



# **IASB Structure and Framework**

Duncan Williamson

# [ IAS ... IFRS ]

- What's the difference between
  - IAS
- and
  - IFRS?

# [ A Balance Sheet Warning! ]

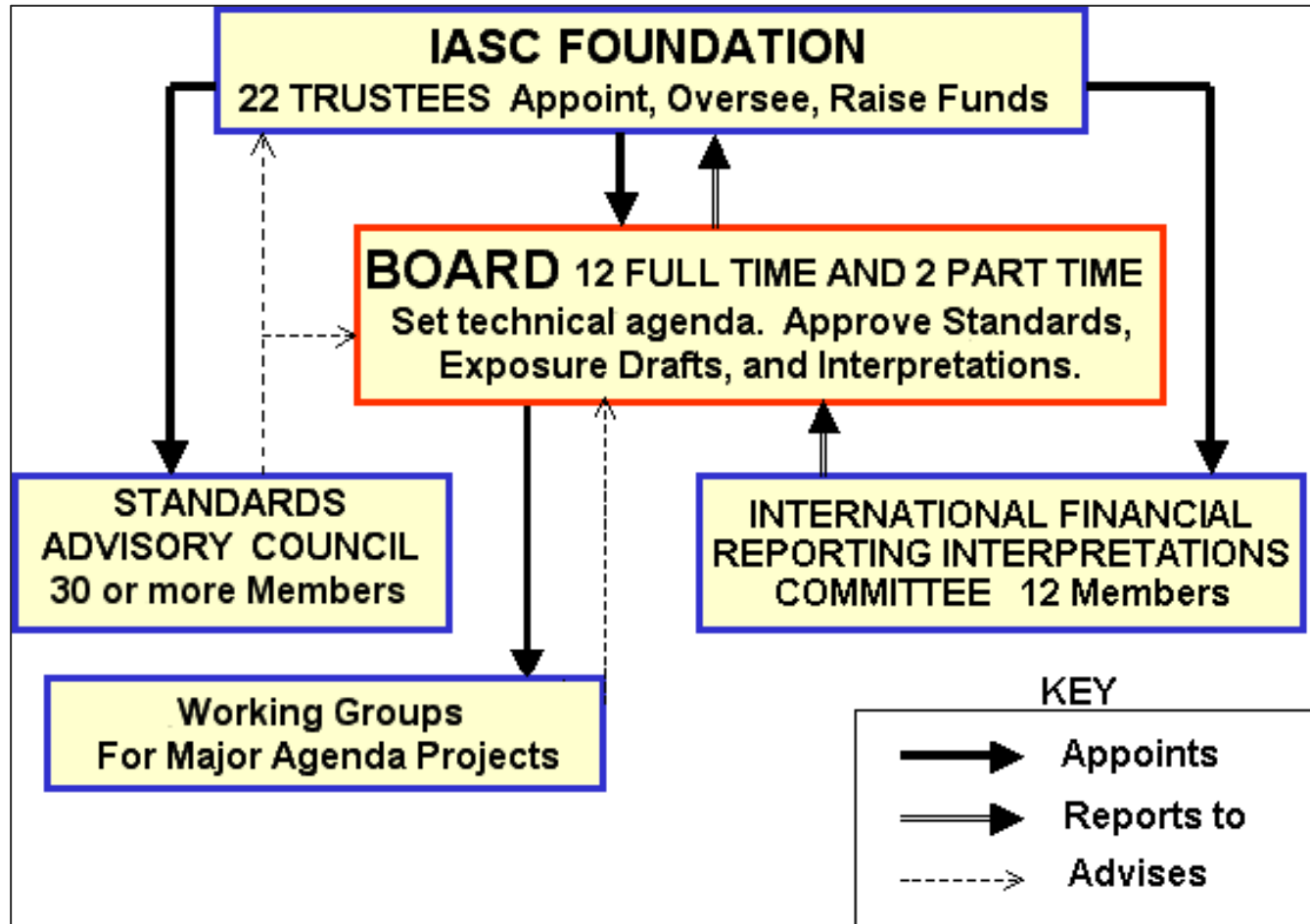
- And the cherished balance sheet, what a joke. Until now I hadn't realised to what extent it's useless. The real assets, like people's expertise, market share, reputation etc don't appear at all. And the numbers that do appear, the value of the machines, inventory and land, have only a remote resemblance to their real value.

