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CONVERGENCE**

Relatore:

Chiar.mo Prof. ANDREA ANGELO AURELIO AMADUZZI

Coordinatore del Dottorato:

Chiar.mo Prof. ALBERTO NOBOLO

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Foreword

Prepared by

Francesca Rossi, IFRS Practitioner

When Matteo asked me to write this foreword I told him right there and then that usually forewords are written by people who have accomplished or published something and whose name is well known or influential.

Matteo replied that I was influential to him and said he asked me to add nothing more to our conversation: his decision had been made.

At that time we were still working together. I began writing the foreword and I was at a good stage, but after a few months I moved on to another job. I decided to take this opportunity to change what I had written and I decided to use this opportunity and space to thank him.

I am so grateful to him because he has always appreciated me and trusted me. He has made all his knowledge available to me and taught me how to work, the best professional behavior and how to deal with difficult situations. He always encouraged me to bring out the best from within myself and made me grow, both professionally and personally, truly enriching my life.

Our professional paths have split, and I already miss his exceptional enthusiasm that I witnessed every single day while working together. So I want to thank him because he made me feel appreciated, worthy of respect and trust in a very unique way.

Matteo is a force of nature that puts passion in everything he does and makes you wonder “How does he do it? How does he succeed in everything he does? How does he manage to know everything?”. It is hard to keep up with his pace but if you can, it is well worth it.

Matteo has put the same passion that I have seen in the workplace in writing this thesis, conveying exceptional strength and a remarkable capacity for analysis and to draw conclusions: the result is what you are about to read.

I appreciate his effort and achievement so much. Academics and professionals are likely to benefit from this research.

I have no doubts that Matteo will continue achieving in the future and I wish only success for him, but most of all, I want to thank him for being a true friend.

Chapter 1 – History of the International Accounting Standards

1.1 Introduction

In a context characterized by a growing integration of markets for goods, services, and capital, with an increased competitiveness among the various participating entities, the role of a clear and efficient economic and financial communication has become, over time, central. This goal should be accomplished through accounting, which can be defined as a set of concepts and techniques that are used with the aim of identifying, measuring and communicating financial information on a specific economic entity to different users. In particular, it refers to a complex set of stakeholders, briefly summarized in Table 1.1, each of which has different interests and expectations in respect of the entity, and consequently requires a different set of information to meet its particular informative needs.

Users can be effectively divided into two macro-categories:

- ✓ Internal users: this category is mainly composed of the entity's management, that is, all those who have an important role in the organization in terms of decision-making. Thus, they use accounting information to take their own economic and financial decisions.
- ✓ External users: this category includes all those who do not participate in the management process of the entity, but are still connected to it through different forms of contracts. Among them, the most important are:
 - a) investors: this category uses accounting information with the purpose of assessing the risk profile and expected return of their investment decisions. Precisely, for this reason they require information that is able to tell them when to sell or buy the various types of shares through which they invest in the entity and, in particular, evaluate the entity's ability to pay dividends;
 - b) employees: they are interested in receiving information regarding the stability and profitability of the firm for which they work, in order to assess the safety of their jobs and their income stability;
 - c) creditors: they are particularly interested in gathering any information that will enable them to assess the ability of the company to fulfill its obligations;
 - d) suppliers: they are interested in having access to the information needed to assess the ability of the entity to pay the debt when due;
 - e) clients: they, instead, require information about the going concern ability of the entity, precisely because it influences directly the continuity of their business;
 - f) government agencies: among the different purposes of the information requested, the main ones are, without any doubt, the determination of the tax due and the regulation of the entity activities.

Thanks to the previous breakdown, it is now possible to identify a logical division of the discipline of accounting, which in fact takes mainly two different shapes to suit the different interests involved:

- ✓ Financial Accounting; and
- ✓ Managerial Accounting.

The *financial accounting* system is primarily prepared for external decision makers, none of whom controls the preparation of the information and reports, nor has much access to the underlying details. Its ability to assess and decide relies solely on the quality of information disclosed and contained in the various documents made available to the public. For this reason, this type of accounting documents is highly regulated in order to increase the quality and standardization of information and to facilitate the process of decision making for all external users. This type of accounting mainly uses financial periodic statements and related disclosures, including for example, income statement, statement of cash flow and other regulatory reports.

The presence of common information needs for all possible recipients led the IASB to make the following choice: "Despite the requirements of the above mentioned users can not all be met from the budget, there are some common needs of all. As investors are providers of risk capital to the company, a budget that meets their information needs will also meet most of the needs of other users of financial statements" (Framework, 2001: § 10).

With the development of global standards, the IASB has thus established as its main goal to provide high quality information that would allow users to make sound economic decisions; in other words, its effort is oriented to guarantee the production of a reporting system useful for investors in making their decisions. Hence, the efforts of the IASB are addressed to a narrow category of external users, considering that a document prepared in accordance with the new principles should still meet the information needs of other users.

1.2 History of the International Accounting Standards

IASC (1973-2000)

The International Accounting Standards Committee (“**IASC**”) was established in 1973 through an agreement made by professional accountancy body from Australia, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom, Ireland and the United States of America. By 2000, sponsorship of the IASC had grown to include all off the professional accountancy bodies that were members of the International Federation of Accountants¹ (“**IFAC**”).

Standard setting was done by the IASC Board, which comprised up to 17 board member delegations: a delegation from the accountancy bodies of each 13 countries plus delegations from each of up 4 other

¹ The IFAC was composed of 152 organisations form 112 Countries.

organizations with an interest in financial reporting. Up to three individuals may be part of a single board member delegation.

The IASC's objectives, as stated in paragraph 2 of the IASC Constitution, were:

- ✓ To formulate and publish in the public interest accounting standards to be observed in the presentation of the financial statements and to promote their worldwide acceptance and observance; and
- ✓ To work generally for the improvement and harmonization of regulations, accounting standards and procedures related to presentation of financial statements.

Until 2001, a part-time volunteer IASC Board set accounting standards. The members came from a wide range of backgrounds: accounting practices, business, financial analysis, accounting education and national accounting standard-setting. The IASC also had a number of observer members, including representatives of the International Organization of Security Commissions ("IOSCO"), the U.S. Financial Accounting Standards Board and the European Commission.

From 1997, the IASC also had an interpretative body, the Standing Interpretations Committee ("SIC"), formed for the purpose of developing interpretations of International Accounting Standards ("IAS") for final approval by the IASC.

IASB

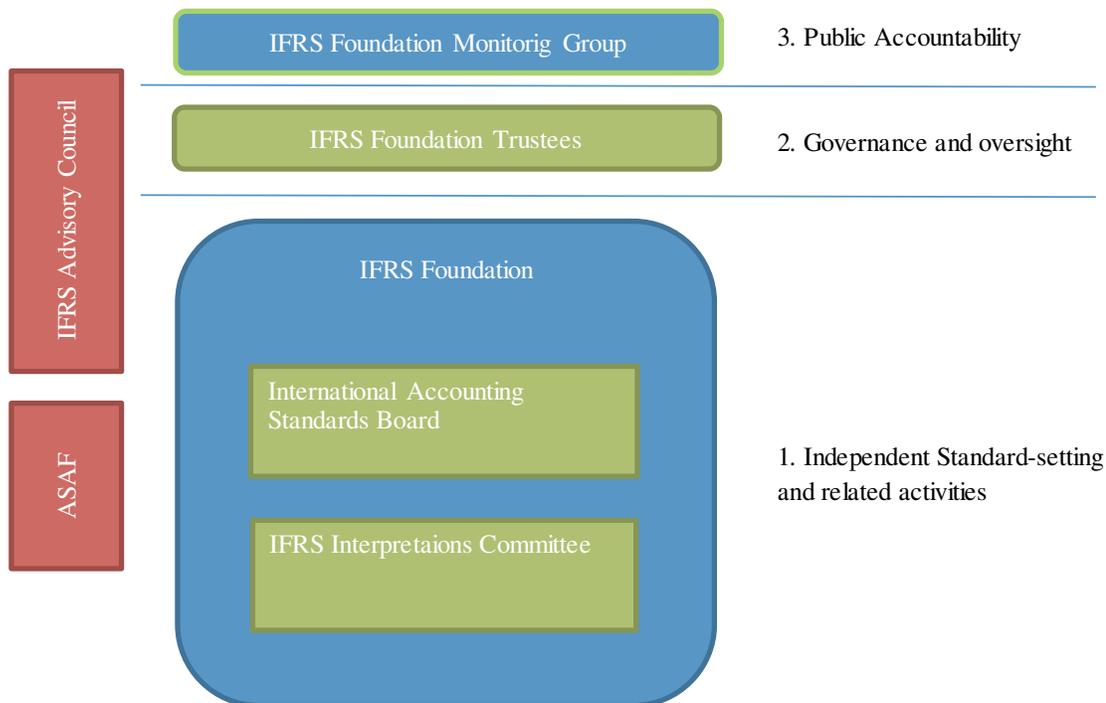
In 1997, the IASC concluded that, to continue to perform its role effectively, it should find a way to bring about convergence between national accounting standards and practices and to develop high quality global accounting standards. To achieve that objective, the organization was restructured, replacing the part-time IASC with a full-time International Accounting Standards Board ("IASB"), with strengthened due process, greater resources, complete independence and other structural changes.

