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2011 Interpretation and Application of International Financial Reporting Standards

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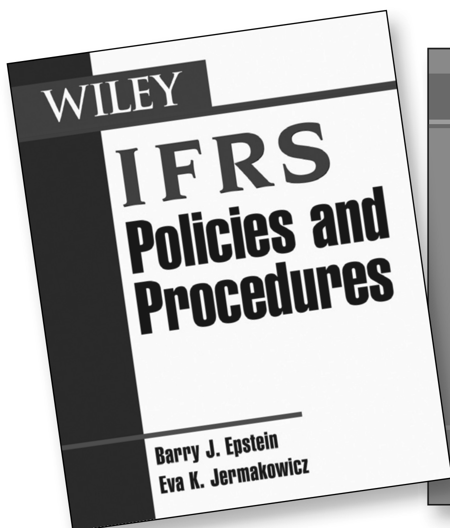

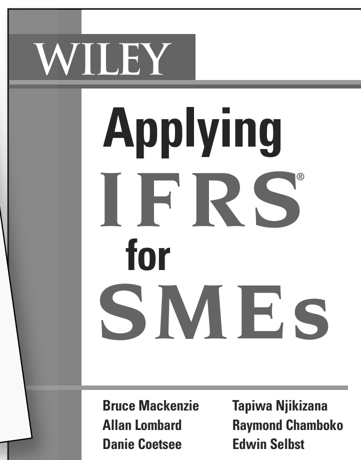

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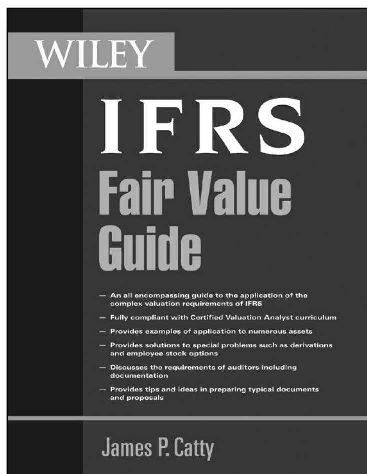

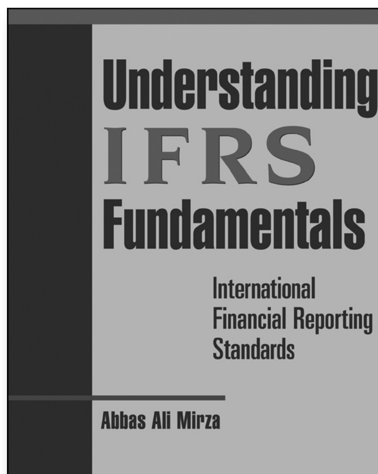

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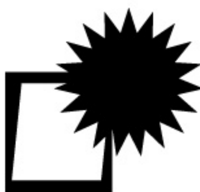

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PREFACE

IFRS: Interpretation and Application of International Financial Reporting Standards provides detailed, analytical explanations and illustrations of all current accounting principles promulgated by the IASB (and its predecessor, the IASC). The book integrates the accounting principles set out in International Financial Reporting Standards (IFRS) including Interpretations issued by the IFRS Interpretations Committee. These materials have been synthesized into a user-oriented topical format, eliminating the need for readers to first be familiar with the names or numbers of the salient professional standards.

The stated goal of the IFRS Foundation and the 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. More and more global economies are adopting IFRS. In fact, the IASB acknowledges that all major economies have established time lines to converge with or adopt IFRS in the near future.

A key event signaling the growing recognition of the primacy of IFRS was the decision by the US Securities and Exchange Commission in 2007 waiving its former requirement for foreign registrants to reconcile key financial statement captions to amounts computed under US GAAP. Now, for those submitting financial statements that fully comply with IFRS, this is no longer required.

The SEC is expected to make a decision in 2011, based on early experience, whether to entirely phase out US GAAP in favor of IFRS. Universal adoption of IFRS appears to now be a virtual certainty, probably within the near term, although the originally promoted target of 2014 to 2016 might conceivably slip one or a few years.

The primary objective of this book is to assist the practitioner, user, or preparer in navigating the myriad practical problems faced in applying IFRS. Accordingly, the paramount goal has been to incorporate meaningful, real-world-type examples in guiding users in the application of IFRS to the complex fact situations that must be dealt with in the actual practice of accounting. In addition to this emphasis, a major strength of this book is that it does explain the theory of IFRS in sufficient detail to serve as a valuable adjunct to, or substitute for, accounting textbooks. Much more than a reiteration of currently promulgated IFRS, it provides the user with an understanding of the underlying conceptual basis for the rules, to enable the reasoning by analogy that is so necessary in dealing with a complex, fast-changing world of commercial arrangements and structures using principles-based standards. Since IFRS is by design less prescriptive than many national GAAP, practitioners have been left with a proportionately greater challenge in actually applying the rules. This book is designed to bridge the gap between these less detailed standards and application problems encountered in practice.

Each chapter of this book, or major section thereof, provides an overview discussion of the perspective and key issues associated with the topics covered; a listing of the professional pronouncements that guide practice; a short overview of new developments and a detailed discussion of the concepts and accompanying examples. A comprehensive checklist following the main text offers practical guidance to preparing financial statement disclosures in accordance with IFRS. Also included is an up-to-date, detailed, tabular comparison between IFRS and US GAAP, which remains the second most commonly encountered financial reporting standards, keyed to the chapters of this book. The book features examples of actual informative disclosures made by companies currently reporting under IFRS.

The authors' wish is that this book will serve practitioners, faculty, and students as a reliable reference tool, to facilitate their understanding of, and ability to apply, the complexities of the authoritative literature. Comments from readers, both as to errors and omissions and as to proposed improvements for future editions, should be addressed to John Wiley & Sons, Inc., 155 N. 3rd Street, Suite 502, DeKalb, Illinois 60115, for consideration in future editions.

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1 INTRODUCTION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

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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, as many as 7,000 listed companies in the 27 European Union member states, plus many others in countries such as Australia, New Zealand, Russia, and South Africa were expected (in the EU, required) to produce annual financial statements in compliance with a single set of international rules—International Financial Reporting Standards (IFRS). Many other business entities, while not publicly held and not currently required to comply with IFRS, also planned to do so, either immediately or over time, in order to conform to what is clearly becoming the new worldwide standard. Since there are about 15,000 SEC-registered companies in the USA that prepare financial statements in accordance with US GAAP (plus countless nonpublicly held companies also reporting under GAAP), the vast majority of the world's large businesses are now reporting under one or the other of these two comprehensive systems of accounting and financial reporting rules.

