training material in the form of worked case studies and questions to support successful learning of the material. Consequently, the book should be useful for students who prepare for professional exams and for financial statement preparers, auditors, regulators, financial analysts, and other users of financial statements who in their work need to be familiar with the standards. The book should help practitioners and students alike understand, implement, and apply the key elements of the standards.

Sir David Tweedie  
Chairman of IASB  
December, 2005



# FOREWORD

## by the Secretary General of IOSCO

In recent years much has been written about International Financial Reporting Standards (IFRS) so it is opportune that a publication such as this would be released at this time particularly since this initiative helps to bring such clarity and focus to the debate.

Globalization is taking place at an ever more rapid pace. As cross-border financial activity increases, capital markets become more dependent on each other. As financial markets become ever more interdependent, there is a greater need for the development of internationally recognized and accepted standards dealing with capital market regulation.

The development of IFRS can be seen within this broader framework. They represent an especially useful instrument designed to promote a stable and more secure international regulatory environment. At the same time, IFRS deliver on accounting and disclosure objectives as well as the pursuit of improved transparency of global financial reporting.

For the International Organization of Securities Commissions (IOSCO), the development and subsequent progress of IFRS represents a priority outcome. The organization has been a key stakeholder with an active involvement in the process of setting the standards and in continually assessing their quality.

This involvement reflects a long history of commitment by IOSCO to efforts aimed at strengthening the integrity of international markets through the promotion of high quality accounting standards, including rigorous application and enforcement.

At the same time, there is an obligation of international standard setters to be responsive to concerns over the application and interpretation of the standards. This is a key complement to the success of IFRS and one which we take seriously.

Ultimately, accounting standards setting is a continuous process that must respond to changes and developments in the markets and the information needs of investors. Indeed, it has always been the case that effective financial reporting is fundamental to investor confidence as well as good corporate governance.

In the long term, the adoption of IFRS in many countries and their use in numerous cross-border transactions will help to bring about these high quality global accounting standards by providing transparent and comparable information in financial reports.

Although as an international standards setter IOSCO is not in position to endorse external publications, we have always recognized that by helping to promote clear information about the IFRS, publications such as this one serve a particularly useful function both as an educational opportunity and also to encourage confidence in these standards. On that basis it is most welcome.

Philippe Richard  
IOSCO Secretary General  
March 2006



## PREFACE

Achieving consistency in financial reporting worldwide is the need of the hour, especially if meaningful comparisons are to be made of financial information emanating from different countries using accounting standards that, until recently, were vastly different from each other. Thus, there has arisen the urgent need for promulgation of a common set of global accounting standards or, in other words, global convergence into a common language of accounting for the financial world. International Financial Reporting Standards (IFRS), the standards promulgated by the International Accounting Standards Board (IASB), previously known as International Accounting Standards (IAS) that were issued by the International Accounting Standard Committee (IASC), the IASB's predecessor body, appear to be emerging as the global accounting standards and, according to some, could even qualify for the coveted title of "the Esperanto of accounting."

This is a challenging and exciting time to be writing a book on IFRS. Challenging, because it is indeed a daunting task to publish a book on a body of knowledge such as IFRS, which is undergoing significant changes at an unprecedented pace. In some cases, changes were made to certain IASB standards within the same year, and thus we, as authors, had to revise chapters when amendments to existing standards were announced. In certain cases, even after chapters were initially written and finalized, in order to keep the book current, we had to rewrite parts. Yet this is also an exciting time to be writing a book on a subject of global importance such as IFRS, since the IASB standards are rapidly being adopted in a large number of countries all around the world. For instance, by the time this book goes to print, most countries in Europe, including all of the 25 member states of the European Union, will require listed companies to prepare their consolidated financial statements in accordance with IFRS instead of local requirements, and many countries in Africa, Asia, Australia, and the Americas are adopting IFRS as their national accounting standards. Knowing full well that the book will have to cater to the requirements of users globally made the task of writing even more challenging.

Whether you are an accountant, auditor, investor, banker, regulator, or financial analyst, understanding and appreciating the fundamental principles and requirements of IFRS has become more important than ever before. In this new financial world, knowledge of the fundamental principles of IFRS is essential to meet the growing demands of a changing regulatory and market environment. Cognizant of that, we embarked on this book project to help users and preparers of IFRS financial statements alike.

We have written this book with the end user in mind, which should make it user-friendly. For instance, if you are an accountant or an auditor working in a country that has recently adopted IFRS (say, one of the countries in the European Union), you are now faced with the challenges of being able to apply these standards and to read and understand financial statements prepared in accordance with them. This book will help you to do that. We believe that this book's real strength lies in the fact that it explains the IASB standards in a lucid manner so even first-time adopters of IFRS can understand the subject. The book illustrates the practical application of the IASB standards using easy-to-apply illustrations and simple examples. It goes a step further and provides copious learning aids in the form of case studies (with worked solutions), multiple-choice questions (with answers), and practical insights. We hope its simple, step-by-step approach will guide you in the application of IFRS.