The IASC Foundation constitution took effect on July 1, 2000. On April 1, 2001, the IASB assumed accounting standard-setting responsibilities. On July 1, 2010, the IASC Foundation was re-named the IFRS Foundation.

1.3 The governance of the International Accounting Standard Board

The principal body within the IFRS Foundation is the IASB, which has sole responsibility for establishing International Financial Reporting Standards ("IFRS"). Other components of the structuring are the Trustees of the IFRS Foundation, a Monitoring Board of capital market regulatory authorities that oversees the Foundation, the IFRS Interpretations Committee and the IFRS Advisory Council.

The table below shows the three-tier structure



Monitoring Board

The monitoring Board was created in January 2009 with the aim of “providing a formal link between the Trustees and public authorities” in order to enhance the public accountability of the IFRS Foundation. The responsibilities of the Monitoring Board include:

- ✓ Participating in the process for appointing Trustees and approving the appointment of Trustees according to the guidelines set out in the IFRS Foundation Constitution;
- ✓ Reviewing the adequacy and appropriateness of Trustee arrangements for financing the IASB;
- ✓ Reviewing the Trustees’ oversight of the IASB’s standard-setting process, in particular with respect to its due process arrangements;
- ✓ Conferring with the Trustees regarding their responsibilities, particularly in relation to the regulatory, legal and policy developments that are pertinent to the IFRS Foundation ‘s oversight of the IASB; and
- ✓ Referring matters of broad public interest related to financial reporting to the IASB through the IFRS Foundation.

As at September 30, 2014, the members of the Monitoring Board are the Emerging Markets and Technical Committees of the IOSCO, the European Union, the Financial Services Agency of Japan and U.S. Securities and Exchange Commission. The Basel Committee on Banking Supervision participates in the Monitoring Board as an observer.

IFRS Foundation

The governance of the IFRS Foundation rests with its 22 Trustees. Their geographical mix is six Trustees from the Asia/Oceania region, six from Europe, six from North America and four from any area. The IFRS Foundation's constitution requires an appropriate balance of professional backgrounds, including auditors, preparers, users, academics and other officials serving the public interest.

Between 2008 and 2012, the Trustees undertook a series of reviews of the structure, constitution and governance of the IFRS Foundation. Changes have been made with a view to strengthening all aspects of the IFRS Foundation's institutional structures to ensure that it acts as a truly global accounting standard setter, independent yet accountable to public authorities.

International Accounting Standards Board

The IASB is the body responsible for establishing IFRSs.

The Board has 16 members (of whom up to three may serve "part time"). The Board's principal responsibilities are to:

- ✓ develop and issue IFRSs in accordance with its established due process; and
- ✓ approve Interpretations developed by the IFRS Interpretations Committee .

The key qualification for Board membership is professional competence and practical experience. The group is required to represent the best available combination of technical expertise and diversity of international business and market experience. To achieve a balance of perspectives and experience, Board members are required to have an appropriate mix of recent practical experience among auditors, users and academics.

The Board is required to be internationally diverse: there will normally be four members from the Asia/Oceania region; four from Europe; four from North America; one each from Africa and South America; and two appointed from any area, subject to maintaining overall geographical balance.

IFRS Advisory Council

The Advisory Council is the formal advisory body to the IASB and the IFRS Foundation Trustees and it provides a forum for a wide range of representatives from user groups, preparers, financial analysts, academics, auditors, regulators, professional accounting bodies and investor groups that are affected by or interested in the IASB's work. The Advisory Council provides advice on a wide range of issues, including:

- ✓ Input on the IASB's agenda;
- ✓ Input on the IASB's work programme including project priorities and consultation on any changes in agenda and priorities; and
- ✓ Advice on projects, with particular emphasis on practical application and implementation issues, including matters relating to existing Standards that may warrant consideration by the Interpretations Committee.

IFRS Interpretations Committee

The Interpretations Committee has 14 voting members appointed by the Trustees for terms of three years. Like the IASB, the Interpretations Committee comprises the best available combination of technical expertise and diversity of international business and market experience, but with the added requirement that they be experienced in the practical application of IFRSs and analysis of financial statements prepared in accordance with IFRSs. The Interpretations Committee assists the IASB in improving financial reporting through timely identification, discussion, and resolution of financial reporting issues within the IFRS framework. The Interpretations Committee's responsibilities are to:

- ✓ Interpret the application of IFRSs and provide timely guidance on financial reporting issues not specifically addressed in IFRSs in the context of the IASB's Conceptual Framework for Financial reporting in accordance with established due process and to undertake other tasks at the request of the Board; and
- ✓ Report to the Board and obtain Board approval for final Interpretations.

Following completion in 2012 of a review of the efficiency and effectiveness of the Interpretations Committee undertaken by the IFRS Foundation, the Committee has available to it a wider range of possible actions to respond to issues referred to it:

- ✓ Enhancing mandatory requirements; and
- ✓ Providing non-mandatory guidance.

The mandatory requirements can include:

- ✓ IFRIC Interpretations; and
- ✓ amendments to standards through: i) the Annual Improvements process; or ii) proposal to the IASB for targeted, narrow-scope amendments that are beyond the scope of the Annual improvements process. These might include proposals for additional application guidance.

Non-mandatory solutions that the Interpretations Committee can use to address issues include:

- ✓ proposals for additional illustrative examples;
- ✓ explanations via rejections notices; and
- ✓ referral to the IFRS Education Initiative.

1.4 How the International Accounting Standards Board develops standards

The process of elaboration and adoption of the international accounting standards, called *Due Process*, is somewhat structured, based on a consultation at the international level, involving both individuals and organizations ranging from accountants and the accounting profession to the stock exchanges, and the regulation and supervision authorities.

The basis of this process is the IFRS Foundation Due Process Handbook, prepared and approved by the Trustees for the first time in October 2008 and updated in December 2010 and in May 2012, in which the steps followed by the IASB in both the development and revision of IFRS are described.

The principles underlying this process, as described in the Handbook, are the following:

- ✓ transparency and accessibility;
- ✓ extensive consultation and responsiveness;
- ✓ accountability.

The process of drafting and revision of accounting standards is divided into six stages, in each of which the Trustees always have the power to ensure compliance. They can be summarized as follows:

Stage 1: Setting the Agenda

At this stage, the IASB, on the basis of investors' needs, decide which issue has to be added to its agenda. The IASB, at this step, considers above all:

- ✓ the relevance to users and the reliability of information that could be provided;
- ✓ whether existing guidance is available;
- ✓ the possibility of increasing convergence;
- ✓ the quality of the standards to be developed;
- ✓ resource constraints.

To help the IASB in considering its future agenda, its staff is asked to identify, review and raise issues that might warrant the IASB's attention.

This phase of the due process already involves a public meeting of the IASB, whose decision is taken, with simple majority, in consultation of the IFRS Advisory Council and other accounting standard-setting bodies.

Stage 2: Project Planning

Once a project has been included in the agenda, the IASB has to decide whether to deal with it alone or cooperating with another standard setter.

After assessing the nature of the issue and the relative interest among the constituents, the IASB can decide whether to establish a working group. In this case, the group is selected by the two most senior members of the technical staff, in other words, the Director of Technical Activities and the Director of Research, which then continue their supervisory activities towards the work carried out by the project manager.

Stage 3: Development and publication of a discussion paper

As it will be described later, the publication of a discussion paper is not mandatory, but it has become a praxis for the IASB to publish any new and important issue in order to solicit in advance any comment and opinion from constituents.

Typically a discussion paper includes:

- ✓ a comprehensive overview of the issue;
- ✓ possible approaches in addressing the issue;
- ✓ the preliminary views of its authors or the IASB; and
- ✓ an invitation to comment.

As in the previous stage, all discussion of technical issues related to the draft paper take place in public session.

Stage 4: Development and publication of an exposure draft

Regardless of whether the IASB has or has not published a discussion paper, the exposure draft is the main means by which the IASB consults the public. Unlike a discussion paper, it establishes a specific proposal in the form of a proposed standard or amendment of an existing standard.

Any development of an exposure draft begins with the analysis of:

- ✓ issues on the basis of staff research and recommendations;
- ✓ comments received on any discussion paper; and
- ✓ suggestions made by the IFRS Advisory Council, working groups and accounting standard setters, and arising from public education sessions.

Once completed and balloted, the draft is then published by the IASB for public comment.

Stage 5: Development and publishing the standard

Founding on the comments to the exposure draft received, the IASB proceeds with the development of IFRS.