There were once scores of unique sets of financial reporting standards among the more developed nations ("national GAAP"). However, most other national GAAP standards have been reduced in importance or are being phased out as nations all over the world have embraced IFRS. For example, Canada announced that Canadian GAAP (which was modeled on and very similar to US GAAP) is to be eliminated and replaced by IFRS in 2011. China required that listed companies employ IFRS beginning with their 2007 financial reporting. Many others planned to follow this same path.

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 had 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. 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. In the authors' view, however, any revisiting of the earlier decision to move decisively toward mandatory use of IFRS for public company financial reporting in the US will create only a minor delay, if any. Simply put, the worldwide trend to uniform financial reporting standards (for which role the only candidate is IFRS) is inexorable and will benefit all those seeking to raise capital and all those seeking to invest.

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 may now opine (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 SEC commissioner and chair recently confirmed that they are committed to a single set of global standards and are on schedule for the 2011 determination whether to incorporate IFRS in the US for US issuers.

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 conditioned 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 authors believe that these difficulties are soon coming to an end, however. 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, with more changes expected in the immediate future. In November 2009 the Boards confirm their aim to complete each milestone project of the Memorandum of Understanding (MOU) by the end of June 2011. These milestone projects include

- Financial instruments
- Consolidations
- Derecognition
- Fair Value Measurement
- Revenue Recognition
- Leases
- Financial Instruments with Characteristics of Equity
- Financial Statement Presentation
- Other MOU Projects
- Other Joint Projects

Details of these and other projects of the standard setters are included in a separate section in each relevant chapter of this book.

It thus is anticipated that by 2011 many distinctions between US GAAP and IFRS will be eliminated, if US GAAP remains an independent set of financial reporting rules, notwithstanding that there remain challenging issues to be resolved before full convergence can occur. For one very important example, while IFRS bans the use of LIFO costing for inventories, it remains a popular financial reporting method under US GAAP because of a "conformity rule" that permits entities to use the method for tax reporting only if it is also used for general-purpose external financial reporting. In times of increasing costs, LIFO almost inevitably results in tax deferrals and is thus widely employed. US-based companies will be reluctant to fully embrace IFRS if it means that this tax strategy must be abandoned.

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, starting in France 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 Germany after its 1870 unification, with the emphasis moving away from market values to historical cost and systematic depreciation. It was used later by governments as the basis of tax assessment when taxes on business profits started to be introduced, mostly in the early twentieth century.

This model of accounting serves primarily as a means of moderating relationships between the individual company and the state. It serves for tax assessment, and to limit dividend payments, and it is also a means of protecting the running of the economy by sanctioning individual businesses that are not financially sound or were run imprudently. While the model has been adapted for stock market reporting and group (consolidated) structures, this is not its main focus.

The other model did not appear until the nineteenth century and arose as a consequence of the industrial revolution. Industrialization created the need for large concentrations of capital to undertake industrial projects (initially, canals and railways) and to spread risks between many investors. In this model the financial report provided a means of monitoring the activities of large businesses in order to inform their (nonmanagement) shareholders. Financial reporting for capital markets purposes developed initially in the UK, in a common-law environment where the state legislated as little as possible and left a large degree of in-

terpretation to practice and for the sanction of the courts. This approach was rapidly adopted by the US as it, too, became industrialized. As the US developed the idea of groups of companies controlled from a single head office (towards the end of the nineteenth century), this philosophy of financial reporting began to become focused on consolidated accounts and the group, rather than the individual company. For different reasons, neither the UK nor the US governments saw this reporting framework as appropriate for income tax purposes, and in this tradition, while the financial reports inform the assessment process, taxation retains a separate stream of law, which has had little influence on financial reporting.

The second model of financial reporting, generally regarded as the Anglo-Saxon financial reporting approach, can be characterized as focusing on the relationship between the business and the investor, and on the flow of information to the capital markets. Government still uses reporting as a means of regulating economic activity (e.g., the SEC's mission is to protect the investor and ensure that the securities markets run efficiently), but the financial report is aimed at the investor, not the government.

Neither of the two above-described approaches to financial reporting is particularly useful in an agricultural economy, or to one that consists entirely of microbusinesses, in the opinion of many observers. Nonetheless, as countries have developed economically (or as they were colonized by industrialized nations) they have adopted variants of one or the other of these two models.

IFRS are an example of the second, capital market-oriented, systems of financial reporting rules. The original international standard setter, the International Accounting Standards Committee (IASC), was formed in 1973, during a period of considerable change in accounting regulation. In the US the Financial Accounting Standards Board (FASB) had just been created, in the UK the first national standard setter had recently been organized, the EU was working on the main plank of its own accounting harmonization plan (the Fourth Directive), and both the UN and the OECD were shortly to create their own accounting committees. The IASC was launched in the wake of the 1972 World Accounting Congress (a five-yearly get-together of the international profession) after an informal meeting between representatives of the British profession (Institute of Chartered Accountants in England and Wales—ICAEW) and the American profession (American Institute of Certified Public Accountants—AICPA).

A rapid set of negotiations resulted in the professional bodies of Canada, Australia, Mexico, Japan, France, Germany, the Netherlands, and New Zealand being invited to join with the US and UK to form the international body. Due to pressure (coupled with a financial subsidy) from the UK, the IASC was established in London, where its successor, the IASB, remains today.

The actual reasons for the IASC's creation are unclear. A need for a common language of business was felt, to deal with a growing volume of international business, but other more political motives abounded also. For example, some believe that the major motivation was that the British wanted to create an international standard setter to trump the regional initiatives within the EU, which leaned heavily to the Code model of reporting, in contrast to what was the norm in the UK and almost all English-speaking nations.

In the first phase of its existence, the IASC had mixed fortunes. Once the International Federation of Accountants (IFAC) was formed in 1977 (at the next World Congress of Accountants), the IASC had to fight off attempts to become a part of IFAC. It managed to resist, coming to a compromise where IASC remained independent but all IFAC members were automatically members of IASC, and IFAC was able to nominate the membership of the standard-setting Board.