In general, the structure and contents of the book are consistent with the order and scope of each standard; each chapter discusses a specific IFRS, and the chapters are ordered consistent with the numbering of the IFRS currently in effect. This structure allows you to use the book as a handbook, side by side with the bound volume of standards issued by IASB. The only exception is the chapter on IAS 39, which is located immediately after the chapter on IAS 32 in this book, since both standards address the same topic: the accounting for financial instruments. Also, the chapters dealing with IAS precede the chapters dealing with IFRS.

We hope that this book will greatly facilitate learning and will also help readers to understand the technical complexities of the standards. Although a great deal of effort has gone into writing this book, we sincerely believe that there is always scope for improvement. *Any suggestions and comments for future editions are therefore encouraged.* We humbly submit that any views expressed in this publication are ours alone and do not necessarily represent those of the firms or organizations we are part of.

Finally, we wish all our readers a very educating journey through the book.

Abbas Ali Mirza  
Graham Holt  
Magnus Orrell  
March 2006



## ACKNOWLEDGMENTS

This book would not have seen the light of the day without the help of so many wonderful people around the globe who have helped us to put it together. This IFRS workbook project was conceived and conceptualized way back in 1998, but due to certain unanticipated issues that surfaced later, the project was dropped, only to be revived in 2005. We would be remiss in our duties if we did not thank the editors at John Wiley & Sons, Inc., USA, who had implicit faith in our abilities and greatly helped us in giving shape to this creative endeavor. In particular, we wish to place on record their sincere appreciation of the help provided to us by the following individuals of John Wiley & Sons: Robert Chiarelli, for his patronage of this book project; John De Remigis, for his stewardship of this book project from its incubation stages in 1998 to its completion in 2006 and for his perseverance for these many years; Judy Howarth and Brandon Dust, for their able guidance and patience; Natasha Andrews and Pam Reh and their editorial staff, for their creative and valuable editorial comments and assistance; and Julie Burdin, for her outstanding marketing plan and ideas.

We also wish to place on record our sincere appreciation of the untiring efforts of Ms. Liesel Knorr, the current secretary general of the German Accounting Standards Board and formerly technical director of the International Accounting Standards Committee (IASC), the predecessor body to the IASB, for her thorough technical review of the entire manuscript. Her invaluable comments have all been taken into account in writing this book.

We are also grateful to all our friends and colleagues who helped us during the preparation of this book.

Abbas Ali Mirza wishes to place on record his sincere gratitude for all the constructive suggestions offered to him by his friends in conceptualizing the idea of such a workbook on IFRS during its formative stages. Furthermore, for their unstinting support, creative ideas, and invaluable contributions, he also wishes to thank his peers and mentors, in particular: Omar Fahoum, chairman and managing partner, Deloitte & Touche (M.E.); Graham Martins, partner, Pannell Kerr Forster, United Arab Emirates; Dr. Barry J. Epstein, partner, Russell Novak & Co., LLP, USA, his longtime coauthor of the other IFRS book published by John Wiley & Sons, Inc., USA (currently entitled *Wiley: IFRS 2006*); and all his partners and colleagues from Deloitte & Touche (M.E.), including but not limited to Joe El Fadl, Graham Lucas, Anis Sadek, Musa Dajani, Ghassan Jaber, Vikas Taktiani, Hala Khalid, Shivani Agarwal, and Umme Kulsoom Soni.

Graham Holt wishes to thank all the special people who have directly and indirectly helped him in preparing this book. (They know he is grateful.)

Magnus Orrell extends his special thanks to his wife, Kristin Orrell, as well as to Andrew Spooner of Deloitte & Touche LLP in the United Kingdom and Bengt-Allan Mettinger, accounting consultant in Thailand, who all read earlier versions of the material in this book relating to financial instruments and provided many valuable comments and suggestions.



## ABOUT THE AUTHORS

**Abbas Ali Mirza** is a partner at Deloitte & Touche (M.E.) based in Dubai and handles audits of major international and local clients of the firm. At Deloitte he is also responsible for regional functions, such as technical consultation on complex accounting and auditing issues. Abbas heads the Learning function for Deloitte, Middle East, and is a member of the Global firm's EMEA Learning Executive. He has had a distinguished career in accounting, auditing, taxation, and business consulting and has worked for international audit and consulting firms in the United States of America, the Middle East, and India. Abbas is a frequent principal/keynote speaker at major global conferences on International Financial Reporting Standards (IFRS) and has chaired world-class events on accounting, such as the World Accounting Summit held in Dubai under the auspices of the United Nations Conference on Trade and Development (UNCTAD). He has been a coauthor, from inception, of another book on IFRS published by John Wiley & Sons, Inc., which is in its tenth anniversary edition and is currently entitled *Wiley: IFRS 2006*. He holds or has held many positions of repute in the accounting profession globally including