At this stage, on the basis of the evidence and the results obtained during the exposure draft, the IASB may decide to submit a public comment revision made through a second exposure draft.

Stage 6: Procedures after an IFRS is issued

After the new IFRS has been prepared and approved, the IASB members meet regularly with various involved parties in order to take into consideration unexpected issues arising from the practical application of the standard and its potential impact.

At this stage the entire IFRS Foundation operates with the purpose of ensuring the consistency and correctness of the application of the principle issued.

Finally, after a consistent period of time, the IASB undertakes activities of study on the various standards issued, so as to carry out a review on the same and related applications, considering, among other things, changes in the financial, regulatory and economic environment. Making references to the results of this analysis, the IASB decides to include or not these issues on its agenda, thereby retaking the cycle of due process from the first step.

It is useful to note that the six processes as described by the handbook are divided into two types of steps, one mandatory and one optional.

The first type includes:

- ✓ developing and ensuing the IASB's technical agenda;
- ✓ preparing and issuing IFRSs and the relative exposure drafts, including any dissenting opinions;
- ✓ consulting the Advisory Council on main projects and the agenda priorities.

The second type includes:

- ✓ publishing a discussion paper, or any other discussion document;
- ✓ holding public auditions.

Although the IASB has the right not to adopt this type of steps, it must, however, respect the “comply or explain” principle: the IASB should explain in the case of non-adoption of any non-mandatory step the reasons that led to this decision.

Even with regard to the due process, the IASB has been criticized during the financial crisis of 2007-2010, for his inability to follow what is established in the handbook. The IASB has been criticized for its inability to issue an exposure draft and to give a short time for comments and opinions to the constituents on the various proposals, particularly with reference to the amendment of IAS 39, regarding the reclassification of financial assets.

In consideration of that, a faster process has been introduced, in order to gain more easily the consensus on urgent matters. The fast process provides for no more than 30 days (thus, less than the ordinary period of three months) for comments by the constituents, but only if at least 75% or the Trustees have previously approved this shorter time frame.

1.5 The importance of Global Standards

Globalization has led to a progressive and growing integration between markets for goods and services, and capital markets, with the natural consequence that firms that previously had to rely almost exclusively on their

domestic market now can serve, almost in the same way, also abroad markets. Starting from that, we believe it is very important to examine all the reasons that encouraged and pushed into the development and subsequent spread of global accounting standards.

The first aim when developing global standards is to improve the functioning of capital markets. The diffusion of such accounting standards should in some way contribute to the removal of barriers and obstacles to cross-border acquisitions and divestitures and should improve inflow of capital from international investors to single countries because of their improved image and credibility.

Last but not least, the spread of global accounting standards makes it easier to compare investment options for the vast array of investors acting in the markets, both as individuals, companies or other types of organizations.

Although partially connected to the first aim, a particular attention should be granted to the goal of improving the comparability of financial information across countries and, at the same time, increasing its quality. Moreover, using a single set of accounting standards removes the necessity to adjust financial statements prepared under different standards for comparability reasons, significantly simplifying the job of financial analysts. The promises of more accurate, comprehensive and timely accounting information are additional elements that contribute to an increase in the quality of a reporting system.

Furthermore, a single set of accounting standards would also lead to cost reductions and risks minimization when looking at financial information. First, the development of international accounting standards would not only reduce the costs for reprocessing the accounting information but also the costs of preparing this information, due to no longer needed reconciliations among the different accounting standards of different countries. As a consequence, risks for investors and stakeholders using accounting information are lower, mostly because of the higher quality of accounting figures and the increased comparability. There are many expected benefits resulting from the adoption of international accounting standards. Their effectiveness, although some empirical evidence described in the next section already exists, is yet to be demonstrated, especially for those effects which should manifest only in the medium-long term.

1.5.1 The consequence of adopting international accounting standards

Since the introduction of IFRS, the attention paid by the academics to its effects has been considerable. The studies carried out are numerous and, although some discrepancies, show some common conclusions.

It is possible to identify three main stream of research related to the introduction of IFRS. The first stream concerns regulation and it is mostly made of theoretical contributions. As suggested by Ball (2005), the development of uniform standards should produce three main advantages:

- ✓ uniform rules does not need to be developed more than once, thus producing economies of scales for future rulers;
- ✓ uniform standards should provide higher protection to auditors from the possibility that managers have incentives to play an “opinion shopping” game
- ✓ uniform standards should result in more comparable financial statements, thus reducing costs related to the lack of comparability.

Moreover, these results should produce indirect positive effects. First of all, more accurate, comprehensive and timely financial statement will probably increase the capability of shareholders to control managers’ decisions and hence push managers into acting according to shareholders’ interests. Second, the risk associated to investing in firms should be lower, reducing the firms’ cost of capital.

However, uniform standards do not come without costs. In particular, it cannot be taken for granted that uniform accounting quality will immediately results from uniform standard, since this conclusion is based on a rather strong assumption, i.e. that “one size fits all”. On the contrary, it could well be possible that differences in terms of size, strategy, investment policy, ownership or financial structure or, even more importantly, differences at country level require different accounting choices. Moreover, this solution would involve high costs related to the need to develop a comprehensive set of accounting rules covering every possible contingency.

The second stream of research on IFRS introduction is concerned with the effects produced by IFRS on capital market and can be divided into three sub-categories: information asymmetry, value relevance and cost of capital.

Referring to the first category, the hypothesis tested by the literature states that with the introduction of IFRS information asymmetry should decline. This hypothesis has been tested on two main areas: the effect on the bid-ask spread and the effect on analysts’ forecast precision. The first has produced conflicting results, since four papers support the hypothesis, while one has produced conflicting results. In fact, focusing on Germany both Leuz and Verrecchia (2000) and Gossen and Selhorn (2006) show that firms using IFRS face a lower bid-ask spread than those using German GAAPs. Moreover, Barth (2011) and Platikanova and Noves (2006) both find that after IFRS there is a general decline in the bid-ask spread, probably due to greater liquidity. On the contrary, Dumontier and Maghraoul find that this result is confined to small firms.

The second area produces conflicting results as well, with some papers supporting the idea that IFRS have improved the accuracy of analysts’ forecasts (Ashbaug and Pincus, 2001; Hogson et al., 2008; Ernsberger et al, 2008) and other papers opposing this idea (Maghraoui, 2008; Cuijpers and Buijink, 2005).

The second category verifies the hypothesis that after IFRS the value relevance of earnings is higher. Once again, the literature has produced conflicting results. On the one hand, Barth et al. (2008), Bartov et al. (2005) and Jermakowicz (2007) all report that earnings are more value relevant after the introduction of IFRS, that is, firms using IFRS exhibit accounting figures that are, on average, more useful for decision making purposes.

However, some papers do not support the hypothesis and report the value relevance is not increased (Hung and Subramanyam, 2007), or that it is even declined (Lin and Paananen, 2008).

The last category of capital market research on IFRS is concerned with the effect of IFRS introduction on the cost of capital. In that case results are stronger and, a part from a few studies by Suijpers and Buijink (2005) and Daske (2006), show that the cost of capital is lower for IFRS users (Ernstberger and Vogler, 2008; Kim and Shi, 2007; Botosan, 1997; Botosan and Plumlee, 2002; Hail, 2002; Francis et al., 2004; Hail and Leuz, 2006).

The third and last stream represents a residual category and comprehend a variety of topics. Among them, the richest one is represented by studies on the relation between IFRS and earnings manipulation. From a theoretical point of view the introduction of IFRS should lead to lower manipulation by firms, since IFRS are more precise, they admit a smaller number of options and prohibit hidden reserves. However, once again results are far from conclusive. Only Barth et al. (2008) support this idea, while Van Tenderloo and Vanstraelen (2005), Paananen (2007) and Lin and Paanen (2008) all show that the level of manipulation (as represented by abnormal accruals or income smoothing) is either not different or even higher for IFRS users when compared to other firms. However, it is important to distinguish between countries with strong legal protection of investors and countries where this protection is rather weak. In the first context, the cost of adopting IFRS as well as the level of earnings manipulation should be lower, due to the fact that managers are less likely to manipulate accounting results reported in the financial statements. Focusing on the second context, instead, where managers have higher chances to engage in earnings management and the quality of accounting figures is lower, the cost of adopting IFRS should be higher.

Finally, two important propositions should be remembered. The first is that the harmonization of standards is necessary, but not sufficient, to achieve international, homogeneous accounting standards. The second is that the quality of accounting information also depends on incentives for firms.

In support to the first proposition, Vogel et al. (2008) note that there is a significant difference in compliance among the various European companies, which varies widely from a minimum of 13% to a maximum of 100%. Companies adopting more seriously the IFRS are identified by Daske et al. (2007) as those who face the larger effects in terms of cost of capital reduction and market liquidity enhancement.