Both the UN and OECD were active in international rule making in the 1970s but the IASC was successful in persuading them to leave establishment of recognition and measure-

ment rules to the IASC. However, having established itself as the unique international rule maker, IASC encountered difficulty in persuading any jurisdiction or enforcement agency to use its rules. Although member professional bodies were theoretically committed to pushing for the use of IFRS at the national level, in practice few national bodies were influential in standard setting in their respective countries (because standards were set by taxation or other governmental bodies), and others (including the US and UK) preferred their national standards to whatever IASC might propose. In Europe, IFRS were used by some reporting entities in Italy and Switzerland, and national standard setters in some countries such as Malaysia began to use IFRS as an input to their national rules, while not necessarily adopting them as written by the IASC or giving explicit recognition to the fact that IFRS were being adopted in part as national GAAP.

IASC's efforts entered a new phase in 1987, which led directly to its 2001 reorganization, when the then-Secretary General, David Cairns, encouraged by the US SEC, negotiated an agreement with the International Organization of Securities Commissions (IOSCO). IOSCO was interested in identifying a common international "passport" whereby companies could be accepted for secondary listing in the jurisdiction of any IOSCO member. The concept was that, whatever the listing rules in a company's primary stock exchange, there would be a common minimum package which all stock exchanges would accept from foreign companies seeking a secondary listing. IOSCO was prepared to endorse IFRS as the financial reporting basis for this passport, provided that the international standards could be brought up to a quality and comprehensiveness level that IOSCO stipulated.

Historically, a major criticism of IFRS had been that it essentially endorsed all the accounting methods then in wide use, effectively becoming a "lowest common denominator" set of standards. The trend in national GAAP had been to narrow the range of acceptable alternatives, although uniformity in accounting had not been anticipated as a near-term result. The IOSCO agreement energized IASC to improve the existing standards by removing the many alternative treatments that were then permitted under the standards, thereby improving comparability across reporting entities. The IASC launched its *Comparability and Improvements Project* with the goal of developing a "core set of standards" that would satisfy IOSCO. These were complete by 1993, not without difficulties and spirited disagreements among the members, but then—to the great frustration of the IASC—these were not accepted by IOSCO. Rather than endorsing the standard-setting process of IASC, as was hoped for, IOSCO seemingly wanted to cherry-pick individual standards. Such a process could not realistically result in near-term endorsement of IFRS for cross-border securities registrations.

Ultimately, the collaboration was relaunched in 1995, with IASC under new leadership, and this began a further period of frenetic activities, where existing standards were again reviewed and revised, and new standards were created to fill perceived gaps in IFRS. This time the set of standards included, among others, IAS 39, on recognition and measurement of financial instruments, which was endorsed, at the very last moment and with great difficulty, as a compromise, purportedly interim standard.

At the same time, the IASC had undertaken an effort to consider its future structure. In part, this was the result of pressure exerted by the US SEC and also by the US private sector standard setter, the FASB, which were seemingly concerned that IFRS were not being developed by "due process." While the various parties may have had their own agendas, in fact the IFRS were in need of strengthening, particularly as to reducing the range of diverse but accepted alternatives for similar transactions and events. The challenges presented to IASB ultimately would serve to make IFRS stronger.

If IASC was to be the standard setter endorsed by the world's stock exchange regulators, it would need a structure that reflected that level of responsibility. The historical Anglo-Saxon standard-setting model—where professional accountants set the rules for them-

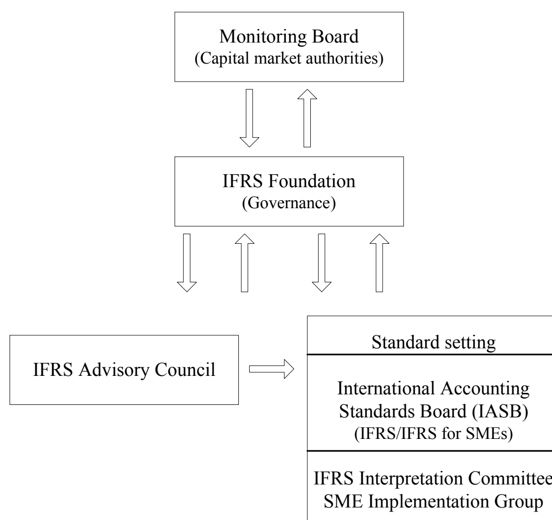
selves—had largely been abandoned in the twenty-five years since the IASC was formed, and standards were mostly being set by dedicated and independent national boards such as the FASB, and not by profession-dominated bodies like the AICPA. The choice, as restructuring became inevitable, was between a large, representative approach—much like the existing IASC structure, but possibly where national standard setters appointed representatives—or a small, professional body of experienced standard setters which worked independently of national interests.

The end of this phase of the international standard setting, and the resolution of these issues, came about within a short period in 2000. In May of that year, IOSCO members voted to endorse IASC standards, albeit subject to a number of reservations (see discussion later in this chapter). This was a considerable step forward for the IASC, which itself was quickly exceeded by an announcement in June 2000 that the European Commission intended to adopt IFRS as the requirement for primary listings in all member states. This planned full endorsement by the EU eclipsed the lukewarm IOSCO approval, and since then the EU has appeared to be the more influential body insofar as gaining acceptance for IFRS has been concerned. Indeed, the once-important IOSCO endorsement has become of little importance given subsequent developments, including the EU mandate and convergence efforts among several standard-setting bodies.

In July 2000, IASC members voted to abandon the organization's former structure, which was based on professional bodies, and adopt a new structure: beginning in 2001, standards would be set by a professional board, financed by voluntary contributions raised by a new oversight body.

The Current Structure

The formal structure put in place in 2000 has the IASC Foundation, a Delaware corporation, as its keystone. The Trustees of the IASC Foundation have both the responsibility to raise funds needed to finance standard setting, and the responsibility of appointing members to the International Accounting Standards Board (IASB), the International Financial Reporting Interpretations Committee (IFRIC) and the Standards Advisory Council (SAC). The structure changed by incorporating the Monitoring Board in 2009, renaming and incorporating the SME Implementation Group in 2010 as follows:



The Monitoring Board is responsible to ensure that the Trustees of the IFRS Foundation discharge their duties as defined by the IFRS Foundation Constitution and to approve the appointment or reappointment of Trustees. The Monitoring Board consists of the Emerging Markets and Technical Committees of the International Organization of Securities Commissions (IOSCO), the European Commission, the Financial Services Agency of Japan (JFSA), and US Securities and Exchange Commission (SEC). The Basel Committee on Banking Supervision currently only participates as an observer.

The IFRS Foundation is governed by trustees and reports to the Monitoring Board. The IFRS Foundation has fundraising responsibilities and oversees the standard-setting work, the IFRS structure and strategy. It is also responsible for the review of the Constitution.