Source: Eliyahu M Goldratt (1994) *It's Not Luck* Gower Publishers page 105

# Overview of the IASB

- **International Accounting Standards Board (IASB)**
- **IASC Foundation (IASCF)**
- **International Financial Reporting Interpretations Committee (IFRIC)**
- **Standards Advisory Council (SAC)**
- **Working Groups**

# The New IASB Structure



# Use of IFRSs in Europe 1

- **Listed companies**
- To implement a *financial reporting strategy* adopted by the European Commission in June 2000, the European Union in 2002 approved an Accounting Regulation requiring all EU listed companies (about 9,000 companies in total) to follow IFRSs in their consolidated financial statements starting in 2005.

# [ Use of IFRSs in Europe 2 ]

- **Unlisted companies**
- Member States may extend the IFRS requirement to non listed companies and to company only statements.

# Endorsement of IFRSs for Use in Europe

- ... IFRSs must be endorsed for use in Europe ...:
  - EU translates the IFRSs into all European languages;
  - the private sector European Financial Reporting Advisory Group (EFRAG) gives its views to the EC;
  - the EC's Accounting Regulatory Committee makes an endorsement recommendation; and
  - the 25 member Commission formally votes to endorse.
- By the end of 2004, the EC had voted to endorse all IASs, IFRSs 1 to 5, and all Interpretations then in existence: but with two carve outs from IAS 39.

# IASB + FASB Convergence

- In October 2002, the IASB and US Financial Accounting Standards Board embarked on a joint programme to converge US and international accounting standards to the maximum extent possible. Activities that are part of that programme include:
  - twice yearly joint meetings;
  - aligned agendas;
  - joint staffing of all major projects;
  - short term convergence projects;
  - convergence inventory of every single difference with a plan to eliminate as many as possible; and
  - coordination of the activities of their respective interpretative bodies EITF and IFRIC.

# Cash and Accruals Accounting 1

- Cash Accounting is ...
- Accruals Accounting is ...
- eg 1 Your computer installation business finishes a job on November 30, 2004, and doesn't get paid until January 10, 2005.
- Under the cash method ...
- Under the accrual method ...

# Cash and Accruals Accounting 2

- eg 2 You pay rent of \$1,200 per year for your business premises. This amount is paid in full in January each year.
- Using the cash method accounting ...
- Under the accrual method ...

# Cash and Accruals Accounting 3

- Determining the Transaction Date
- With the accrual method, sometimes it's not so easy to know when the sale or purchase has occurred. The key date here is the job completion date.
- Not until you finish a service, or deliver all the goods a contract calls for, do you put the income down in your books.
- Likewise, you don't record an item as an expense until the service is completed or all goods have been received and installed, if necessary.

# Benefits of Accruals Accounting 1

- better measurement of costs and revenues, including comparisons between years
- greater focus on outputs rather than inputs
- more efficient and effective use of resources, eg, through charges for fixed assets
- full cost of providing a service can be compared with outside suppliers

# Benefits of Accruals Accounting 2

- a better indication of the sustainability of government policy
- improved accountability
- better financial management and
- greater comparability of management performance results.

# [ The IASB Framework ]

- ... for the preparation and presentation of financial statements
- Purpose and Status of the Framework: it's not a Standard and describes the basic concepts by which financial statements are prepared. However ...

# IAS 8.10

- In the absence of a Standard or an Interpretation that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:
  - (a) relevant to the economic decision making needs of users; and
  - (b) reliable, in that the financial statements:
    - (i) represent faithfully the financial position, financial performance and cash flows of the entity;
    - (ii) reflect the economic **substance** of transactions, other events and conditions, and not merely the legal **form**;
    - (iii) are neutral, ie free from bias;
    - (iv) are prudent; and
    - (v) are complete in all material respects.