In support of the second proposition, Daske et al. (2008) show that the benefits of the adoption of IFRS occur only in contexts in which firms have incentives to be transparent and where the legal enforcement is very strong. In addition, Wang and Yu (2008) maintain that countries where firms are more likely to report transparently are those where there is a better stakeholders protection and the legal framework is effective, such as countries with a common-law matrix.

To recap, we can conclude that no clear evidence can be drawn from studies on IFRS introduction, mostly because results are frequently inconclusive, many studies have been conducted in a single country, does not accounting for differences in incentives or enforcement mechanisms between different systems, and because many studies concerned voluntary adopters, that is firms that decided to move from local GAAP to IFRS. It could well be possible that these adopters are (very) different from firms forced to adopt IFRS in terms of both incentives and characteristics. Hence, we cannot conclude with certainty that findings on this kind of firms will also apply to mandatory adopters.

1.6 The global adoption

As it is well known, the IASB, being a private organization, has no power to impose IFRS and their subsequent amendments either to the various countries or towards individual companies.

For this reason each country or better, each region, has adopted a different system to embrace the international accounting standards. For example, among the various techniques, it is possible to adopt IFRS as they are issued, change national standards to achieve convergence in the long term, or develop national standards that are essentially based on IFRS.

This section will briefly illustrate some adoption examples, coming from various regions of the world that adopted or converged to IFRS.

Europe

Europe is the most important example of region where the application of IFRS is implemented through a specific procedure (endorsement), in which it is also verified that the adopted standards meet the criteria of the European Union public policy.

The process of introduction of IFRS in the European Union began with the EU Regulation No 1606/2002, which, with the primary objective of ensuring a more harmonized transparency and greater comparability of financial statements, introduced the obligation, within 2005, for all companies listed in regulated markets to prepare their consolidated financial statements according to international accounting standards issued by the IASB.

This regulation, however, introduced the option for each EU member state to allow or even require the preparation of unconsolidated financial statements in accordance with IFRS and to require or permit the application of the same accounting standards also to unlisted companies.

The Regulation No 1606/2002 also introduced the basic mechanisms of the endorsement process for the IFRS adoption. The role of this mechanism is not to reformulate or replace an IFRS, but to oversee the adoption of new standards and new interpretations, intervening only if there are gaps or inconsistencies with the economic and legal context of the European Community.

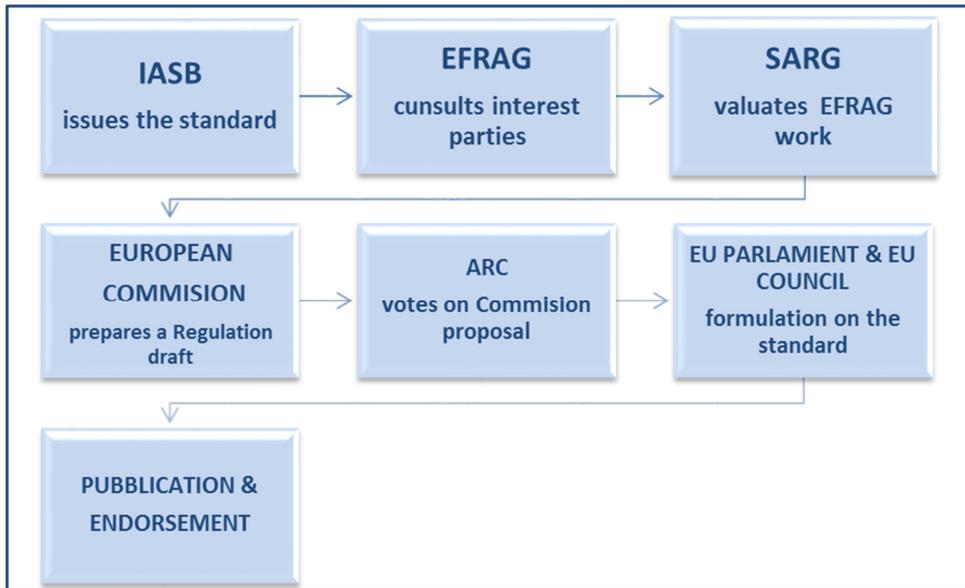
The Regulation states three criteria that any IFRS must comply with when are likely to be adopted:

1. the standard should respect the principle of true and fair representation;
2. the standard should follow the European public good;
3. the standard should respect all the basic criteria of financial statements, in order to give useful information to users.

The process, which lasts about 29 weeks, is based on a two-tier structure in which a regulatory level works with one of experts and can be summarized as follows:

1. the IASB develops and issues a standard;
2. soon after the European Financial Reporting Advisory Group (EFRAG), which is also the mechanism by which Europe participates in the global debate on accounting standards, holds various consultations with the interested parties;
3. after the consultation session, the EFRAG delivers its advice to the Commission whether the new standard meets the criteria of endorsement; in other words, if the standard respects the European public good, understandability, relevance, reliability, and comparability. In addition, EFRAG prepares a study on potential economic impacts of the standards' application;
4. the Standard Advice Review Group (SARG) releases its opinion whether the EFRAG endorsement advice is objective and balanced;
5. based on the two advices, the Commission prepares a draft endorsement Regulation, adopted through a regulatory comitology procedure, based on the Council Decision No 468/1999, so that the Accounting Regulatory Committee (ARC) votes on Commission proposal, following a qualified majority rule;
6. if the ARC's vote is positive, the European Parliament and the Council of European Union have 3 months to oppose the adoption of the draft Regulation. After this period without any explicit formulation, the silence gives consent, so that the Commission adopts the draft Regulation;
7. after the adoption, the Regulation is published in the Official Journal, entering into force on the date expressed in the Regulation itself.

The table below shows the EU Endorsement Process.



The first implementation goes back to Regulation No 1725/2003, in which 32 accounting international standards were accepted, with the only exception of IAS 32, IAS 39, and SIC 17, as related to the above IAS, which were adopted by subsequent Regulations.

Russia

The process of adoption of IFRS in Russia was initially characterized by a gradual convergence of Russian Accounting Principles to IFRS, which began already from 1998.

In 2004, the Central Bank of Russian Federation (“**CBR**”) required for all credit institutions to prepare their financial statements according to accounting standards issued by the IASB. The request initially excluded the financial statements of public traded companies, with the exception of A-listed Company that have to prepare financial statements in accordance with IFRS or U.S. GAAP.

A significant date was 27 July 2010, when the Federal Law on Consolidated Financial Statements was adopted, which introduced the use of IFRS to prepare the consolidated financial statements of listed companies. Furthermore, the law also arranged to required the preparation in accordance with these accounting standards to credit institutions and insurance companies for their consolidated financial statements. The same Law and the Government Resolution 107 of February 2011 introduced a mechanism of endorsement, which implemented the new standards and new interpretations, which will come into force during the calendar year subsequent to the endorsement.

The Law also allows the option of postponing until 2015 the adoption of these accounting standards for two types of companies: those adopting internationally recognized principles alternative to IFRS and those having only listed debt securities.

The endorsement process of IFRS adopted in Russia begins with a linguistic analysis of the text provided by the IASB, carried out by an external body. After that, the National Accounting and Reporting Standards Foundation (“**NOFA Foundation**”), a non-commercial organization, is appointed by the Ministry of Finance to conduct an independent analysis on the suitability of IFRS for the Russia accounting system.

In particular, it verifies the possibility of adopting the IFRS as issued or if they need some changes to fit the Russian context, and report its findings to the Ministry of Finance. The Ministry of Finance is therefore responsible for the final decision and the actual endorsement of accounting standards, however, after having also heard the CBR and the Federal Securities Market.

Canada

A primary role in the process of adoption of international accounting standards in Canada was that of the International Accounting Standards Board, responsible for establishing the accounting standards for Canadian companies, and whose authority derives directly from the Canadian Institute of Chartered Accountants (“**CICA**”).

In January 2006, the AcSB (the Canadian Accounting Standards Board) has defined, in the Strategic Plan, three different types of reporting standards for Canadian companies. In particular, it distinguishes among publicly accountable companies, non-publicly accountable companies, and finally non-profit organizations.

For the first type of companies the AcSB has planned to adopt IFRS as issued by the IASB as Canadian GAAP starting from fiscal year subsequent to 1 January 2011. The only exceptions are: companies with regulated activities, which have had to defer the adoption up to 1 January 2012; investment companies, which have the possibility of deferral to January 1, 2013; and finally pension and insurance trusts similar to the pension ones, for which the AcSB has determined that the Canadian GAAP should be followed, rather than what is established in IAS 26.

It is also worth noting that for publicly accountable companies that are registered with the U.S. SEC, as well as for companies operating in markets dominated by U.S. companies, the opportunity to prepare their financial statements according to U.S. GAAP is still given.

For the second and the third type of companies, the AcSB has only provided the possibility of a voluntary adoption of IFRS, while they are normally in force of the Accounting Standards arising from Canadian standards.