The IFRS Advisory Council (formerly the SAC) is the formal advisory body to the IASB and the Trustees of the IFRS Foundation. Members consist of user groups, preparers, financial analysts, academics, auditors, regulators, professional accounting bodies and investor groups.

The IASB is an independent body that is solely responsible for establishing International Financial Reporting Standards (IFRS), including IFRS for SMEs. The IASB also approves new interpretations.

The IFRS Interpretations Committee (IFRIC) is a committee comprised mostly of technical partners in audit firms but also includes preparers and users. IFRIC's function is to answer technical queries from constituents about how to interpret IFRS—in effect, filling in the cracks between different rules. In recent times it has also proposed modifications to standards to the IASB, in response to perceived operational difficulties or need to improve consistency. IFRIC liaises with the US Emerging Issues Task Force and similar bodies and standard setters, to try to preserve convergence at the level of interpretation.

Working relationships are set up with local standard setters who have adopted or converged with International Financial Reporting Standards (IFRSs), or are in the process of adopting or converging with IFRSs. The statement of working relationship sets out a range of activities that should be undertaken to facilitate the adoption and use of IFRS.

Process of IFRS Standard Setting

The IASB has a formal due process which is set out in the *Preface to IFRS*, and *The Due Process Handbook of the IASB*. At a minimum, a proposed standard should be exposed for comment, and these comments should be reviewed before issuance of a final standard, with debates open to the public. However, this formal process is rounded out in practice, with wider consultation taking place on an informal basis.

The IASB's agenda is determined in various ways. Suggestions are made by the Trustees, the IFRS Advisory Council, liaison standard setters, the international audit firms and others. These are debated by IASB and tentative conclusions are discussed with the various consultative bodies. The IASB also has a joint agenda committee with the FASB. Long-range projects are first put on the research agenda, which means that preliminary work is being done on collecting information about the problem and potential solutions. Projects can also arrive on the current agenda outside that route.

The agenda was largely driven in the years immediately after 2001 by the need to round out the legacy standards, to ensure that there would be a full range of standards for European companies moving to IFRS in 2005. Also, it was recognized that there was an urgent need to effect modifications to many standards in the name of convergence (e.g., acquisition accounting and goodwill) and to make needed improvements to other existing standards. These needs were largely met by mid-2004.

Once a project reaches the current agenda, the formal process is that the staff (a group of about 20 technical staff permanently employed by the IASB) drafts papers which are then discussed by IASB in open meetings. Following that debate, the staff rewrites the paper, or writes a new paper which is then debated at a subsequent meeting. In theory there is an internal process where the staff proposes solutions, and IASB either accepts or rejects them. In practice the process is more involved: sometimes (especially for projects such as financial instruments) individual Board members are delegated special responsibility for the project, and they discuss the problems regularly with the relevant staff, helping to build the papers that come to the Board. Equally, Board members may write or speak directly to the staff outside of the formal meeting process to indicate concerns about one thing or another.

The due process comprises six stages: (1) setting the agenda; (2) planning the project; (3) developing and publishing the discussion paper; (4) developing and publishing the Exposure Draft; (5) developing and publishing the standard and (6) the stages after the standard is issued. The process also includes discussion of Staff Papers outlining the principal issues and analysis of comments received on Discussion Papers and Exposure Drafts. Final draft standards are sometimes provided to certain individuals or entities for final comments before the final ballot.

Final ballots on the standard are carried out in secret, but otherwise the process is quite open, with outsiders able to consult project summaries on the IASB Web site and attend Board meetings if they wish. Of course, the informal exchanges between staff and Board on a day-to-day basis are not visible to the public, nor are the meetings where IASB takes strategic and administrative decisions.

The basic due process can be modified in different circumstances. The Board may decide not to issue Discussion Papers or to reissue Discussion Papers and Exposure Drafts.

The IASB also has regular public meetings with the Analyst Representative Group (ARG) and the Global Preparers Forum (GPF), among others. Special groups such as the Financial Crisis Advisory Group are set up from time to time. Formal working groups are established for certain major projects to provide additional practical input and expertise. Apart from these formal consultative processes, IASB also carries out field trials of some standards (as it recently did on performance reporting and insurance), where volunteer preparers apply the proposed new standards. The IASB may also hold some form of public consultation during the process, such as round table discussions. The IASB engages closely with stakeholders around the world such as investors, analysts, regulators, business leaders, accounting standard setters, and the accountancy profession.

Constraints

The debate within IASB demonstrates the existence of certain pervasive constraints that will influence the decisions taken by it. A prime concern has, heretofore, been achieving *convergence*. In October 2002, the IASB signed an agreement with the FASB (the Norwalk Agreement) stating that the two boards would seek to remove differences and converge on high-quality standards. This agreement set in motion short-term adjustments and both standard setters subsequently issued a number of Exposure Drafts and final standards changing their respective standards in order to converge with the other on certain issues. The agreement also involved a commitment to the long-term development of joint projects (business combinations, performance reporting, revenue recognition, etc.).

The desire for convergence was driven to a great extent by the perception that international investment is made riskier by the use of multiple reporting frameworks, and that the global capital market would benefit from the imposition of a single global reporting basis—but also specifically by the knowledge that European companies that wished to be listed in

the US needed to provide reconciliations of their equity and earnings to US GAAP when they did this. Foreign companies registered with the SEC are required to prepare an annual filing on Form 20-F that, until late 2007—unless the reporting entity prepared its financial statements under US GAAP—required a reconciliation between the entity's IFRS or national GAAP and US GAAP for earnings and equity. This reconciliation was said to be costly to prepare, and resulted in companies reporting, in effect, two different operating results for the year, which was not always understood or appreciated by the capital markets. As of year-end 2007, this requirement was eliminated, provided that the foreign private issuers (i.e., SEC registrants) complied fully with IFRS. Note that IFRS as adopted by the European Union contains departures from IFRS as promulgated by the IASB, and thus reconciliation has not been (thus far, at least) waived.

