

IFRS: An Introduction (3rd ed.)

Solutions to Assignments

CHAPTER 1

1. What international organization began the movement toward international accounting standards and when and how did the United States become involved?

The establishment of the International Accounting Standards Committee (IASC) in 1973 began the movement toward international accounting standards.

The FASB in the United States first formally expressed interest in international standards when it issued a plan for a global focus on standard setting in 1991. The FASB began to collaborate with the IASC and became a founding member of the G4 + 1. The G4 + 1 was a working group consisting of standard setters in the United Kingdom, Canada, the United States, and Australia, plus the IASC.

2. What is the IASB; when was it formed; and why is its structure important?

The initiative of the G4 + 1 led eventually to formation of the IASB in 2001.

“... the SEC and the FASB were deeply involved in the establishment of the restructured IASB, and the structure, governance, and independence of the IASB are largely modeled on the FASB’s.” said by IASB chair. Because IASB doesn’t represent any particular country or interest of entities, the goal of IASB is to offer standards of financial reporting accepted by worldwide.

3. Briefly, what is the process followed by the IASB for issuing an IFRS?

IASB and staff will set an agenda of possible issues and study the worthiness of discussions. After the research, the issue will be brought for public discussion. After considering all comments from its discussion paper, exposure draft is issued to receive more comments. After all, IASB will publish a final IFRS; but IASB still continue to receive further suggestions.

4. Why is each of the following important and how does each relate to the concepts of convergence and adoption?

- a. Memorandum of Understanding (MOU) between the FASB and the IASB
- b. The SEC Roadmap

- a. MOU in 2002 laid out the joint commitment of cooperation between FASB and the IASB working toward convergence. Through it, two parties can build up and maintain the compatibility of IFRS and GAAP.
- b. The SEC Roadmap is set up for the adoption of IFRS. The Roadmap is published for public comment, leading to the adoption of IFRS by U.S. issuers. The SEC can follow the roadmap and decide whether to mandate IFRS for U.S. public companies.

5. What conditions must the IASB meet in order for adoption of IFRS by the United States in 2011? List the two conditions that will be the most difficult to accomplish.

- Sufficient development and application of standards
- Independence funding of the IFSC Foundation and the standard setting process

6. In your opinion, what are the two most important arguments in favor of allowing IFRS for U.S. public companies?

1. Enhances transparency and comparability among companies globally: IFRS enables investors and other users to more readily assess performance and to make comparisons among companies, especially in such industries as banking, insurance, motor vehicles, pharmaceuticals, and telecommunications.
2. Lowers costs: IFRS present opportunities for global U.S. companies to lower costs through standardization of financial reporting, centralization of processes, improved controls, and better cash management.
3. Improves liquidity, valuation, and cost of capital: Research appears to show that U.S. companies would benefit financially from adoption of IFRS in countries with relatively strict enforcement regimes and where the institutional environment provides incentives for more transparent earnings, as in the United States. In countries with weak enforcements and poor reporting incentives, the introduction of IFRS has no effect.
4. Provides an option now available to others: Adoption of IFRS by the SEC would give public companies the same option that foreign companies and private, nonpublic companies now have.

7. In your opinion, what are the two most important arguments against allowing IFRS for public U.S. companies?

- (1) U.S. GAAP have a longer history and is more comprehensive than IFRS. Differences between IFRS and U.S. GAAP are significant (2) Some U.S. standards that differ from IFRS may be difficult to change
- (3) IASB needs strengthening as an independent, global standard setter
- (4) Continued existence of European IFRS undermines global comparability
- (5) Significant changes to the U.S. reporting infrastructure are needed
- (6) U.S. accountants and educators need to adapt to IFRS
- (7) Elimination of U.S. GAAP for U.S. companies contradicts the general sentiment in for maintaining control in the United States.