In 2009, the AcSB has finally formed an IFRS Discussion Group, in order to create a public forum on the application of IFRS in Canada.

Brazil

Brazil has operated under two different strategies. On one hand, the Brazilian accounting standards have undergone a process of convergence to IFRS; on the other hand, the listed companies governed by Comissão de Valores Mobiliários were required to make a formal financial statement in accordance with IFRS issued by the IASB.

Nevertheless, there are some exceptions to what has been said above. Banks, in fact, regulated by the Central Bank of Brazil, have to prepare financial statements in accordance with pre-existing accounting rules. However, larger banks have to prepare financial statements in accordance with IFRS from 2010 onwards. There is a similar prediction for insurance companies, which are also obliged to comply with Brazilian accounting standards and therefore the IFRS in 2011.

South Africa

South Africa completed the process of convergence in 2004, through a radical roadmap, consisting in the adoption of full IFRS issued up to that date and therefore removing all the differences between SA GAAP and IFRS, with the exception of the legacy effect of different effective dates along with the non-application of IAS 1. From that year the South African standard setter body, the Accounting Practices Board, has implemented all the standards and interpretations issued by the IASB without adding any change.

Since 2005 the JSE Limited, South Africa's securities exchange, required to all the listed companies to prepare their financial statements according to IFRS, while the unlisted companies could choose between IFRS or SA GAAP. In addition to that, the JSE added some additional disclosure requirements, as well as some interpretations related to specific issues of the African environment, such as the determination of the tax payable on dividends.

From 2011 there has been a distinction between the various categories of firms, each of them being subject to different accounting standards. For example, the SA GAAP are now only valid for certain specific types of companies, while listed companies adopting IFRS and companies of considerable size, even if unlisted, must apply either IFRS or IFRS for SMEs.

China

Similarly to Russia, the responsible for the development and promulgation of the Chinese accounting standards is the Ministry of Finance (MOF) through its Accounting Regulatory Department (ARD). The Ministry started its development activities in 1993, but the advent of IFRS has had a key role in the development of accounting standards in China.

In November 2005 there was a meeting between representatives of the China Accounting Standards Committee (CASC, headed by the Accounting Regulatory Department) and those of the IASB to discuss the process of convergence of Chinese accounting standards with IFRS. At the conclusion of the meeting, the parties concluded that the priority of the CASC was the convergence to IFRS, but at the same time they noted that the process would take time and that the responsibility for the modus operandi of convergence would have uniquely belonged to the People's Republic of China.

Subsequently, in 2006, the Ministry of Finance issued a series of new and revised accounting standards, called Accounting Standard for Business Enterprises (ASBEs), in force for all listed companies starting from January 1, 2007.

A further step forward was made in April 2010, when the Road Map for Continual Convergence of the ASBEs with IFRSs was issued, that, in addition to broadening the scope of the ASBEs, confirmed the intention of the MOF to continue the process of convergence to IFRS.

The ASBEs are essentially in line with the corresponding IFRS, for example for recognition, measurement, presentation, and disclosure of many transactions and events, but also for the topics covered. However, there are still some important differences such as non-monetary transactions and business combination under common control.

Japan

Even the Japanese experience has shown a gradual convergence to IFRS, in particular with the fit and alignment of Japanese GAAP standards issued by the IASB.

In 2007, in fact, the Accounting Standards Board of Japan (ASBJ) and the IASB reached an agreement, called "The Tokyo Agreement", which established the gradual process of convergence to IFRS. In 2008, the good work done by the ASBJ led the European Commission to accept, for non-EU companies listed on a European market, the Japanese GAAP as equivalent to IFRS.

This work, therefore, continued in 2009, when the Business Advisory Council, the body that advises the Financial Services Agency, drafted and approved a roadmap for the adoption of IFRS in Japan, which contains some key points. The first of these was the possibility of voluntary adoption of IFRS for all globally widespread industrial or financial companies, beginning in fiscal year ending after 31 March 2010.

Australia/Oceania

The Australian Financial Reporting Council (FRC) has played a key role in the process of convergence to IFRS in Australia, when in 2002 it announced through its president that it had formalized the project of adoption of IFRS by 1 January 2005. The FRC is a statutory body created by the Australian Securities and Investments

Commission Act 2001, with a variety of tasks, including the responsibility to provide a broad view of the development of accounting and auditing standards, as well as control the actual independence of auditors, thus bringing its observations directly to the Australian Government.

According to the orientation expressed by the FRC, the Australian Accounting Standards Board (AASB) issued accounting standards equivalent to IFRS (AIFRS) in July 2004. It should also be remembered that the Australian accounting standards have the force of law for local corporations, so that also the IFRS to be adopted must pass under the scrutiny of this body. The use of AIFRS has permitted in this way to make the financial statements of profit consistent with the financial statements prepared under IFRS.

However, at the time of the first adoption, the AASB allowed, for some AIFRS, the use of only some of the possible treatments available in the equivalent standards issued by the IASB. Therefore, in 2007, the AASB issued his standards AASB 2007-4 which determined that the AIFRS should reflect the exact requirements and the exact literal expression of IFRS. By this Standard, the remaining options on the IFRS accounting policy were incorporated, as well as the disclosure requirements of the Australian context and the comments that were not contained in the corresponding IFRS, with the exception of those referred to situations normally retrievable in the Australian environment.

The process, however, has not stopped, and the AASB has confirmed its intention to continue the work of making the Australian accounting standards compatible with IFRS, in order to comply with the direction given by the FRC.

1.7 The convergence issue

The convergence process, still developing, has received a major boost from the growth and development of a global economy. In this session it is considered worthy to briefly illustrate not only the main factors that have supported this process, but also the advantages and disadvantages of the same, which are still being discussed by professionals and academics worldwide.

Analyzing the factors that led to put changes in financial reporting, three are particularly important:

- ✓ the compelling case of harmonization of financial reporting: global companies need accounting and financial information that they can understand and interpret for running business decision and making strategic plans.
- ✓ the strengthening of institutional framework for setting standards: the international standard setters IASB and FASB work towards elimination of any difference, in order to reach the convergence of the relative accounting standard.

- ✓ the adoption of IFRS by various territories and region: for example, the first boost was June 2002, when the EU Commission Regulation required that all EU listed companies prepared their consolidated financial statement using IFRS, rather than national GAAP.

As it can be imagined, there are several advantages from the converge process, some of which are obvious and some others are not. They can be summarized as it follows:

- ✓ convergence increases the verifiability of financial statements for auditors and regulators;
- ✓ it increases comparability among financial statements;
- ✓ it avoids any need of reconciliation to another country's accounting standards;
- ✓ it reduces national standard-setting costs;
- ✓ thanks to all the advantages said above, convergence makes accessing to foreign capital market easier, thus increasing market efficiency and, most of all, lowering the cost of capital for companies.

However, there are also several disadvantages. In other words, the convergence process has shown some weaknesses, that have been involved in all the debates globally hold by academics and professionals, and that will give, once they will be overcome, the possibility to reach an efficient and harmonized financial reporting system.

The main weaknesses can be summarized as follows:

- ✓ Management can structure the financial statements in order to meet the form over the substance established by the accounting standards, exploiting the weaknesses of a new set of accounting standards.
- ✓ An uneven implementation of accounting standards will make it difficult to ensure credible financial statements.
- ✓ Convergence implies high costs from the involved parts, and requires a continuous work by each part, in order to follow the business landscape changes.
- ✓ The conformation of international standards could also reduce the competition among systems, and could not consider any local peculiarity of a specific environment.

Chapter 2 - History of the US General Accepted Accounting Principles

2.1 History of the U.S. GAAP

Since 1973, the Financial Accounting Standards Board (“**FASB**”) has been the designated organization in the private sector for establishing standards of financial accounting that govern the preparation of financial reports by non-governmental entities. Those standards are officially recognized as authoritative by the Security and Exchange Commission (“**SEC**”) and the American Institute of Certified Public Accountants.

The SECO has statutory authority to establish financial accounting and reporting standards for publicly held companies under the Securities Exchnage Act of 1934. Throughout its history, however, the Commission’s policy has been to rely on the private sector for this function to the extent that the private sector demonstrates ability to fulfil the responsibility in the public interest.

The mission of the FASB is to establish and improve standards of financial accounting and reporting that foster financial reporting by non-governmental entities that provides decision-useful information to investors and other users of financial reports.

That mission is accomplished through a comprehensive and independent process that encourages broad participation, objectively considers all stakeholders views and is subject to oversight by the Financial Accounting Foundation’s Board of Trustees.