A major concern for financial reporting is that of *consistency*, but this is a complex matter, since IASB has something of a hierarchy of consistency. As a paramount consideration, IASB would want a new standard to be consistent with its *Conceptual Framework* (currently under development, and discussed below). Thereafter, there may be conflicts both between being consistent with US GAAP and being consistent with preexisting IFRS. However, there is little or no desire to maintain consistency with standards marked for extinction or in clear need of major revision. For example, IASB believes that a number of extant standards are inconsistent with the *Framework* (e.g., IAS 20 on government grants), and need to be changed, or are ineffective or obsolete (e.g., IAS 17 on leases), so there is little purpose in seeking to make a new standard consistent with them. Equally, since it aims to converge with US GAAP, it seems illogical to adopt a solution that is deliberately at variance with US GAAP, which will then have to be reconsidered as part of the convergence program. (Note that the convergence effort is expected, at least in the near term, to continue, notwithstanding the elimination of the SEC's reconciliation requirement and the prospective replacement of US GAAP for public company financial reporting by IFRS. Both parties continue to work on projects having completion dates no later than mid-2011.)

Those members of IASB who have worked in North America are concerned that standards avoid creating abuse opportunities. Experience has sadly shown that there may well be attempts by preparers to evade the intended result of accounting standards, using so-called "financial engineering," in order to be able to achieve the earnings or presentations in the statement of financial position that are desired, particularly in the short term (e.g., quarterly earnings). This concern is sometimes manifested as a desire to impose uniform and inflexible standards, allowing few or no exceptions. There is a justifiable perception that many standards become very complicated because they contain too many exceptions to a simple and basic rule (for example: eliminate complex lease accounting requirements and simply report the property rights and debt obligations implicit in all lease arrangements).

IASB also manifests some concerns about the practicality of the solutions it mandates. While some preparers might think that it is not sympathetic enough in this regard, it actually has limited the extent to which it requires restatements of previous years' reported results when the rules change, particularly in IFRS 1, *First-Time Adoption*. The *Framework* does include a cost/benefit constraint—that the costs of the financial reporting should not be greater than the benefits to be gained from the information—which is often invoked during debates over proposed standards, although IASB considers that preparers are not the best ones to measure the benefits of disclosure.

There is also a procedural constraint that IASB has to manage, which is the relationship between the Exposure Draft and the final standard. IASB's due process requires that there should be nothing introduced in the final standard that was not exposed at the Exposure Draft stage, as otherwise there must be reexposure of the material. This means that where there are several solutions possible, or where a line can be drawn in several places, IASB may tend

towards the most extreme position in the Exposure Draft, so as not to narrow its choices when further deliberating the proposal in the light of constituents' comments.

Conceptual Framework for Financial Reporting

The IASB inherited the IASC's *Framework for the Preparation and Presentation of Financial Statements* (the *Framework*). Like the other current conceptual frameworks among Anglo-Saxon standard setters, this derives from the US conceptual framework, or at least those parts of it completed in the 1970s. The *Framework* states that "the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions." The information needs of investors are deemed to be of paramount concern, but if financial statements meet their needs, other users' needs would generally also be satisfied.

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

The qualitative characteristics of financial statements are understandability, relevance, reliability and comparability. Reliability comprises representational faithfulness, substance over form, completeness, neutrality and prudence. It suggests that these are subject to a cost/benefit constraint and that in practice there will often be a trade-off between characteristics. The *Framework* does not specifically include a "true and fair" requirement, but says that application of the specified qualitative characteristics should result in statements that present fairly or are true and fair. IAS 1, *Presentation of Financial Statements*, as revised in 2007, states that financial statements are "a structured representation of the financial position and financial performance of an entity…(whose) objective…is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions." It further states that "fair presentation requires faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria…set out in the *Framework*….The application of IFRS, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation."

Of great importance are the definitions of assets and liabilities. According to IASB, "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." 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 future benefits." Equity is simply a residual arrived at by deducting the liabilities from assets. Neither an asset nor a liability is recognized in the financial statements unless it has a cost or value that can be measured reliably—which, as the *Framework* acknowledges, means that some assets and liabilities may, of necessity, go unrecognized.

The asset and liability definitions have, in the past, not been central to financial reporting standards, many of which were instead guided by a "performance" view of the financial statements. For example, IAS 20 on government grants has been severely criticized and targeted for either revision or elimination, in part because it allows government grants to be treated as a deferred credit and amortized to earnings, while a deferred credit does not meet the *Framework* definition of a liability. Similarly, IFRS 3 requires that where a bargain purchase is identified in a business combination, a gain on a bargain purchase (commonly referred to as negative goodwill) should be released to profit or loss immediately, in contrast to

practice under IAS 22 which treated it as a deferred credit—an account that, however, did not actually meet the defined criteria for recognition as a liability.

Accounting standards are now largely driven by statement of financial position considerations. Both FASB and IASB now intend to analyze solutions to reporting issues in terms of whether they cause any changes in assets or liabilities. The revenue recognition project that both bodies are pursuing is perhaps the ultimate example of this new and rigorous perspective. This project has tentatively embraced the view that where an entity receives an order and has a legally enforceable contract to supply goods or services, the entity has both an asset (the right to receive future revenue) and a liability (the obligation to fulfill the order) and it follows that, depending upon the measurement of the asset and the liability, some earnings could be recognized at that point. This would be a sharp departure from existing GAAP, under which executory contracts (i.e., contracts upon which neither party has yet performed) are almost never formally recognized, and never create earnings.

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

Conceptual Framework Project

FASB and IASB have been, since 2005, revisiting their respective conceptual frameworks, the objective of which is to build on them by refining and updating them and developing them into a common framework that both can use in developing accounting standards. With concurrent IASB and FASB deliberations and a single integrated staff team, this is truly an international project. IASB believes that it has made good progress on the first phase of the project. Most of the debate for the first year or so focused on the objectives of financial reporting and the qualitative characteristics of decision-useful financial reporting information, and a joint Discussion Paper on these matters was issued in late 2006. This was followed, in May 2008, by Exposure Drafts of the first two (of eight) chapters for the proposed new conceptual framework (Phase A Exposure Draft). The first two chapters deal with, respectively, the objective of financial reporting and the qualitative characteristics of decision-useful financial reporting information. The final chapters on phase A of the conceptual framework project is expected before the end of 2010.

Regarding the objective of financial reporting, the Phase A Exposure Draft proposes the following definition:

> *The objective of general-purpose financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers. Capital providers are the primary users of financial reporting. To accomplish the objective, financial reports should communicate information about an entity's economic resources, claims on those resources, and the transactions and other events and circumstances that change them. The degree to which that financial information is useful will depend on its qualitative characteristics.*

As with the existing FASB Conceptual Framework, this definition of the objective for financial reporting has a wider scope than financial statements, *per se*. It actually sets forth

the objective of financial reporting in general, including a range of possible narrative and other presentations that would accompany and amplify the financial statements.