- 21st Session Chairman, United Nations' Intergovernmental Working Group of Experts on International Standards on Accounting & Reporting (ISAR), to which position he was elected at the UNCTAD in Geneva in November 2004
- Member of the Developing Nations Permanent Task of the International Federation of Accountants (IFAC), recently renamed IFAC's Developing Nations Committee
- Member of the Accounting Standards Committee, Securities and Exchange Board of India (SEBI), India
- Vice-Chairman of Auditors' Group, Dubai Chamber of Commerce and Industry (DCCI)
- Technical Adviser to the Gulf Co-operation Council Accounting and Auditing Organization (GCCAAO)
- Member of the Consultative Group of Experts on Corporate Governance Disclosures, United Nations Conference on Trade & Development (UNCTAD)
- Member of the Consultative Group of Experts on Corporate Social Responsibility, United Nations Conference on Trade & Development (UNCTAD)

**Graham Holt** qualified as a Chartered Accountant (Institute of Chartered Accountants in England & Wales) with Price Waterhouse and is a fellow of the Association of Chartered Certified Accountants (ACCA). He holds B.Com and MA Econ qualifications also. As a current ACCA examiner, he has been prominent in the development of their IFRS stream and their examination scheme. He is a principal lecturer at the Manchester Metropolitan University Business School, where he is director of Professional Courses. Graham has given lectures on IFRS throughout the world and has many publications in the subject area. He has also been involved in running training courses on IFRS.

**Magnus Orrell** is in the national office of Deloitte & Touche LLP in Wilton, Connecticut (USA), where he specializes in financial instrument accounting issues under both IFRS and U.S. GAAP. Prior to joining Deloitte, he most recently served as project manager at the International Accounting Standards Board (IASB) in London, the United Kingdom, where he played a key role in the development of the current version of the international standards on financial instruments. Previously in his career, he served as a member of the Secretariat of the Basel Committee on Banking Supervision at the Bank for International Settlements (BIS) in Basel, Switzerland; as an official of the European Commission in Brussels, Belgium; and as an accounting expert at the Financial Supervisory Authority in Stockholm, Sweden. Apart from being a Certified Public Accountant (CPA) in the State of Connecticut, he also holds the Chartered Financial Analyst (CFA) designation conferred by the CFA Institute (formerly the Association for Investment Management and Research). Additionally, he holds a degree and master of science in business administration and economics, a degree of master of laws, and a master of accounting and financial management. He has been a frequent speaker on financial reporting issues at seminars, conferences, and executive-level meetings in many countries in Europe, Asia, and the Americas, and has authored articles in both accountancy and finance periodicals.



# 1 INTRODUCTION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

## 1. INTRODUCTION

International Accounting Standards (IAS), now renamed International Financial Reporting Standards (IFRS), are gaining acceptance worldwide. This section discusses the extent to which IFRS are recognized around the world and includes a brief overview of the history and key elements of the international standard-setting process.

## 2. WORLDWIDE ADOPTION OF IFRS

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

**2.2** A major breakthrough came in 2002 when the European Union (EU) adopted legislation that requires listed companies in Europe to apply IFRS in their consolidated financial statements. The legislation came into effect in 2005 and applies to more than 7,000 companies in 28 countries, including countries such as France, Germany, Italy, Spain, and the United Kingdom. The adoption of IFRS in Europe means that IFRS replace national accounting standards and requirements as the basis for preparing and presenting group financial statements for listed companies in Europe.

**2.3** Outside Europe, many other countries are also moving to IFRS. In 2005, IFRS had become mandatory in many countries in Southeast Asia, Central Asia, Latin America, Southern Africa, the Middle East, and the Caribbean. In addition, countries such as Australia, Hong Kong, New Zealand, Philippines, and Singapore had adopted national accounting standards that mirror IFRS. It was estimated that more than 70 countries required their listed companies to apply IFRS in preparing and presenting financial statements in 2005.

### **Countries that have Adopted IFRS**

Countries in which some or all companies are required to apply IFRS or IFRS-based standards are listed below.

#### ***Africa:***

Egypt, Kenya, Malawi, Mauritius, Namibia, South Africa, Tanzania

#### ***Americas:***

Bahamas, Barbados, Costa Rica, Dominican Republic, Ecuador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Nicaragua, Panama, Peru, Trinidad and Tobago, Venezuela

#### ***Asia:***

Armenia, Bahrain, Bangladesh, China, Georgia, Hong Kong, Jordan, Kazakhstan, Kuwait, Kyrgyzstan, Lebanon, Nepal, Oman, Philippines, Qatar, Singapore, Tajikistan, United Arab Emirates

#### ***Europe:***

Austria, Belgium, Bosnia, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Macedonia, Malta, Netherlands, Norway, Poland, Portugal, Romania, Russia, Slovenia, Slovak Republic, Spain, Sweden, Ukraine, United Kingdom, Yugoslavia

#### ***Oceania:***

Australia, New Zealand, Papua New Guinea

**2.4** The adoption of standards that require high-quality, transparent, and comparable information is welcomed by investors, creditors, financial analysts, and other users of financial statements.