8. Exercise: State the name of each of the organizations represented by the acronyms listed below and give a brief statement to the organization's importance to IFRS:

- | | |
|---------|----------|
| a. IASC | d. IASCF |
| b. IAS | e. IFRIC |
| c. IFAC | f. SAC |

a. IASC: International Accounting Standard Committee, IASC work with FASB to found G4+1, which is the initial formation of IASB.

b. IAS: International Accounting Standards, IAS was issued by IASC. Due to receiving many criticisms, IASC work on revise IAS in order to come out a set of core standards, which are IFRS.

c. IFAC: International Federation of Accountants. The member bodies in IASC are also the member bodies in IFAC. d. IASCF: IASC Foundation, appointing and overseeing the IASB. It's a not-for-profit, private sector body consisting of a geographically and professionally diverse group twenty-two trustees.

e. IFRIC: International Financial Reporting Interpretation Committee, issuing interpretations of IFRS when there is doubt about the appropriate accounting treatment.

f. SAC: Standards Advisory Council, which consists of a wide-range of representative from user groups, financial analysts, auditors, regulators, advises the IFRS on a broad range of issues.

9. Class or group discussion: Should the SEC require U.S. public companies to use IFRS?

Yes. The adoption of IFRS will enhance transparency and comparability among companies

globally and have lower costs, also improves liquidity, valuation, and cost of capital, and provides an option now available to others.

- 10. Case: Off-Shore Jewelry, Inc. is a relatively small, but fast-growing U.S. based private company. It designs, manufactures, and distributes fine jewelry in the United States. To reduce costs, it has manufacturing facilities in several countries including Malaysia and Mexico. Off-Shore Jewelry, Inc. also maintains relations with global banks and has considered a merger with a large jewelry company in Europe. A member of the Audit Committee of the company's board of directors has asked you, as CFO of the company, to report to board on whether the company should adopt IFRS. Develop a recommendation to the board, including reasons to support your recommendation, and discuss possible downsides.**

Figure 1–1: Structure and Oversight of the IASB

Figure 1–2: Due Process

Yes, because adoption of IFRS allows the company investors easily compare the companies with others, lower costs through standardization of financial reporting, results in improvements in liquidity, valuation and cost of capital. As a CFO, I definitely should let the company adopt the IFRS; then Off-Shore Jewelry Inc is able to expand the services in Europe.

No, because Off-Shore Jewelry Inc. is based in U.S. The company is still a private company, which doesn't need to offer the comparability and transparency for the global investors. Moreover, the company also needs to report to U.S government, instead of Europe. The adoption of IFRS will bring more cost to the company. Therefore, the adoption is not recommended.

CHAPTER 2

1. What are IFRS and how do they relate to IAS?

IASB achieves its objectives primarily by developing and publishing IFRS and promoting the use of those standards in financial statements and reporting. To aid in the development of future IAS and in the review of existing IAS, the IASB issued the *Conceptual Framework for Financial Reporting* for external users.

2. What is the objective of financial statements and what assumption underlies them?

The objective of financial statements is to provide information about the reporting entity's economic resources, claims against the reporting entity, and the effects of transactions and other events and conditions that change those resources and claims.

Accrual accounting assumes that information is most useful when the effects of transactions and other events are recognized when they occur (and not when cash or its equivalent is received or paid) and that they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.

3. Why are the qualitative characteristics important to users of financial statements?

Qualitative characteristics are the attributes that make the financial information provided in financial statements useful to users. Financial information has fundamental qualitative characteristics of relevance and faithful representation and may have the enhancing qualitative characteristics which are comparability, verifiability, timeliness and understandability that improve their usefulness. All qualitative characteristics are subject to the cost constraint.

4. What is the difference between relevance and faithful representation?

Financial information has the quality of relevance when it is capable of making a difference in the decisions made by users. In other words, relevant information influences users' economic decisions, aiding their evaluation of past, present, or future events, or confirming or correcting their past evaluations.

Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena but also faithfully represent the phenomena that it purports to represent.