Financial reporting is aimed primarily at capital providers. That does not mean that others, such as management, will not find financial reports useful, but rather that, in deciding on the principles for recognition, measurement, presentation, and disclosure, the information needs of capital providers are to be given paramount consideration.

The draft holds that *decision usefulness* to capital providers is the overriding purpose of financial reporting. Providing information about *management stewardship* of the assets entrusted to it is an important part of that objective. The 2010 Exposure Draft on the Reporting Entity confirms the importance of management commentary and proposed the following objective of financial reporting that incorporates management stewardship:

> *The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful in making decisions about providing resources to the entity and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided.*

The language of the Phase A Exposure Draft cites *present and potential* investors as its means of acknowledging that general purpose financial reports are used both for future investment decisions as well as assessing the stewardship of resources already committed to the entity.

The draft identifies equity investors, lenders and other creditors (including suppliers, employees and customers) as *capital providers*, which are those whose information needs are to be met through general purpose financial reports. Governments, their agencies, regulatory bodies, and members of the public are identified as groups that may find the information in general purpose financial reports useful, but these are not defined as being primary users.

The Phase A Exposure Draft continues with the current philosophy that financial reporting should provide information that enables capital providers to assess the entity's ability to generate net cash inflows, coupled with an ability to assess management's ability to protect and enhance the capital providers' investments.

The *stewardship responsibilities of management* are addressed explicitly by the draft document, which notes that management "is accountable to the entity's capital providers for the custody and safekeeping of the entity's economic resources and for their efficient and profitable use" and that the entity complies with applicable laws, regulations and contractual requirements. The ability of management to discharge these responsibilities effectively has an obvious impact on the entity's ability to generate future net cash inflows, suggesting that potential investors are also assessing management performance as they make their investment decisions.

IASB and FASB both note that users of financial reports should be aware of the limitations of the information included in financial reports—specifically because the information is heavily based on estimates, rather than exact measures, and thus involve the application of judgment. Also, users are cautioned to recognize that financial reports are only one source, of potentially many, of information needed by those making investment, credit and similar resource allocation decisions. Thus, other sources of relevant information must also be consulted, for insights about general economic conditions, political events and industry outlooks, among possibly many other topics.

The draft holds that information about the effects of transactions and other events that change assets and liabilities is also essential. Financial reporting must also include management's explanations (an example being the *management discussion and analysis* required under SEC filings in the US), since management knows more about the entity than could any

external users. Such explanations, properly constructed and communicated, should provide insight into significant estimates and assumptions used by management.

Chapter two of the proposed new conceptual framework document, which has also been exposed for comment, addresses the qualitative characteristics and constraints of decision-useful financial reporting information. IASB and FASB have refined the approach first seen in the earlier (2006) Discussion Paper, such that there are now two fundamental qualitative characteristics:

- Relevance, and
- Faithful representation.

In addition, there are certain characteristics that are said to enhance the decision-usefulness of financial information. These are complementary to the fundamental qualitative characteristics and are: comparability (including consistency), verifiability, timeliness and understandability. These are defined as follows by the Exposure Draft:

> **Relevant** information is that which has predictive value, confirmatory value or both; in other words it is capable of influencing the decisions of capital providers. The users do not need to use such information, but merely have to be given access to it.
>
> **Faithful representation** implies that decision-useful financial information represents faithfully the economic phenomenon (those affecting financial position and results of operations) that it purports to represent.
>
> The enhancing qualitative characteristics are said to help users to distinguish more useful information from less useful information.
>
> **Timeliness** means that the information is provided when it is still highly useful for decision-making purposes.
>
> **Comparability** refers to the ability to identify similarities in—and differences between—two sets of economic phenomena. It is not to be confused with uniformity, which still does not exist under either US GAAP or IFRS (although the range of alternatives has narrowed over recent decades). *Consistency* (the use of the same accounting policies and procedures within an entity from period to period, or in a single period across entities) aids comparability.
>
> **Verifiability** helps to assure users that information represents faithfully the economic phenomena that it purports to represent. It implies that knowledgeable and independent observers could reach a general consensus (but not necessarily absolute agreement) that the information does represent faithfully the economic phenomena it purports to represent without material error or bias, or that an appropriate recognition or measurement method has been applied without material error or bias. It means that independent observations would yield essentially the same measure or conclusions.
>
> **Understandability** enables users who have a reasonable knowledge of business and economic and financial activities and financial reporting, and who apply reasonable diligence to comprehend the information, to gain insights into the reporting entity's financial position and results of operations, as intended. Understandability is enhanced when the information is classified, characterized and presented clearly and concisely. The draft asserts that relevant information should not be excluded solely because it may be too complex or difficult for some users to understand.

The Basis for Conclusions accompanying the Phase A Exposure Draft lists additional candidate attributes that were considered by the Boards, but not included in the proposals. These include *transparency* (which was concluded was subsumed within faithful representation and understandability); *true and fair view* (deemed to be equivalent to faithful representation); *credibility* (which is implied by verifiability); and *high quality* (which generally is achieved by adherence to the objective and qualitative characteristics of financial reporting). One other candidate, *internal consistency*, was rejected because IASB and FASB concluded that this, while desirable and a goal of both bodies, could impede the evolution of financial reporting standards.

Two pervasive constraints may also limit the information provided in useful financial reports:

- Materiality, and
- Cost

Regarding *materiality*, which has long been invoked but often not defined in terms precise enough for users and preparers, information is to be deemed material if its omission or misstatement could influence the decisions that users make on the basis of an entity's financial information. Materiality is not a matter to be considered by standard-setters but by preparers and their auditors. That is, financial reporting requirements will be promulgated without regard to materiality criteria, but actual adherence to such rules may be omitted when the effect of doing so would not be material to the users.

As concerns the *cost-benefit* criterion, it has been stated that the benefits of providing financial reporting information should justify the costs of providing that information. Presumably this will constrain the imposition of certain new requirements, although this is a relative concept, and as information technology continues to evolve and the cost of preparing and distributing financial and other information declines, this constraint conceivably will be relaxed as well.

The Reporting Entity Exposure Draft describes a reporting entity as follows:

> *A reporting entity is a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether management and the governing board of that entity have made efficient and effective use of the resources provided.*

The Reporting Entity Exposure Draft clarifies that the existence of a legal entity is neither necessary nor sufficient to identify a reporting entity. Further, a reporting entity can include more than one entity or it can be a portion of a single entity.