To accomplish its mission, the main FASB acts to:

- ✓ Improve the usefulness of financial reporting by focussing on the relevance and faithfully representation of financial information, as well as other enhancing characteristics of useful information including comparability, verifiability, timeliness and understandability;
- ✓ Guide and educate the public, including users, the individuals that prepare financial statements, auditors and others. Through its open due process, outreach to constituents, the form of the standards themselves and related implementation activities, the FASB improves the common understanding of the nature and purposes of information contained in financial reports.
- ✓ Keep standards current to reflect changes in methods of doing business and changes in the economic environment.
- ✓ Consider promptly any significant areas of deficiency in financial reporting that might be improved through the standards-setting process.
- ✓ Promote the convergence of accounting standards internationally concurrent with improving the quality of financial reporting.

The FASB develops standards for financial accounting and reporting and related implementation guidance. The FASB also develops accounting concepts. Concepts are useful in guiding the FASB in establishing standards and in providing a frame of reference, or conceptual framework, for resolving accounting issues.

The FASB's work on both standards and concepts is based on research and analysis conducted by the FASB's technical staff and others. The FASB solicits the views of various stakeholders in the financial reporting system on all accounting and reporting issues.

The FASB is part of a structure that is independent of all other business and professional organizations. That structure includes the Financial Accounting Foundation ("**Foundation**"), the FASB, the Financial Accounting Standards Advisory Council ("**FASAC**"), the Governmental Accounting Standards Board ("**GASB**") and the Governmental Accounting Standards Advisory Council ("**GASAC**").

2.1.1 Financial Accounting Foundation ("FAF")

The Foundation is the independent, private sector organization that is responsible for the oversight, administration and finances of the FASB, the GASB, and their advisory councils FASAC and GASAC. The Foundation's primary duties include protecting the independence and integrity of the standards-setting process and appointing members of the FASB, GASB, FASAC and GASAC

Organized in 1972, the FAF is the independent, private-sector organization with responsibility for:

- ✓ establishing and improving financial accounting and reporting standards;
- ✓ education constituents about those standards;
- ✓ selecting the members of the standard-setting Boards and Advisory Councils;
- ✓ the oversight, administration and finances of its standard-setting Boards, the FASB and the Governmental Accounting Standards Board and their Advisory Councils; and
- ✓ protecting the independence and integrity of the standard-setting process.

The Foundation is a non-stock Delaware corporation that operates exclusively for charitable, educational, scientific and literary purposes within the meaning of Section 501 of the Internal Revenue Code.

The FAF mission is to establish and improve financial accounting and reporting standards, fostering financial reporting that provides decision-useful information to investors and other users of financial reports. This mission is accomplished through a comprehensive and independent standard-setting process that encourages broad participation, objectively considers all stakeholder views and is subject appropriate oversight and accountability.

2.1.2 Financial Accounting Standards Board

In 1973, the Foundation established the FASB to establish and improve standards of financial accounting and reporting for non-governmental entities. Consistent with that mission, the FASB maintains the FASB Accounting Standards Codification which represents the source of authoritative standards of accounting and reporting, other than those issued by the SEC, recognized by the FASB to be applied by non-governmental entities.

The FASB establishes and improves standards and concepts through a comprehensive and independent process that encourages broad participation, objectively considers all stakeholder views and is subject to oversight by the Foundation's Board of Trustees. FASB members exercise their judgment after research, due process and careful deliberation. They are guided by these principles:

- ✓ To be objective in its decision making and to ensure, insofar as possible, the neutrality of information resulting from its standards. To be neutral, information must report economic activity as faithfully.
- ✓ To actively solicit and carefully weigh the views of stakeholders in developing standards and concepts. The ultimate determinant of standards and concepts, however, must be the FASB's judgment, based on research, public input and careful deliberation, about the usefulness of the resulting information.
- ✓ To issue standards only when the expected benefits justify the perceived costs. The FASB strives to determine that proposed standards fill a significant need and that the perceived costs they impose, compared with possible alternative, are justified in relation to the overall expected benefits.
- ✓ To issue high-quality standards, which are grounded in a consistently applied conceptual framework, set forth objectives and principles stated in clear and unambiguous language and foster consistent application by providing structure and necessary detail derived from the principles.
- ✓ To manage the process of improving standards in ways that balance the desire to minimize disruption of accounting and financial reporting process with the need to improve the decision-usefulness of information in financial reports. The FASB establishes reasonable effective dates and transition provisions when new standards are introduced. The FASB must also balance the desire for comprehensive improvements in standards with the need for incremental changes that produce timely reporting improvements in areas to important to users.
- ✓ To provide clear and timely communications, endeavouring at all times to keep the public informed of important developments about the FASB's operations and activities.
- ✓ To review the effects of past decision and interpret, amend, or replace standards in a timely fashion if such action is indicated.

2.1.3 Financial Accounting Standards Advisory Council

The primary function of FASAC is to advise the FASB on technical issues on the Board's agenda, possible new agenda items, project priorities, procedural matters that may require the attention of the FASB and other matters as may be requested by the FASB or its chairman. At present, the Council has more than 30 members who represent a broad cross section of the FASB's constituency. A an organization of knowledgeable and experienced individuals, FASAC works closely with the FASB in an advisory capacity to ensure that the views of its members are constantly and effectively communicated to the FASB on a timely basis.

FASAC consists of no less than 20 persons appointed by the Foundation's Board of Trustees who are knowledgeable about the issues involving, and impact of, financial accounting and reporting who possess an expertise of value to the FASB. FASAC's membership broadly represents varied professional and occupational backgrounds with no profession or occupation dominating and, as a means of involving the public in the

accounting standards setting process, includes investors, creditors and other users of financial statements, individuals with experience as issuers, auditors, educators and those with experience in government.

The By-Laws of the Foundation charge FASAC with responsibility for consulting with the FASB about major technical issues, the FASB's agenda of project and the priorities of the projects, matters likely to require the attention of the FASB and such other matters as may be requested by the FASB or its Chairman. In fulfilling that responsibility, FASAC members are expected to provide input respect of standards of financial accounting and reporting proposed for issuance by the FASB, as well as input on such other matters as may be referred to them or FASAC from time to time by the FASAC also are expected to communicate their individual perceptions of potential effects of proposed or authoritative pronouncements and provide comments on broader policy questions, such as whether stakeholders' view are being appropriately balanced, cost-benefit relationships, and due process considerations. FASAC members are encouraged to consult with one another and others, and to speak and write publicly on issues with respect to the work of FASAC and the FASB.

2.2 How the Financial Accounting Standards Board develops standards

The objective of the FASB policy of openness and broad public participation in the standards-setting process is to stimulate consideration and debate among the FASB's stakeholders on matters of significance to the public. Members of the FASB, the FASB technical staff, advisory councils and advisory committees are free to express their individual views on matters under consideration in order to stimulate constructive public dialogue. The FASB encourages the public to do likewise and invites individuals and organizations to make their views and concerns known to the FASB through thoughtful, reasoned and timely communication at all stages of the FASB's process.

2.2.1 Chairman

The Foundation's By-Laws provide that the principal officer of the FASB is its chairman, who is appointed by and serves at the pleasure of the Foundation's Board of Trustees and presides at the FASB's meeting. The primary duties and authorities of the FASB Chairman are to:

- ✓ Prepare short and long range project plans of the FASB, including the agenda of specific projects and their priorities, for submission to the members of the FASB for approval.
- ✓ Transmit short and longer range project plans to the Trustees and FASAC. The Chairman provides to the Trustees and FASAC quarterly and annual reports (Chairman's Report) about the activities of the FASB and its progress relative to its project plans and an annual report evaluating the FASB's performance within the context of its mission. Quarterly reports include information such as pronouncements issued, changes to the FASB's technical agenda, outreach meetings with stakeholders and other significant matters.
- ✓ Prepare and submit an annual budget to the Trustees for their approval, after consulting with FASB members and staff Directors as appropriate.

- ✓ Determine personnel requirements, hire and retain FASB staff members, and fix their duties and compensation in accordance with Foundation policies. The Chairman also may appoint and contract with persons or organizations with respect to research and other technical services to be performed by them as consultants or independent contracts.
- ✓ Establish FASB advisory committees and project resource groups.
- ✓ In the event the FASB does not endorse a change to U.S. GAAP proposed by the PCC, provide a written document to the PCC Chair explaining the reasons for the non-endorsement.

The FASB Chairman works in cooperation with the staff Directors and other members of the FASB in fulfilling those responsibilities. The FASB Chairman also works in cooperation with the FASAC Chairman to assist FASAC in accomplishing its functions and facilitating the work of the FASB. The FASB and GASB Chairman regularly consult with each other to enhance the effectiveness of the interrelationships between the Boards and their staffs.

The FASB Chairman may delegate or assign particular functions or duties to other members of the FASB, staff Directors or other members of the technical staff, advisory committees, FASAC, or such others as the FASB Chairman may deem appropriate.

2.2.2 Project Plans

The FASB is responsible for establishing short and long range project plans, including an agenda of specific project and their priorities, which plans and all modifications thereto shall be approved at least a majority of the FASB's members.