Without common standards, it is difficult to compare financial information prepared by entities located in different parts of the world. In an increasingly global economy, the use of a single set of high-quality accounting standards facilitates investment and other economic decisions across borders, increases market efficiency, and reduces the cost of raising capital.

### **3. REMAINING EXCEPTIONS**

**3.1** Measured in terms of the size of their capital markets, the most significant remaining exceptions to the global recognition of IFRS are the United States (US), Japan, and Canada. In these countries, entities continue to be required to follow local accounting standards.

**3.2** The International Accounting Standards Board (IASB), the body in charge of setting IFRS, works closely with the national accounting standard-setting bodies in these countries, including the US Financial Accounting Standards Board (FASB) and the Accounting Standards Board of Japan (ASBJ), to narrow the differences between local accounting standards and IFRS. In Canada, a proposal for conforming local accounting standards to IFRS has been published.

**3.3** In the US, the domestic securities regulator (Securities and Exchange Commission, SEC) has developed a roadmap for eliminating the current requirement for non-US companies that raise capital in US markets to prepare a reconciliation of their IFRS financial statements to US Generally Accepted Accounting Principles (US GAAP).

### **4. THE INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE**

From 1973 until 2001, the body in charge of setting the international standards was the International Accounting Standards Committee (IASC). The principal significance of IASC was to encourage national accounting standard setters around the world to improve and harmonize national accounting standards. Its objectives, as stated in its Constitution, were to

- Formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their worldwide acceptance and observance
- Work generally for the improvement and harmonization of regulations, accounting standards, and procedures relating to the presentation of financial statements

#### **4.1 IASC and the Accounting Profession**

IASC always had a special relationship with the international accounting profession. IASC was created in 1973 by agreement between the professional accountancy bodies in nine countries, and, from 1982, its membership consisted of all those professional accountancy bodies that were members of the International Federation of Accountants (IFAC), that is, professional accountancy bodies in more than 100 countries. As part of their membership in IASC, professional accountancy bodies worldwide committed themselves to use their best endeavors to persuade governments, standard-setting bodies, securities regulators, and the business community that published financial statements should comply with IAS.

#### **4.2 IASC Board**

The members of IASC (i.e., professional accountancy bodies around the world) delegated the responsibility for all IASC activities, including all standard-setting activities, to the IASC Board. The Board consisted of 13 country delegations representing members of IASC and up to four other organizations appointed by the Board. The Board, which usually met four times per year, was supported by a small secretariat located in London, the United Kingdom.

#### **4.3 The Initial Set of Standards Issued by IASC**

In its early years, IASC focused its efforts on developing a set of basic accounting standards. These standards usually were worded broadly and contained several alternative treatments to accommodate the existence of different accounting practices around the world. Later these standards came to be criticized for being too broad and having too many options.

#### 4.4 Improvements and Comparability Project

Beginning in 1987, IASC initiated work to improve its standards, reduce the number of choices, and specify preferred accounting treatments in order to allow greater comparability in financial statements. This work took on further importance as securities regulators worldwide started to take an active interest in the international accounting standard-setting process.

#### 4.5 Core Standards Work Program

**4.5.1** During the 1990s, IASC worked increasingly closely with the International Organization of Securities Commissions (IOSCO) on defining its agenda. In 1993, the Technical Committee of IOSCO held out the possibility of IOSCO endorsement of IASC Standards for cross-border listing and capital-raising purposes around the world and identified a list of core standards that IASC would need to complete for purposes of such an endorsement. In response, IASC in 1995 announced that it had agreed on a work plan to develop the comprehensive set of core standards sought after by IOSCO. This effort became known as the Core Standards Work Program.

**4.5.2** After three years of intense work to develop and publish standards that met IOSCO's criteria, IASC completed the Core Standards Work Program in 1998. In 2000, the Technical Committee of IOSCO recommended securities regulators worldwide to permit foreign issuers to use IASC Standards for cross-border offering and listing purposes, subject to certain supplemental treatments.

#### 4.6 International Accounting Standards and SIC Interpretations

During its existence, IASC issued 41 numbered Standards, known as International Accounting Standards (IAS), as well as a *Framework for the Preparation and Presentation of Financial Statements*. While some of the Standards issued by the IASC have been withdrawn, many are still in force. In addition, some of the Interpretations issued by the IASC's interpretive body, the so-called Standing Interpretations Committee (SIC), are still in force.