A faithful representation, by itself, does not necessarily result in useful information. For example, a reporting entity may receive property, plant, and equipment through a government grant. Obviously, reporting that an entity acquired an asset at no cost would faithfully represent its cost, but that information would probably not be very useful or relevant.

5. What are the three underlying concepts of relevance and what is their nature?

Predictive value: Financial information has predictive value if users can use it to predict future outcomes. Financial information need not be a prediction or forecast to have predictive value. Users employ financial information with predictive value in making their own predictions.

Confirmative value: Financial information has confirmatory value if it confirms or changes previous evaluations.

Materiality: Information is material if its omission or misstatement could influence the user's economic decisions taken on the basis of the specific entity's financial statement. Materiality is related to both the nature of an item and its size or misstatement.

Immaterial items are not relevant to the economic decision.

Information that has predictive value often also has confirmatory value.

6. What are the three underlying concepts of faithful representation and what is their nature?

Completeness: Financial information is complete if it contains all information necessary for a user to understand what is being depicted, including all necessary descriptions and explanations.

Neutrality: To be neutral, the information contained in financial statements must be free from bias. There must be no deliberate slanting, emphasizing, deemphasizing, or misstating of information.

Free from error: Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors. Thus, free from error here does not mean perfectly accurate in all respects.

7. What is the difference between fundamental and enhancing qualitative characteristics?

Qualitative characteristics are the attributes that make the financial information provided in financial statements useful to users. To be useful, financial information must have the fundamental qualitative characteristics of relevance and faithful representation. Enhancing qualitative characteristics improve the usefulness of information that is relevant and faithfully represented. They may also help determine which of two ways should be used to depict a phenomenon if both are considered equally relevant and faithfully represented.

8. Why is comparability important to users of financial statements?

Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. Unlike the other qualitative characteristics, comparability does not relate to a single item. A comparison requires at

least two items. For instance, users may compare the financial statements of an entity through time in order to identify trends and also compare the financial statements of different entities in order to evaluate their relative financial position, performance, and changes in financial position. The use of alternative accounting methods among entities diminishes comparability.

9. Is verifiability the same as accuracy?

Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Verifiability does not imply precise measurements of the elements of financial statements. A range of possible amounts and the related probabilities can also be verified. Accuracy means the financial statements are totally free from errors.

10. What are the characteristics of understandability?

Information has the quality of understandability if users readily comprehend it. Classifying, characterizing, and presenting information clearly and concisely makes it understandable. Users are assumed to have a reasonable knowledge of business, economic activities, and accounting as well as a willingness to study the information with reasonable diligence. However, relevant information about complex matters should not be excluded merely on the grounds that it may be too difficult for certain users to understand.

11. What constraint can limit the application of qualitative characteristics to accounting information and how can this constraint be overcome?

Underlying all aspects of financial reporting is the cost constraint, which recognized that reporting financial information imposes costs. It is important that these costs are justified by the benefits derived by the users. There are the costs of providing information by entities as well as costs of confidence; there will presumably be a better functioning of capital markets and a lower cost to the economy as a whole.

12. What are assets, liabilities, and equity? Define each.

Asset: An economic resource of a company that is expected to benefit the company's future operations.

Liability: A business's present obligations to pay cash, transfer assets, or provide services to other entities in the future.

Equity: Represents the claims of the owners of a corporation to the assets of the business.

13. How does the IFRS balance sheet equation differ from the one used in the United States?

IFRS balance sheet equation: $\text{Assets} = \text{Liabilities} + \text{Equity}$

United States balance sheet equation: $\text{Assets} - \text{Liabilities} = \text{Equity}$

14. What are revenues and expenses? Define each.

Income: The 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: Decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

15. What are recognition, derecognition, and measurement? Define each and explain how they relate to each other.

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: 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.

Derecognition is the removal of a previously recognized asset or liability from an entity's statement of financial position.

Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognized and carried in the balance sheet and income statement.