This Exposure Draft confirms that if an entity controls one or more entities, it should present consolidated financial statements. An entity controls another entity when it has the power to direct the activities of that other entity to generate benefits for (or limit losses to) itself. However, if one entity has *significant influence* over another entity, it specifically does not control that other entity. "Parent-only" financial statements may be presented provided they are presented with consolidated financial statements. Combined financial statements may be prepared for commonly controlled entities in a group. The final chapter on the reporting entity is expected before the end of 2010.

Discussion has since moved on to the elements of financial statements recognition and measurement principles. The elements and recognition phase will revise and clarify the definition of assets and liabilities, resolve differences regarding other elements and their definitions and revise the recognition criteria. The time for issuing any documents regarding this phase is not set.

The objective of the measurement phase is to provide guidance to select measurement bases that satisfy the objectives and qualitative characteristics of financial reporting. A mixed measurement basis will still be applied in IFRS. A Discussion Paper is expected in the first quarter of 2011.

Other components of the conceptual framework project will address presentation, and disclosure, purpose and status, and application to not-for-profit entities, but the timing for most of these is still uncertain.

Hierarchy of Standards

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

1. IAS/IFRS and SIC/IFRIC Interpretations, when these specifically apply to a transaction or condition.
2. In the absence of such a directly applicable standard, judgment is to be used to develop and apply an accounting policy that conforms to the definitions, recognition criteria, and measurement concepts for assets, liabilities, income, and expense set forth in the *Framework*.
3. If this is not possible, the preparer should then look to recent pronouncements of other standard setters which use a similar conceptual framework to develop its standards, as well as other accounting literature and industry practices that do not conflict with guidance in the IFRS dealing with the same and similar circumstances or with the definitions set forth in the *Framework*.

In effect, therefore, if existing IFRS do not address an accounting issue, the preparer should consider guidance in analogous national GAAP. In the authors' view, the most obvious choice is US GAAP, partly because that is the most complete set of standards, and partly because in the global capital market, US GAAP is the alternative best understood and most widely applied (after IFRS itself). In any event, given the professed intention of IFRS and US GAAP to converge, it would make little sense to seek guidance in any other set of standards, unless US GAAP was also silent on the matter needing clarification. Users should be cautious in relying on any standards not part of IFRS, however.

The IASB and Financial Reporting in the US

Although IASC and FASB were created almost contemporaneously, FASB largely ignored IASB until the 1990s. It was only then that FASB became interested in IASC, when IASC was beginning to work with IOSCO, a body in which the SEC has always had a powerful voice. In effect, both the SEC and FASB were starting to consider the international financial reporting area, and IASC was also starting to take initiatives to encourage standard setters to meet together occasionally to debate technical issues of common interest.

IOSCO's efforts to create a single passport for secondary listings, and IASC's role as its standard setter, while intended to operate worldwide, would have the greatest practical significance for foreign issuers in terms of the US market. It was understood that if the SEC were to accept IFRS in place of US GAAP, there would be no need for a Form 20-F reconciliation, and access to the US capital markets by foreign registrants would be greatly facilitated. The SEC has therefore been a key factor in the later evolution of IASC. It encouraged IASC to build a relationship with IOSCO in 1987, and also observed that too many options for diverse accounting were available under IAS. SEC suggested that it would be more favorably inclined to consider acceptance of IAS (now IFRS) if some or all of these alternatives were reduced. Shortly after IASC restarted its IOSCO work in 1995, the SEC issued a statement (April 1996) to the effect that, to be acceptable, IFRS would need to satisfy the following three criteria:

1. It would need to establish a core set of standards that constituted a comprehensive basis of accounting;
2. The standards would need to be of high quality, and would enable investors to analyze performance meaningfully both across time periods and among different companies; and
3. The standards would have to be rigorously interpreted and applied, as otherwise comparability and transparency could not be achieved.

IASC's plan was predicated on its completion of a core set of standards, which would then be handed over to IOSCO, which in turn would ask its members for an evaluation, after which IOSCO would issue its verdict as to acceptability. It was against this backdrop that the SEC issued a "concept release" in 2000, that solicited comments regarding the acceptability of the core set of standards, and whether there appeared to be a sufficiently robust compliance and enforcement mechanism to ensure that standards were consistently and rigorously applied by preparers, whether auditors would ensure this, and whether stock exchange regulators would verify such compliance.

This last-named element remains beyond the control of IASB, and is within the domain of national compliance bodies or professional organizations in each jurisdiction. The IASC's Standards Interpretations Committee (SIC, which was later succeeded by IFRIC) was formed to help ensure uniform interpretation, and IFRIC has taken a number of initiatives to establish liaison channels with stock exchange regulators and national interpretations bodies—but the predominant responsibilities remain in the hands of the auditors, the audit oversight bodies, and the stock exchange oversight bodies.

The SEC's stance at the time was that it genuinely wanted to see IFRS used by foreign registrants, but that it preferred convergence (so that no reconciliation would be necessary) over the acceptance of IFRS as they were in 2000 without reconciliation. In the years since, the SEC has in many public pronouncements supported convergence and, as promised, waived reconciliations in 2008 for registrants fully complying with IFRS. Thus, for example, the SEC welcomed various proposed changes to US GAAP to converge with IFRS.

Relations between FASB and IASB have grown warmer since IASB was restructured, perhaps influenced by the growing awareness that IASB would assume a commanding position in the financial reporting standard-setting domain. The FASB had joined the IASB for informal meetings as long ago as the early 1990s, culminating in the creation of the G4+1 group of Anglophone standard setters (US, UK, Canada, Australia and New Zealand, with the IASC as an observer), in which FASB was an active participant. Perhaps the most significant event was when IASB and FASB signed the Norwalk Agreement in October 2002, which set out a program for the convergence of their respective sets of financial reporting standards. The organizations' staffs have worked together on a number of vital projects, including business combinations and revenue recognition, since the Agreement was signed and, later, supplemented by the 2006 Memorandum of Understanding between these bodies. The two boards have a joint agenda committee whose aim is to harmonize the timing with which the boards discuss the same subjects. The boards are also committed to meeting twice a year in joint session.