##### List of IAS Still in Force for 2006 Financial Statements

IAS 1, *Presentation of Financial Statements*  
 IAS 2, *Inventories*  
 IAS 7, *Cash Flow Statements*  
 IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*  
 IAS 10, *Events After the Balance Sheet Date*  
 IAS 11, *Construction Contracts*  
 IAS 12, *Income Taxes*  
 IAS 14, *Segment Reporting*  
 IAS 16, *Property, Plant, and Equipment*  
 IAS 17, *Leases*  
 IAS 18, *Revenue*  
 IAS 19, *Employee Benefits*  
 IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*  
 IAS 21, *The Effects of Changes in Foreign Exchange Rates*  
 IAS 23, *Borrowing Costs*  
 IAS 24, *Related-Party Disclosures*  
 IAS 26, *Accounting and Reporting by Retirement Benefit Plans*  
 IAS 27, *Consolidated and Separate Financial Statements*  
 IAS 28, *Investments in Associates*  
 IAS 29, *Financial Reporting in Hyperinflationary Economies*  
 IAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*  
 IAS 31, *Interests in Joint Ventures*  
 IAS 32, *Financial Instruments: Disclosure and Presentation*  
 IAS 33, *Earnings per Share*  
 IAS 34, *Interim Financial Reporting*  
 IAS 36, *Impairment of Assets*  
 IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*  
 IAS 38, *Intangible Assets*

IAS 39, *Financial Instruments: Recognition and Measurement*  
 IAS 40, *Investment Property*  
 IAS 41, *Agriculture*

**List of SIC Interpretations Still in Force for 2006 Financial Statements**

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

**5. THE INTERNATIONAL ACCOUNTING STANDARDS BOARD**

**5.0.1** In 2001, fundamental changes were made to strengthen the independence, legitimacy, and quality of the international accounting standard-setting process. In particular, the IASC was replaced by the International Accounting Standards Board (IASB) as the body in charge of setting the international standards.

**Key Differences between IASC and IASB**

The IASB differs from the IASC, its predecessor body, in several key areas:

- Unlike the IASC, the IASB does not have a special relationship with the international accounting profession. Instead, IASB is governed by a group of Trustees of diverse geographic and functional backgrounds who are independent of the accounting profession.
- Unlike the Board members of the IASC, Board members of the IASB are individuals who are appointed based on technical skill and background experience rather than as representatives of specific national accountancy bodies or other organizations.
- Unlike the IASC Board, which only met about four times a year, the IASB Board usually meets each month. Moreover, the number of technical and commercial staff working for IASB has increased significantly as compared with IASC. (Similar to IASC, the headquarters of the IASB is located in London, the United Kingdom.)

The interpretive body of the IASC (SIC), has been replaced by the International Financial Reporting Interpretations Committee (IFRIC).

**5.0.2** The objectives of the IASB, as stated in its Constitution, are to

- (a) Develop, in the public interest, a single set of high-quality, understandable, and enforceable global accounting standards that require high-quality, transparent, and comparable information in financial statements and other financial reporting to help participants in the various capital markets of the world and other users of the information to make economic decisions;
- (b) Promote the use and rigorous application of those standards; and
- (c) Work actively with national standard setters to bring about convergence of national accounting standards and International Financial Reporting Standards to high-quality solutions.

**5.0.3** At its first meeting in 2001, IASB adopted all outstanding IAS issued by the IASC as its own Standards. Those IAS continue to be in force to the extent they are not amended or withdrawn

by the IASB. New Standards issued by IASB are known as IFRS. When referring collectively to IFRS, that term includes both IAS and IFRS.

#### **List of IFRS**

IFRS 1, *First-time Adoption of International Financial Reporting Standards*  
 IFRS 2, *Share-Based Payment*  
 IFRS 3, *Business Combinations*  
 IFRS 4, *Insurance Contracts*  
 IFRS 5, *Noncurrent Assets Held for Sale and Discontinued Operations*  
 IFRS 6, *Exploration for and Evaluation of Mineral Resources*  
 IFRS 7, *Financial Instruments: Disclosures*

**5.0.4** One of the initial projects undertaken by IASB was to identify opportunities to improve the existing set of Standards by adding guidance and eliminating inconsistencies and choices. The improved Standards, adopted in 2003, form part of IASB's so-called stable platform of Standards for use in 2005 when a significant number of countries around the world moved from national accounting requirements to IFRS, such as all the countries in the European Union.

### **5.1 Structure and Governance of IASB**

#### **5.1.1 Trustees**

The governance of IASB rests with the Trustees of the International Accounting Standards Committee Foundation (the "IASB Foundation Trustees" or, simply, the "Trustees"). The Trustees have no involvement in IASB's standard-setting activities. Instead, the Trustees are responsible for broad strategic issues, budget, and operating procedures, as well as for appointing the members of IASB.