# IAS 8.11

- In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources 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.

# The IASB Framework

- Defines the objective of financial statements;
- Identifies the qualitative characteristics that make information in financial statements useful; and
- Defines the basic elements of financial statements and the concepts for recognising and measuring them in financial statements.  
[F.1]

# General Purpose Financial Statements

- ... prepares and presents at least annually to meet the common information needs of a wide range of users external to the enterprise
- **QUESTION:** Who are these users and what are their needs?

# [ Users and their Information Needs ]

- Investors
- Employees
- Lenders
- Suppliers and other trade creditors
- Customers
- Governments and their agencies
- Public [F.9]

# Responsibility for Financial Statements

- **QUESTION:** who has the primary responsibility for preparing and presenting the enterprise's financial statements? [F.11]

# The Objective of Financial Statements

- ... is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions.
- ... meet the common needs of most users. However... do not provide all the information that users may need ... because they are historic
- ... also show the results of the **stewardship** of management, or the **accountability of management** for the resources entrusted to it ... [F.12-14]



# Financial Position ...

## Balance Sheet

- ■ The financial **position** of an enterprise is affected by the economic resources it controls, its **financial structure**, its **liquidity and solvency**, and its capacity to adapt to changes in the environment in which it operates.
- Information about an enterprise's financial history is useful in predicting its future. [F.16+19]

# Performance

- Performance is the ability of an enterprise to earn a **profit** on the resources that have been invested in it. History may help to predict future **cash flows** [F.17]
- ... information about performance is primarily provided in an income statement [ a **period** statement]. [F.19]

# Changes in Financial Position

- Users of financial statements seek information about investing, financing and operating activities ... helps in assessing how well the enterprise is able to generate and use **cash** and **cash equivalents** ...  
→ [F.18]
- The cash flow statement provides this kind of information and **IAS 1** adds a fourth basic financial statement, the statement showing changes in equity.

# Notes and Supplementary Schedules

- The financial statements also contain notes and supplementary schedules and other information that
  - (a) explains items in the balance sheet and income statement,
  - (b) discloses the risks and uncertainties affecting the enterprise, and
  - (c) explains any resources and obligations not recognised in the balance sheet. [F.21]

# Let's Look at Some Statements

**Deloitte.**

**IAS PLUS**

International Financial  
Reporting Standards

Model financial statements

**Page 1**

# [ Underlying Assumptions ]

- Let's define these vital terms

- **Accrual Basis ... [F.22]**

- ■ **Going Concern ... [F.23]**

- Why are these assumptions so important?

# Qualitative Characteristics of Financial Statements

- These characteristics are the attributes that make the information in financial statements useful to investors, creditors, and others. The Framework identifies four principal qualitative characteristics: [F.24]
  - Understandability
  - Relevance
  - Reliability
  - Comparability

# [ Understandability ]

- Information should be presented in a way that is readily understandable ***by users who have a reasonable knowledge of business and economic activities and accounting*** and who are willing to study the information diligently. [F.25]

# [ Relevance 1 ]

- Information in financial statements is relevant when it influences the economic decisions of users. It can do that both by
- (a) helping them evaluate past, present, or future events relating to an enterprise and by
- (b) confirming or correcting past evaluations they have made. [F.26-28]

# [ Relevance 2 ]

- ➔ ■ **Materiality** is a component of relevance. Information is material if its omission or misstatement could influence the economic decisions of users. [F.29]
- **Timeliness** is another component of relevance. To be useful, information must be provided to users within the time period in which it is most likely to bear on their decisions. [F.43]