However, certain problems remain, largely of the structural variety. FASB operates within a specific national legal framework, while IASB does not. Equally, both have what they term "inherited" GAAP (i.e., differences in approach that have a long history and are not easily resolved). FASB also has a tradition of issuing very detailed, prescriptive ("rules-based") standards that give bright line accounting (and, consequently, audit) guidance, which are intended to make compliance control easier and remove uncertainties. Notwithstanding that detailed rules had been ardently sought by preparers and auditors alike for many dec-

ades, in the post-Enron world, after it became clear that some of these highly prescriptive rules had been abused, interest turned toward developing standards that would rely more on the expression of broad financial reporting objectives, with far less detailed instruction on how to achieve them ("principles-based" standards). This was seen as being superior to the US GAAP approach, which mandated an inevitably doomed effort to prescribe responses to every conceivable fact pattern to be confronted by preparers and auditors.

This exaggerated rules-based vs. principles-based dichotomy was invoked particularly following the frauds at US-based companies WorldCom and Enron, but before some of the more prominent European frauds, such as Parmalat (Italy) and Royal Ahold (the Netherlands) came to light, which would suggest that neither the use of US GAAP nor IFRS could protect against the perpetration of financial reporting frauds if auditors were derelict in the performance of their duties or even, on rare occasions, complicit in managements frauds. As an SEC study (which had been mandated by the Sarbanes-Oxley Act of 2002) into principles-based standards later observed, use of principles alone, without detailed guidance, reduces comparability. The litigious environment in the US also makes companies and auditors reluctant to step into areas where judgments have to be taken in uncertain conditions. The SEC's solution: "objectives-based" standards that are both soundly based on principles and inclusive of practical guidance.

Events in the mid- to late-2000s have served to accelerate the pressure for full convergence between US GAAP and IFRS. In fact, the US SEC's decision in late 2007 to waive reconciliation requirements for foreign registrants complying with "full IFRS" was a clear indicator that the outright adoption of IFRS in the US is on the horizon, and that the convergence process may be made essentially redundant if not actually irrelevant. The SEC has since granted qualifying US registrants (major players in industry segments, the majority of whose world-wide participants already report under IFRS) the limited right to begin reporting under IFRS in 2009, after which (in 2011) it has indicated it will determine the future path toward the supercession of US GAAP by IFRS.

In late 2008, the SEC proposed its so-called "roadmap" for a phased-in IFRS adoption, setting forth four milestones that, if met, could lead to wide-scale adoption beginning in 2014. Under the new leadership, which assumed office in 2009, the SEC may act with less urgency on this issue, and achievement of the "milestones"—which include a number of subjective measures such as improvement in standards and level of IFRS training and awareness among US accountants and auditors—leaves room for later balking at making the final commitment to IFRS. Notwithstanding these possible impediments to progress, the authors believe that there is an inexorable move toward universal adoption of IFRS, and that the leading academic and public accounting (auditing) organizations must, and will, take the necessary steps to ensure that this can move forward. For example, in the US the principal organization of academicians is actively working on standards for IFRS-based accounting curricula, and the main organization representing independent accountants is producing Web-based materials and live conferences to educate practitioners about IFRS matters.

While the anticipated further actions by the US SEC will only directly promote or require IFRS adoption by multinational and other larger, publicly held business entities, and later by even small, publicly held companies, in the longer run, even medium- and smaller-sized entities will probably opt for IFRS-based financial reporting. There are several reasons to predict this "trickle down" effect. First, because some involvement in international trade is increasingly a characteristic of all business operations, the need to communicate with customers, creditors, and potential partners or investors will serve to motivate "one language" financial reporting. Second, the notion of reporting under "second-class GAAP" rather than under the standards employed by larger competitors will eventually prove to be unappealing. And thirdly, IASB's issuance of a one-document comprehensive standard on financial re-

porting by entities having no public reporting responsibilities (IFRS for SMEs, discussed later in this chapter), coupled with formal recognition under US auditing standards that financial reporting rules established by IASB are a basis for an expression of an auditor's professional opinion may actually find enthusiastic support among smaller US reporting entities and their professional services providers, even absent immediate adoptions among publicly held companies.

In a March 2010 statement, the SEC stated that staff has been directed to develop a work plan to enhance both the understanding of the SEC's purpose and public transparency regarding the incorporation of IFRS in the US. The execution of this work plan and the completion of the projects in the MOU by 2011 will position the SEC to make a decision regarding such an incorporation of IFRS. However, if the SEC determines in 2011 to incorporate IFRS in the US, the first time that US issuers will report under IFRS is foreseen to be only in 2015 or 2016, thus extending the initial proposal to implement IFRS by 2014.

The IASB and Europe

Although France, Germany, the Netherlands and the UK were founding members of predecessor organization IASC and have remained heavily involved with IASB, the European Commission as such has generally had a fitful relationship with the international standard setter. The EC did not participate in any way until 1990, when it finally became an observer at Board meetings. It had had its own regional program of harmonization since the 1960s and in effect only officially abandoned this in 1995, when, in a policy paper, it recommended to member states that they seek to align their rules for consolidated financial statements on IFRS. Notwithstanding this, the Commission gave IASB a great boost when it announced in June 2000 that it wanted to require all listed companies throughout the EU to use IFRS beginning in 2005 as part of its initiative to build a single European financial market. This intention was made concrete with the approval of the IFRS Regulation in June 2002 by the European Council of Ministers (the supreme EU decision-making authority).

The EU decision was all the more welcome given that, to be effective in legal terms, IFRS have to be enshrined in EU statute law, creating a situation where the EU is in effect ratifying as laws the set of rules created by a small, self-appointed, private-sector body. This proved to be a delicate situation, which was revealed within a very short time to contain the seeds of unending disagreements, as politicians were being asked in effect to endorse something over which they had no control. They were soon being lobbied by corporate interests that had failed to effectively influence IASB directly, in order to achieve their objectives, which in some cases involved continued lack of transparency regarding certain types of transactions or economic effects, such as fair value changes affecting holding of financial instruments. The process of obtaining EU endorsement of IFRS was at the cost of exposing IASB to political pressures in much the same way that the US FASB has at times been the target of congressional manipulations (e.g., over stock-based compensation accounting rules in the mid-1990s, the derailing of which arguably contributed to the practices that led to various backdating abuse allegations made in more recent years).

The EU created an elaborate machinery to mediate its relations with IASB. It preferred to work with another private-sector body, created for the purpose, the European Financial Reporting Advisory Group (EFRAG), as the formal conduit for EU inputs to IASB. EFRAG was formed in 2001 by a collection of European representative organizations (for details see www.efrag.org), including the European Accounting Federation (FEE) and a European employer organization (UNICE). EFRAG in turn formed the small Technical Expert Group (TEG) that does the detailed work on IASB proposals. EFRAG consults widely within the EU, and particularly with national standard setters and the European Commission to canvass