#### **5.1.2 The Board**

The Board is responsible for all standard-setting activities, including the development and adoption of IFRS. The Board has 14 members from around the world who are selected by the Trustees based on technical skills and relevant business and market experience. The Board, which usually meets once a month, has 12 full-time members and 2 part-time members. The Board members are from a mix of backgrounds, including auditors, preparers of financial statements, users of financial statements, and academics.

#### **5.1.3 Standards Advisory Council**

IASB is advised by the Standards Advisory Council (SAC). It has about 40 members appointed by the Trustees and provides a forum for organizations and individuals with an interest in international financial reporting to provide advice on IASB agenda decisions and priorities. Members currently include chief financial and accounting officers from some of the world's largest corporations and international organizations, leading financial analysts and academics, regulators, accounting standard setters, and partners from leading accounting firms.

#### **5.1.4 International Financial Reporting Interpretations Committee (IFRIC)**

IASB's interpretive body, IFRIC, is in charge of developing interpretive guidance on accounting issues that are not specifically dealt with in IFRSs or that are likely to receive divergent or unacceptable interpretations in the absence of authoritative guidance. IFRIC members are appointed by the Trustees.

#### **List of IFRIC Interpretations**

IFRIC 1, *Changes in Existing Decommissioning, Restoration and Similar Liabilities*  
 IFRIC 2, *Members' Shares in Cooperative Entities and Similar Instruments*  
 IFRIC 3, *Emission Rights* (withdrawn)

IFRIC 4, *Determining Whether an Arrangement Contains a Lease*  
IFRIC 5, *Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*  
IFRIC 6, *Liabilities Arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment*  
IFRIC 7, *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies*  
IFRIC 8, *Scope of IFRS 2*  
IFRIC 9, *Reassessment of Embedded Derivatives*

#### **5.1.5 Standard-Setting Due Process**

As part of its due process in developing new or revised Standards, the Board publishes an Exposure Draft of the proposed Standard for public comment in order to obtain the views of all interested parties. It also publishes a “Basis for Conclusions” to its Exposure Drafts and Standards to explain how it reached its conclusions and to give background information. When one or more Board members disagree with a Standard, the Board publishes those dissenting opinions with the Standard. To obtain advice on major projects, the Board often forms advisory committees or other specialist groups and may also hold public hearings and conduct field tests on proposed Standards.

# 2 IASB FRAMEWORK

## 1. INTRODUCTION

**1.1** The *Framework for the Preparation and Presentation of Financial Statements* (the “*Framework*”) sets out the concepts that underlie the preparation and presentation of financial statements, that is, the objectives, assumptions, characteristics, definitions, and criteria that govern financial reporting. Therefore, the *Framework* is often referred to as the “conceptual framework.” The *Framework* deals with

- (a) The objective of financial statements
- (b) Underlying assumptions
- (c) The qualitative characteristics that determine the usefulness of information in financial statements
- (d) The definition, recognition, and measurement of the elements from which financial statements are constructed
- (e) Concepts of capital and capital maintenance

**1.2** The *Framework* does not have the force of a Standard. Instead, its purposes include, first, to assist and guide the International Accounting Standards Board (IASB) as it develops new or revised Standards and, second, to assist preparers of financial statements in applying Standards and in dealing with topics that are not addressed by a Standard. Thus, in case of a conflict between the *Framework* and a specific Standard, the Standard prevails over the *Framework*.

### Practical Insight

In the absence of a Standard or an Interpretation that specifically applies to a transaction, other event, or condition, IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, requires management to use its judgment in developing and applying an accounting policy that results in information that is relevant and reliable. In making that judgment, management is required to refer to, and consider the applicability of, in descending order: (a) the requirements and guidance in Standards and Interpretations dealing with similar and related issues; and (b) the definitions, recognition criteria, and measurement concepts for assets, liabilities, income, and expenses in the *Framework*. Thus, the *Framework* serves as a guide for preparers to resolve accounting issues in the absence of more specific requirements.

## 2. OBJECTIVE OF FINANCIAL STATEMENTS

The objective of financial statements is to provide information about the financial position, performance, and changes in financial position of an entity that is useful to a wide range of users in making economic decisions (e.g., whether to sell or hold an investment in the entity). Users include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies, and the public. Because investors are providers of risk capital, it is presumed that financial statements that meet their needs will also meet most of the needs of other users.

## 3. UNDERLYING ASSUMPTIONS

Normally, two assumptions underlying the preparation and presentation of financial statements are the accrual basis and going concern.

### 3.1 Accrual Basis

**3.1.1** When financial statements are prepared on the *accrual basis of accounting*, the effects of transactions and other events are recognized when they occur (and not as cash or its equivalent is

received or paid), and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.

**3.1.2** The accrual basis assumption is also addressed in IAS 1, *Presentation of Financial Statements*, which clarifies that when the accrual basis of accounting is used, items are recognized as assets, liabilities, equity, income, and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements in the *Framework*.