# [ Reliability 1 ]

- Information in financial statements is reliable if it is free from material error and bias and can be depended upon by users to represent events and transactions faithfully. Information is not reliable when it is purposely designed to influence users' decisions in a particular direction. [F.31-32]
- ➔ ■ There is sometimes a **trade off** between relevance and reliability: and judgement is required to provide the appropriate balance. [F.45]

# [ Reliability 2 ]

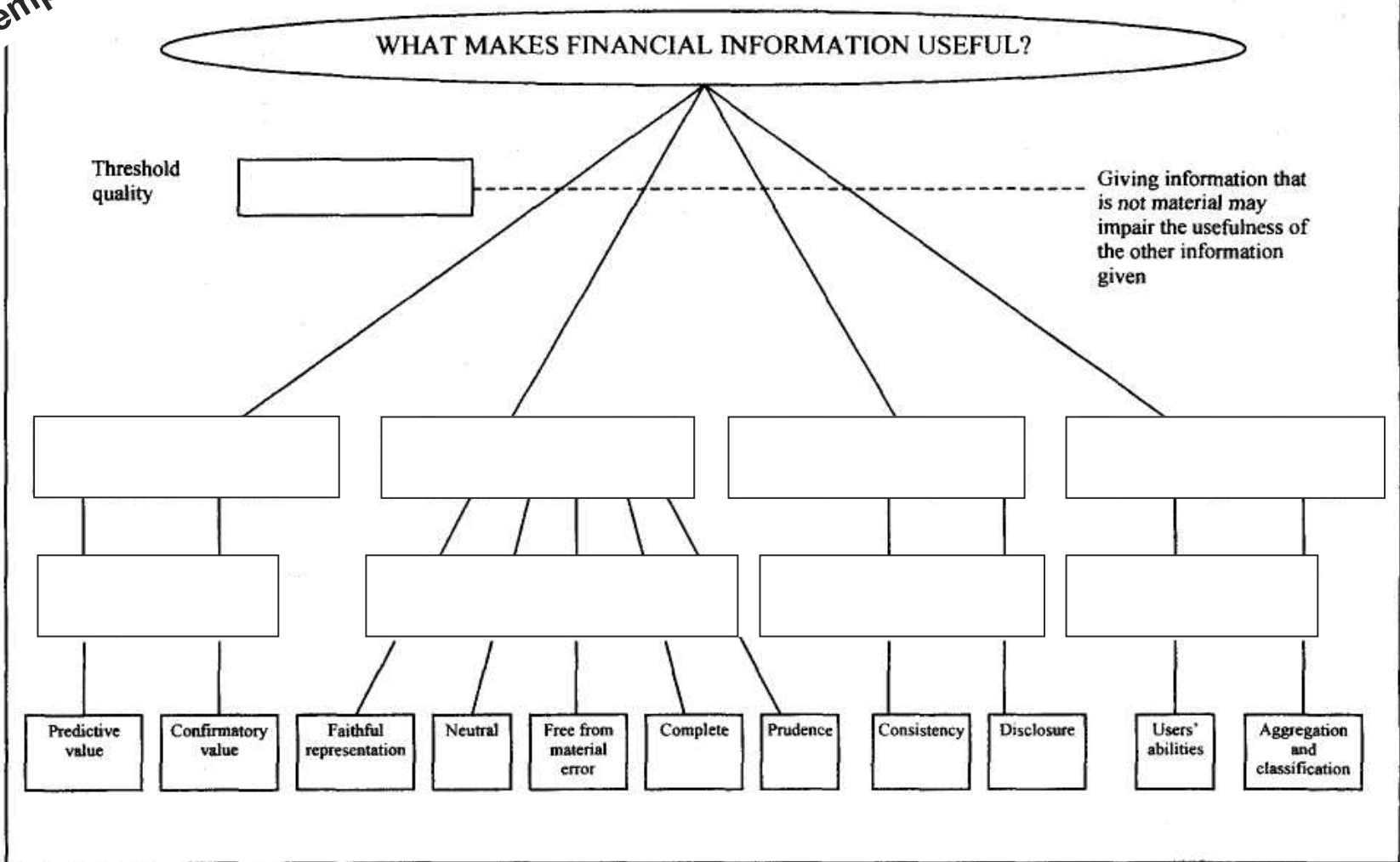
- ■ Reliability is affected by the use of **estimates** and by **uncertainties** associated with items recognised and measured in financial statements. These uncertainties are dealt with, in part, by disclosure and, in part, by exercising prudence in preparing financial statements.
- ■ **Prudence** is ... [F.36-37]