The FASB consults with FASAC concerning, among other things, major technical issues, the FASB's agenda of projects and the priorities of the projects and matters likely to require the attention of the FASB. The FASB also considers timely suggestions from other individuals and organizations.

When the FASB approves a project and assigns its priority, the staff Directors will generally assign one or more members of the FASB's technical staff to work on the project.

2.2.3 Technical Staff

The FASB Chairman is responsible for determining the FASB's personnel requirements and for selecting its technical staff. The FASB staff will, in the judgment of the FASB Chairman, each have a concern for users and the public interest in matters of financial accounting and reporting, and collectively have knowledge and experience in investing, accounting, finance, business, accounting education and research. The Chairman has authority to hire, retain and contract with staff members to determine their duties and remuneration, in accordance with the Foundation's policies, as well as to contract with any other persons or organizations with respect to research and other technical services to be performed by consultants or independent contractors.

A source of technical staff is the FASB's "Fellow Program" and "Postgraduate Program". Members of the Fellow Program typically have experience or a background in public accounting, academe, or industry and serve as technical staff members for generally a two-year term on the understanding that they expect to return to their sponsoring employers. Members of the Postgraduate Program are individuals seeking a career in accounting that are nominated by their school's accounting department. They serve as technical staff members for generally a one-year term.

Members of the FASB's technical staff and other persons and groups employed, hired or otherwise retained or appointed by or at the direction of the FASB Chairman serve at the pleasure of the Chairman or as otherwise provided in contracts made by or at the Chairman's direction.

2.2.4 Advisory Committees and Project Resource Groups

Advisory committees play an important role in the process of establishing and improving standards of financial accounting and reporting. Advisory committees supplement the FASB's advisory councils, FASAC and the PCC. Advisory committees are intended to be indefinite-lived and are formed for the purpose of providing regular and focused input on a broad range of strategic and technical issues from the perspective of a particular industry sector or stakeholder type. Advisory committees also may be a mechanism for communication between the FASB and its stakeholders.

The FASB Chairman shall establish a written charter for each advisory committee, subject to consultation with the Trustees, FASB members and staff Directors as appropriate. The charter describes the purpose and responsibilities of the committee, its size and qualifications for membership (including limits on the term of membership) and operating procedures. Operating procedures for an advisory committee shall be consistent with the FASB's Rules of Procedure.

The FASB Chairman makes appointments to an advisory committee after consultation with FASB members and Directors, as appropriate. Members may be anyone possessing relevant expertise or viewpoints. Members serve at the pleasure of the FASB Chairman or as otherwise provided in contracts made by or at the Chairman's direction. In appointing members, the Chairman seeks nominations from existing Committee members and Foundation-established councils, FASB members, and other interested entities, organizations and persons, including the Foundation's Trustees.

The Chairman shall appoint a chairman for each advisory committee, which, depending on the committee's nature and purpose, may be a committee member, an FASB member or an FASB staff member.

The FASB will evaluate the purpose, composition and effectiveness of each advisory committee every three years, making revisions to its charter as necessary and appropriate.

The FASB Chairman also may establish a limited-life, project specific resource group to provide experience and diverse viewpoints on the issues in a specific standards-setting project and as a means for identifying potential implementation issues at an early date. The FASB Chairman makes appointments to a project

resource group after consultations with FASB members and staff Directors, as appropriate. Resource groups comprise individuals with relevant expertise or experience.

2.2.5 Emerging Issues task Force

The FASB established the Emerging Issues Task Force (“EITF”) to assist it in the early identification, discussion and resolution of emerging issues affecting financial accounting and reporting and of problems in implementing standards of accounting and reporting for nongovernmental entities. Unlike advisory committees, the work of the EITF goes beyond simply identifying and advising the Board on reporting issues. The EITF also works to reach consensus on the appropriate accounting treatment and provide guidance on those issues. Consensus guidance developed by the EITF amends the Accounting Standards Codification if approved by a majority of the FASB.

Consistent with that purpose, the EITF comprises individuals who are knowledgeable in accounting and financial reporting and are in positions that make them aware of emerging issues. The task force Chairman and other members are appointed by and serve at pleasure of the FASB Chairman.

An Accounting Standards Update is issued to amend the Accounting Standards Codification to reflect consensus guidance of the EITF. Consensus of the EITF are exposed for public comment through the issuance of an Exposure Draft of a proposed Accounting Standards Update. A majority of the FASB must approve the issuance of an Accounting Standards Update or an Exposure Draft of an Accounting Standards Update containing an EITF consensus.

2.2.6 Research Projects

After consulting with the appropriate staff Director, the FASB Chairman may provide for research and obtain or commit the necessary staff or other personnel and funds to execute the research as the Chairman may deem necessary or desirable in the circumstances. Other members of the FASB, its technical staff, its advisory councils and advisory committees, or any other individual or organization may submit research proposal to the FASB Chairman for consideration.

Research is generally directed to specific issues associated with projects that are on the FASB’s technical agenda or that may be added to the FASB’s technical agenda. As such, the research may be expected to have a problem solving orientation and to provide information about specific questions and the impact of alternative solutions. Theoretical and conceptual research also will be conducted if the circumstances warrant it.

Written research data and summaries of research data constitute a part of the FASB’s public file.

2.2.7 Public Forums

The FASB will seek information about financial accounting and reporting issues by holding public forums if, in its judgment, it determines that a public forum is necessary to making an informed decision. The basis for a public forum generally will be an Exposure Draft or a Discussion Paper. The FASB will determine the number

of forums to be held for a project and the time, date, location and general format each. A member of the FASB or its technical staff will conduct such forums pursuant to procedures approved by the FASB Chairman.

The FASB will publicly announce its intention to hold a forum as soon as practicable, but no less than 30 days before the date of the earliest forum. Those public announcements will be made through a posting on the FASB's website.

2.3 The accounting standards codification – reorganizing and codifying U.S. GAAP

Before the accounting standards codification (“ASC”) the U.S. Accounting Literature consisted of more than 2,000 separate, loosely connected documents. Therefore, the idea of FASB was a simple one: let's reorganize this mass of literature into a single document organized by a major accounting topic.

On 1 July 2009, the FASB launched the FASB Accounting Standards Codification as the single source of authoritative nongovernmental U.S. generally accepted accounting principles. The ASC is effective for interim and annual periods ending after 15 September 2009. All existing accounting standards documents are superseded as described in FASB Statement No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles. All other accounting literature not included in the Codification is non-authoritative.

The Codification reorganizes the thousands of U.S. GAAP pronouncements into roughly 90 accounting topics and displays all topics using a consistent structure. It also includes relevant Securities and Exchange Commission guidance that follows the same topical structure in separate sections in the ASC.

While the ASC does not change GAAP, it introduces a new structure – one that is organized in an easily accessible, user-friendly online research system. The FASB expects that the new system will reduce the amount of time and effort required to research an accounting issue, mitigate the risk of non-compliance with standards through improved usability of the literature, provide accurate information with real-time updates as new standards are released and assist the FASB with the research effort required during the standard-setting process.

Chapter 3 - International Convergence

3.1 Overview

The globalization of the market has increased the number of transactions cross-border; many companies are listed on different markets. In this scenario is very important to define a common set of international accounting standards; in particular, the goals of international accounting convergence are: to reduce the cost of companies, to increase the comparability of the performance, to define a common accounting language in the world.

The set of principles issued by International Accounting Standard Board (“IASB”) were identified to achieve the international convergence. In the last years, the IFRS are applied in many countries (as of 2014 about 130 countries require or permit the application of IFRS²). The countries where IFRS is used already cover more than half of the world’s GDP. Another interesting fact is that the use of IFRS is no longer concentrated in Europe. The spread of IFRS in the Americas, Asia and Africa is such that the combined GDP of non- European jurisdictions is over \$ 23 trillion, more than the combined EU-GDP of \$ 17 trillion³.

The U.S. market is most important market in the world. It is easy to understand that the goal of International Convergence will be reached only when the most important economy will apply or will permit to apply the IFRS. From 2007, the Security Exchange Commission (“SEC”) permits to non U.S. issuers to prepare their financial statements with IFRS without reconciliation to U.S. GAAP. The SEC does not permit to apply the IFRS for U.S. issuer. Is not possible estimated when and how the U.S. market will require the application of IFRS.

For U.S. prepares, public or private, knowledge of IFRS is important. IFRS is increasingly relevant to many U.S. businesses as they engage in cross-border merger and acquisitions, report to their non-U.S. stakeholders and manage their overseas operations.

This chapter analysis the steps of IASB and FASB to reach a convergence between of the two set of standard, the goals achieved during the years, the residual main differences and the next steps.

3.2 A brief history

International convergence of accounting standards is not a new idea. The concept of convergence first arose in the late 1950 in response to post World War II economic integration and related increases in cross-border capital flows.