## 3.2 Going Concern

**3.2.1** When financial statements are prepared on a *going concern* basis, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations, but will continue in operation for the foreseeable future. If this assumption is not valid, the financial statements may need to be prepared on a different basis and, if so, the basis used is disclosed.

**3.2.2** The going concern assumption is also addressed in IAS 1, which requires management to make an assessment of an entity's ability to continue as a going concern when preparing financial statements.

## 4. QUALITATIVE CHARACTERISTICS OF FINANCIAL STATEMENTS

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. According to the *Framework*, the four principal qualitative characteristics are

- (1) Understandability
- (2) Relevance
- (3) Reliability
- (4) Comparability

### 4.1 Understandability

“Understandability” refers to information being readily understandable by users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.

### 4.2 Relevance

**4.2.1** “Relevance” refers to information being relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present, or future events or confirming, or correcting, their past evaluations. The concept of relevance is closely related to the concept of *materiality*. The *Framework* describes materiality as a threshold or cut-off point for information whose omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.

**4.2.2** The concept of materiality is further addressed in IAS 1, which specifies that each material class of similar items shall be presented separately in the financial statements and that items of a dissimilar nature or function shall be presented separately unless they are immaterial. Under the concept of materiality, a specific disclosure requirement in a Standard or an Interpretation need not be met if the information is not material.

### 4.3 Reliability

**4.3.1** “Reliability” refers to information being free from material error and bias and can be depended on by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent. According to the *Framework*, to be reliable, information must

- Be free from material error
- Be neutral, that is, free from bias
- Represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent (*representational faithfulness*). If information is to represent faithfully the transactions and other events that it purports to represent, the *Framework* specifies that they need to be accounted for and presented in accordance with their substance and economic reality even if their legal form is different (*substance over form*).

- Be complete within the bounds of materiality and cost

**4.3.2** Related to the concept of reliability is *prudence*, whereby preparers of financial statements should include a degree of caution in exercising judgments needed in making estimates, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not justify the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses, because the financial statements would not be neutral and, therefore, not reliable.

#### 4.4 Comparability

**4.4.1** “Comparability” refers to information being comparable through time and across entities. To achieve comparability, like transactions and events should be accounted for similarly by an entity throughout an entity, over time for that entity, and by different entities.

**4.4.2** Consistency of presentation is also addressed in IAS 1. It specifies that the presentation and classification of items in the financial statements, as a general rule, shall be retained from one period to the next, with specified exceptions.

#### 4.5 Constraints

In practice, there is often a trade-off between different qualitative characteristics of information. In these situations, an appropriate balance among the characteristics must be achieved in order to meet the objective of financial statements.

##### *Examples*

*Examples of trade-offs between qualitative characteristics of information follow:*

- *There is a trade-off between reporting relevant information in a timely manner and taking time to ensure that the information is reliable. If information is not reported in a timely manner, it may lose its relevance. Therefore, entities need to balance relevance and reliability in determining when to provide information.*
- *There is trade-off between benefit and cost in preparing and reporting information. In principle, the benefits derived from the information by users should exceed the cost for the preparer of providing it.*
- *There is a trade-off between providing information that is relevant, but is subject to measurement uncertainty (e.g., the fair value of a financial instrument), and providing information that is reliable but not necessarily relevant (e.g., the historical cost of a financial instrument).*

### 5. ELEMENTS OF FINANCIAL STATEMENTS

**5.1** The *Framework* describes the elements of financial statements as broad classes of financial effects of transactions and other events. The elements of financial statements are

- **Assets.** An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
- **Liabilities.** A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
- **Equity.** Equity is the residual interest in the assets of the entity after deducting all its liabilities.
- **Income.** Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.
- **Expenses.** Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

**5.2** According to the *Framework*, an item that meets the definition of an element should be recognized (i.e., incorporated in the financial statements) if

- (a) It is probable that any future economic benefit associated with the item will flow to or from the entity; and
- (b) The item has a cost or value that can be measured with reliability.

The *Framework* notes that the most common measurement basis in financial statements is historical cost, but that other measurement bases are also used, such as current cost, realizable or settlement value, and present value.

## **6. CONCEPTS OF CAPITAL AND CAPITAL MAINTENANCE**

**6.1** The *Framework* distinguishes between a financial concept of capital and a physical concept of capital. Most entities use a financial concept of capital, under which capital is defined in monetary terms as the net assets or equity of the entity. Under a physical concept of capital, capital is instead defined in terms of physical productive capacity of the entity.