# [ Comparability ]

- Users must be able to compare the financial statements of an enterprise ***over time*** so that they can identify trends in its financial position and performance. Users must also be able to compare the financial statements of ***different enterprises***. Disclosure of accounting policies is essential for comparability. [F.39-42]

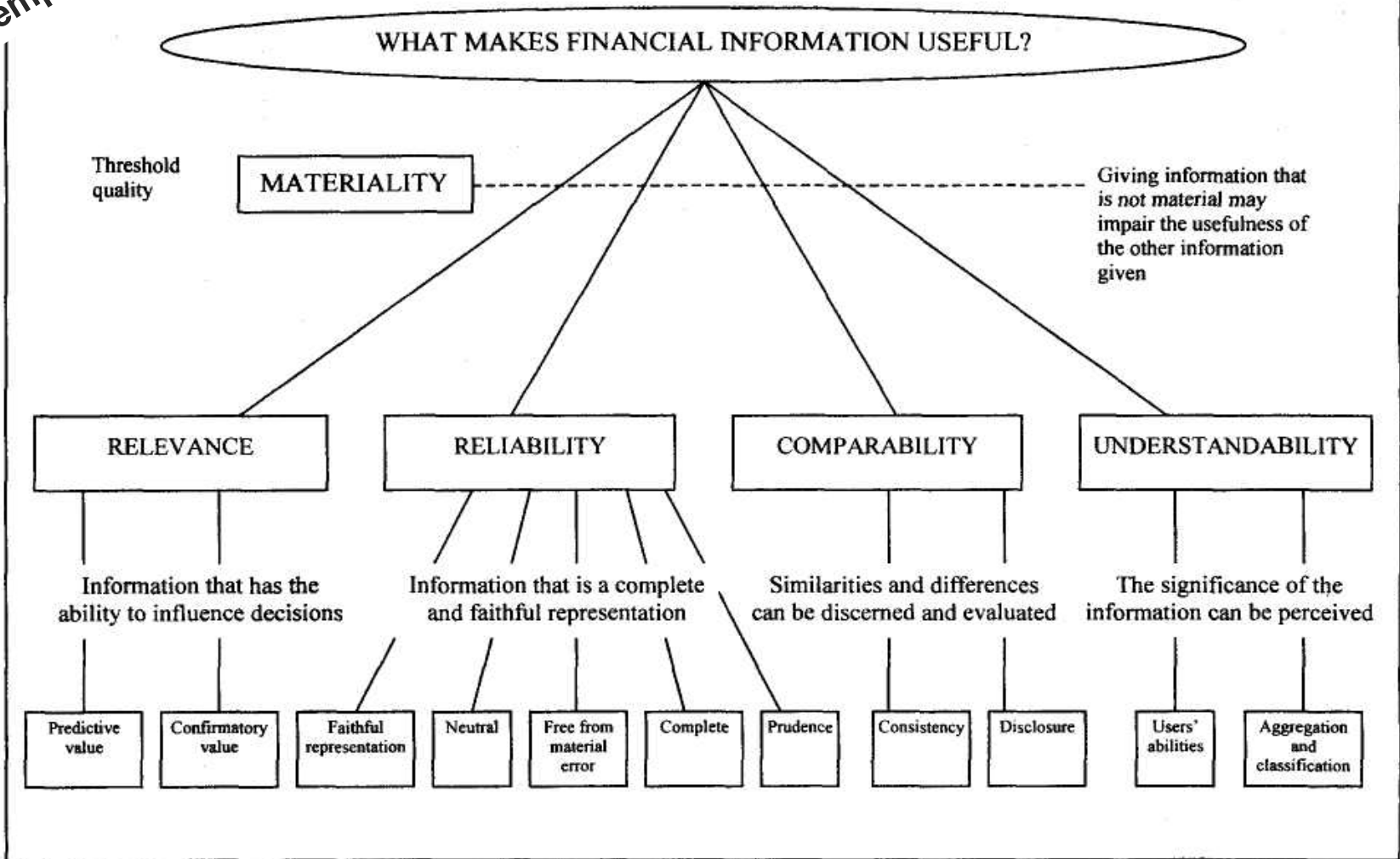
Fill in the empty boxes

## THE QUALITATIVE CHARACTERISTICS OF FINANCIAL INFORMATION



Fill in the empty boxes

## THE QUALITATIVE CHARACTERISTICS OF FINANCIAL INFORMATION



# Assessing the Characteristics

- **QUESTION:** do the Deloitte Model Financial Statements comply with the four Qualitative Characteristics?
- Say why or why not ... give examples whether yes or no!

# The Elements of Financial Statements 1

- Financial statements portray the financial effects of transactions and other events by grouping them into broad classes according to their economic characteristics. These broad classes are termed the elements of financial statements. The elements directly related to financial position (balance sheet) are: [F.49]

- ...

- ...

- ...

## QUESTION:

What are these three elements?

# The Elements of Financial Statements 2

- The elements directly related to performance (income statement) are: [F.70]
  - ...
  - ...
- ... **QUESTION:**
- ... What are these two elements?
- The cash flow statement reflects both income statement elements and changes in balance sheet elements. [F.47]

# Definitions of the elements relating to financial position 1

- Let's define these terms:
  - **Asset** ... [F.49(a)]
  - **Liability** ... [F.49(b)]
  - **Equity** ... [F.49(c)]

# Definitions of the elements relating to financial position 2

- **Asset.** An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise. [F.49(a)]
- **Liability.** A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits. [F.49(b)]
- **Equity.** Equity is the residual interest in the assets of the enterprise after deducting all its liabilities. [F.49(c)]

# Definitions of the elements relating to performance 1

- Let's define these terms ...
- **Income** ... [F.70]