So accountants have to measure value of items, and then recognize them in the financial statements. If there are no more future economic benefits made by this item, accountants need to derecognize it from the financial statements.

16. List the three sections that all proposed financial statements should contain.

All statements will be divided into three categories as follows:

Business: Includes line items related to operating and investing activities.

Financing: Includes line items related to financing activities.

Income taxes: Includes line items related to discontinued operations and equity.

17. How does the balance sheet under proposed IFRS differ from U.S. GAAP?

GAAP and IFRS have pretty similar format in balance, which IFRS named as statement of financial position. IFRS do not prescribe a format for the statement of financial position. IFRS require the separation of current and non-current assets, and current and non-current liabilities and that they be listed in order of liquidity. In contrast to U.S. practice, IFRS specifically prohibit “deferred tax assets/liabilities”.

18. What is the proposed new name for the income statement and why does it have this name?

The new name is Statement of Comprehensive Income. The boards agreed that other comprehensive income can be presented either as the last component of the income statement or as a separate statement. When using the combined statement, the title “Statement of Comprehensive Income” is appropriate.

19. How does the proposed IFRS statement of cash flows differ from the way most of these statements are prepared in the United States?

In a significant difference from U.S. GAAP, IFRS exclude non-cash investing and financing activities from the statement of cash flows. Entities disclose the relevant information related to these transactions in the notes to financial statements.

20. Class or group discussion: Is historical cost or fair value more in line with the qualitative characteristics of the conceptual framework? Why?

Fair value underlies the measurement of all items under IFRS. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable parties in an arm’s length transaction. A measure of value used in accounting in which the price of an asset on the balance sheet is based on its nominal or original cost when acquired by the company. Based on the historical-cost principle, under U.S. GAAP, most assets held on the balance sheet are to be recorded at the historical cost even if they have significantly changed in value over time. Therefore, in order to fitting into the neutrality, comparability characteristics in IFRS, Fair value is more appropriate.

21. Class or group discussion: Define the concept of cost constraint under U.S. GAAP. Does it have any role under IFRS? Give an example of how IFRS might differ in their application.

Cost constraint recognizes that reporting financial information imposes costs. It is important that these costs are justified by the benefits derived by the users. There are the costs of providing information by entities as well as costs of obtaining and analyzing information by users. IFRS puts more emphasize of a principle-based approach to financial reporting. In some cases, this may lead a less costly application than under U.S. GAAP, where a rules-based approach dominates.

22. Exercise: Match the selected sections of IASB-proposed financial statements (letters) with their respective components (numbers):

- 1) E 2) D 3) G 4) B 5) A
6) E 7) F 8) C 9) D 10) A
11) F 12) C 13) G 14) A

23. Exercise: Match the selected sections of IASB-proposed statement of comprehensive income statement (letters) with their respective components (numbers).

- 1) B 2) F 3) I 4) B 5) E
6) C 7) D 8) F 9) D 10) G
11) D 12) I 13) H 14) D 15) B
16) I 17) A

24. Exercise: Match the selected sections of IASB-proposed statement of financial position (letters) with their respective components (numbers).

- 1) D 2) F 3) A 4) C 5) E
6) A 7) C 8) A 9) G 10) H
11) A 12) B 13) G 14) C 15) B
16) G 17) C

25. Case: Assume you work for a company that has used the U.S. GAAP practice of valuing Buildings at historical cost less accumulated depreciation. Your company is considering revaluing the building annually based on fair value. Based on the concepts underlying the IFRS framework, how does fair value differ from historical cost? (Use the example of fair value presented in the text as a starting point.)

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable parties in an arm's length transaction. According to one former member of the IASB, fair values

- Are *relevant*
- Have *predictive value*

- Have *confirmative value*
- Are *faithful representations* of assets and liabilities
- Have *completeness*
- Are *neutral*
- Are *error free*
- Are *comparable*
- *Should be verifiable*
- Are *timely*
- *Are understandability*