**6.2** Under the financial capital maintenance concept, a profit is earned if the financial amount of the net assets at the end of the period exceeds the financial amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Under the physical capital maintenance concept, a profit is instead earned if the physical productive capacity (or operating capability) of the entity (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

## MULTIPLE-CHOICE QUESTIONS

1. What is the authoritative status of the *Framework*?

- (a) It has the highest level of authority. In case of a conflict between the *Framework* and a Standard or Interpretation, the *Framework* overrides the Standard or Interpretation.
- (b) If there is a Standard or Interpretation that specifically applies to a transaction, it overrides the *Framework*. In the absence of a Standard or an Interpretation that specifically applies, the *Framework* should be followed.
- (c) If there is a Standard or Interpretation that specifically applies to a transaction, it overrides the *Framework*. In the absence of a Standard or an Interpretation that specifically applies to a transaction, management should consider the applicability of the *Framework* in developing and applying an accounting policy that results in information that is relevant and reliable.
- (d) The *Framework* applies only when IASB develops new or revised Standards. An entity is never required to consider the *Framework*.

**Answer: (c)**

2. What is the objective of financial statements according to the *Framework*?

- (a) To provide information about the financial position, performance, and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.
- (b) To prepare and present a balance sheet, an income statement, a cash flow statement, and a statement of changes in equity.
- (c) To prepare and present comparable, relevant, reliable, and understandable information to investors and creditors.
- (d) To prepare financial statements in accordance with all applicable Standards and Interpretations.

**Answer: (a)**

3. Which of the following are underlying assumptions of financial statements?

- (a) Relevance and reliability.
- (b) Financial capital maintenance and physical capital maintenance.
- (c) Accrual basis and going concern.
- (d) Prudence and conservatism.

**Answer: (c)**

4. What are qualitative characteristics of financial statements according to the *Framework*?

- (a) Qualitative characteristics are the attributes that make the information provided in financial statements useful to users.
- (b) Qualitative characteristics are broad classes of financial effects of transactions and other events.

- (c) Qualitative characteristics are nonquantitative aspects of an entity's position and performance and changes in financial position.
- (d) Qualitative characteristics measure the extent to which an entity has complied with all relevant Standards and Interpretations.

**Answer: (a)**

5. Which of the following is **not** a qualitative characteristic of financial statements according to the *Framework*?

- (a) Materiality.
- (b) Understandability.
- (c) Comparability.
- (d) Relevance.

**Answer: (a)**

6. When should an item that meets the definition of an element be recognized, according to the *Framework*?

- (a) When it is probable that any future economic benefit associated with the item will flow to or from the entity.
- (b) When the element has a cost or value that can be measured with reliability.
- (c) When the entity obtains control of the rights or obligations associated with the item.
- (d) When it is probable that any future economic benefit associated with the item will flow to or from the entity and the item has a cost or value that can be measured with reliability.

**Answer: (d)**

# 3 PRESENTATION OF FINANCIAL STATEMENTS (IAS 1)

## 1. INTRODUCTION

IAS 1 provides guidelines on the presentation of the “general purpose financial statements,” thereby ensuring comparability both with the entity’s financial statements of previous periods and with those of other entities. It provides overall requirements for the presentation of financial statements, guidance on their structure, and the minimum requirements for their content. It also prescribes the components of the financial statements that together would be considered a complete set of financial statements.

## 2. SCOPE

The requirements of IAS 1 are to be applied to all “general purpose financial statements” that have been prepared and presented in accordance with International Financial Reporting Standards (IFRS). “General purpose financial statements” are those intended to meet the needs of users who are not in a position to demand reports that are tailored according to their information needs. IAS 1 is not applicable to condensed interim financial statements prepared according to IAS 34. Additional requirements for banks and similar financial institutions are contained in IAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*. Modification of the presentation requirements of the Standard may be required by nonprofit entities and those entities whose share capital is not equity.

## 3. DEFINITIONS OF KEY TERMS

**Impracticable.** Applying a requirement becomes impracticable when the entity cannot apply a requirement despite all reasonable efforts to do so.

**International Financial Reporting Standards (IFRS).** Standards and interpretations adopted by the International Accounting Standards Board (IASB). They include

- (a) International Financial Reporting Standards
- (b) International Accounting Standards
- (c) Interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC)

**Material.** An item is deemed to be material if its omission or misstatement would influence the economic decisions of a user taken on the basis of the financial statements. Materiality is determined based on the item’s nature, size, and/or the surrounding circumstances.

**Notes to financial statements.** A collection of information providing descriptions and disaggregated information relating to items included in the financial statements (i.e., balance sheet, income statement, statement of changes in equity, and cash flow statement), as well as those that do not appear in the financial statements but are disclosed due to requirements of IFRS.

### Practical Insight

“Materiality” as a concept has been the subject of debate for years yet there are no clear-cut parameters to compute materiality. What would normally be expected to influence one person’s viewpoint may not necessarily influence another person’s economic decisions based on the financial statements. Furthermore, materiality is not only “quantitative” (i.e., measured in terms of numbers) but also “qualitative” (because it depends not only on the “size” of the item