- **Expense** ... [F.70]

# Definitions of the elements relating to performance 2

- **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. [F.70]
- **Expense.** 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. [F.70]

# Recognition of the Elements of Financial Statements 1

- We will be looking at this in more detail when we consider IAS 18 *Revenue*
- Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the following criteria for recognition: [F.82-83]
- It is probable that any future economic benefit associated with the item will flow to or from the enterprise; and
- The item's cost or value can be measured with reliability.

# Recognition of the Elements of Financial Statements 2

- Based on these general criteria:
- **An asset** is recognised in the balance sheet when ... [F.91]
- **A liability** ... [F.91]
- **Income** is recognised in the income statement when ... [F.92]
- **Expenses** are recognised when... [F.94]

# Measurement of the Elements of Financial Statements 1

- Measurement involves assigning monetary amounts at which the elements of the financial statements are to be recognised and reported. [F.99]
- The Framework acknowledges that a variety of measurement bases are used today to different degrees and in varying combinations in financial statements, including: [F.100]
  - Historical cost
  - Current cost
  - Net realisable (settlement) value
  - Present value (discounted)

# Measurement of the Elements of Financial Statements 2

- Historical cost is the measurement basis most commonly used today, but it is usually combined with other measurement bases. The Framework does not include concepts or principles for selecting which measurement basis should be used ... [F.101]

# Measurement of the Elements of Financial Statements 3

- **Take a look** at the Model Statements and read how the company uses the Historical Cost Basis of Measurement. See page 13:

Notes to the consolidated financial statements  
for the year ended 31 December 2005

3. Significant accounting policies

# [ Reference ]

- I recognise the help I received from the materials prepared by Deloitte, Touche, Tohmatsu in preparing this presentation.