Started efforts focused on harmonization – reducing difference among the accounting principles used in major capital markets around the world. By 1990, the notion of harmonization was replaced by the concept of convergence – the development of a unified set of high-quality, international accounting standards that would be used in at least all major capital markets.

² Paul Pacter (2014), *IFRS as a global standards: a pocket guide 2014*, IFRS Foudantion

³ Hans Hoogervorst (2014), *Charting progress towards global accounting standards*, IFRS Foundation

The International Accounting Standards Committee, formed in 1973, was the first international standards-setting body. It was reorganized in 2001 and became an independent international standard setter, the International Accounting Standards Board. Since then, the use of international standards has progressed.

The FASB and the IASB have been working together since 2002 to improve and converge US generally accepted accounting principles and IFRS. As of 2013, Japan and China were also working to convergence their standards with IFRS. The securities and Exchange Commission consistently has supported convergence of global accounting standards. However, the Commission has not yet decided whether to incorporate International Financial Accounting Standards into the US financial reporting system. The Commission staff issued its final report on the issue in July 2012 without making a recommendation.

The following is a chronology of some of the key events in the evolution of the international convergence of accounting standards.

- ✓ The 1960 – Call for International Standards and Some Early Steps
- ✓ The 1970 and 1980 – An International Standard-Setting Body Takes Root
- ✓ The 1990 – The FASB Formalized and Expands its International Activities
- ✓ The 2000 – The Pace of Convergence Accelerates: Use of International Standards Grows Rapidly, the FASB and IASB Formally collaborate, and US Explores Adopting International Accounting Standards

The 2002 – The Norwalk Agreement

In September 2002, the FASB and the IASB met jointly and agreed to work together to improve and converge U.S. GAAP and IFRS. The Norwalk Agreement set out the shared goal of developing compatible, high-quality accounting standards that could be used for both domestic and cross-border financial reporting. It also established broad tactics to achieve their goal: develop standards jointly, eliminate narrow differences whenever possible and stay converged.

To achieve compatibility, the Boards agreed, as a matter of high priority to:

- ✓ undertake a short-term project aimed at removing a variety of individual differences between U.S. GAAP and IFRS;
- ✓ remove other differences between IFRS and U.S. GAAP that would have remained at January 1, 2005, through coordination of their future work programs; that is through the mutual undertaking of discrete, substantial projects which both Boards would address concurrently;
- ✓ continue progress on the joint projects that they are currently undertaking; and,
- ✓ encourage their respective interpretative bodies to coordinate their activities.

The 2006 – A Roadmap for Convergence between IFRS and US GAAP

In February 2006, the FASB and IASB issued a Memorandum of Understanding (“**MoU**”) that described the progress they hoped to achieve toward convergence by 2008. In the MoU, the two Boards reaffirmed their

shared objective of developing high-quality, common accounting standards. The MoU elaborated on the Norwalk Agreement, setting forth the following guidelines in working toward convergence:

- ✓ convergence of accounting standards can best be achieved by developing high-quality, common standards over time;
- ✓ instead of trying to eliminate differences between standards that are in need of significant improvement, the Boards should develop a new common standard that improves the quality of financial information;
- ✓ serving the needs of investors means that the Boards should seek to converge by replacing weaker standards with stronger standards.

Consistently with those guidelines, and after discussions with representative of the European Commission and the SEC staff, the FASB and the IASB had agreed to work towards the following goals for the IASB-FASB convergence program by 2008.

Short-term convergence

The goal by 2008 was to reach a conclusion about major differences in the following few focused areas would have been eliminated through one or more short-term standard-setting projects and, if so, complete or substantially complete work in those areas.

Topics for short-term convergence included:

e x a m i n e d b y t h e F A S B	e x a m i n e d b y t h e I A S B
fair value option	borrowing costs
impairment (jointly with the IASB)	impairment (jointly with the FASB)
income tax (jointly with the IASB)	income tax (jointly with the FASB)
investment properties	government grants
research and development	joint ventures
subsequent events	segment reporting

Other projects

The goal by 2008 was to have made significant progress on joint projects in areas identified by both Boards where current accounting practices of U.S. GAAP and IFRSs were regarded as candidates for improvement.

After considering the complexity of those topics and consultation requirements, the Boards set the following goals for 2008 for convergence topics already on either their active agendas or research programs.

topics already on an Active Agenda			
convergence topic	current status on the FASB agenda	current status on the IASB agenda	progress would have been achieved by 2008
1. business combination	on agenda - deliberation was in process	on agenda - deliberation was in process	to have issued converged standards (projected for 2007), the contents and effective dates of which would have been determined after taking full account of comments received in response to Exposure Draft
2. consolidations	on agenda	on agenda	to implement work aimed at the completed development of converged standards as a matter of high priority
3. fair value measurement guidance	completed standard expected in the first half of 2006	on agenda	to have issued converged guidance aimed at providing consistency in the application of existing fair value requirements
4. liabilities and equity distinctions	on agenda	on agenda	to have issued one or more due process documents relating to a proposed standard
5. performance reporting	on agenda	exposure draft on a first phase	to have issued one or more due process documents on the full range of topics in this projects
6. post - retirement benefits (including pensions)	on agenda	not yet on the agenda	to have issued one or more due process documents relating to a proposed standard
7. revenue recognition	on agenda	on agenda	to have issued one or more due process documents relating to a proposed comprehensive standar

As reported in the MoU, the objective of the goals set out was to provide a time frame for convergence efforts in the contexts of both the objective of removing the need for IFRS reconciliation requirements by 2009 and the existing agendas of the Boards. Items designed as convergence topics among the existing research programs of the Boards included.

topics already being researched, but not yet on an Active Agenda			
convergence topic	current status on the FASB agenda	current status on the IASB agenda	progress would have been achieved by 2008
1. derecognition	was in the pre-agenda research phase	on research agenda	to have issued a due process document relating to the results of staff research efforts
2. financial instruments (replacement of existing standards)	on research agenda and working group established	on research agenda and working group established	to have issued one or more due process documents relating to the accounting for financial instruments
3. intangible assets	not yet on agenda	on research agenda	to have considered and made a decision about the scope and timing of a potential agenda project
4. leases	pre-agenda research	on research agenda	to have considered and made a decision about the scope and timing of a potential agenda project

The conceptual framework

In the MoU the Boards expressed their commitment to develop a joint project on respective Conceptual Frameworks. As part of their Conceptual Framework projects, the IASB and FASB would have been addressing issues relating to the range of measurement attributes (including cost and fair value).

The FASB's conceptual framework was developed principally in 1970s and 1980s. Intended to help guide the FASB in developing standards on particular topics, it consists of a series of documents that address key concepts relating to the objectives of financial reporting, qualitative characteristics of financial reporting, the elements of financial statements and recognition and measurement of items in financial statements. The IASB has a similar, but much shorter document⁴ that it inherited from its predecessor body, the IASC.

Although these documents have been helpful in guiding standard-setting decision, experience has shown that they need further work and improvement to address gaps in certain areas and to refine some of the core thinking on other key conceptual matters. Accordingly, and consistent with the board's commitment to convergence, it made sense to develop a single, improved conceptual framework. So, near the end of 2004, the Boards began the effort. The initial areas of focus for improving and converging the conceptual guidance were the objectives and qualitative characteristics of financial reporting by business enterprises, the elements of financial statements of business enterprises and on what is termed the reporting entity.

The 2007 – Securities and Exchange Commission accepts from foreign private issuers of financial statements prepared in accordance with IFRS.

⁴ *Framework for the Preparation and Presentation of financial statements*

In December 2007, the Securities and Exchange Commission (“SEC”) adopted rules to accept from foreign private issuers in their filings with the Commission financial statements prepared in accordance with IFRS as issued by IASB without reconciliation to US GAAP as used in the United States.

The 2008 – The FASB and IASB update their MoU and the SEC issues a proposed roadmap to adoption of IFRS in the U.S. and a proposed rule on optional early use of IFRS.

In September 2008, the FASB and the IASB issued an update to the 2006 MoU to report the progress they have made since 2006 and to establish their convergence goals through 2011.

The following is a description of the agreed-upon pathway for completing the MoU projects that discusses separately short-term convergence projects and major joint projects

Short-term convergence

The MoU set the goal of concluding by 2008 whether major differences in a few focused areas would have been eliminated through one or more short-term projects and, if so, completing. The status of those short-term projects follows.

- ✓ Projects completed: the FASB and IASB issued standards on a number of short-term convergence projects. Bringing U.S. GAAP into line with IFRS, the FASB issued a new or amended standards that introduced a fair value option⁵ and adopted the IFRS approach to accounting for research and development assets acquired in a business combination⁶. Converging IFRS with U.S. GAAP, the IASB published new standards on borrowing costs⁷ and segment reporting⁸.
- ✓ Ongoing short-term convergence: the IASB published an Exposure Draft on joint arrangements⁹ in September 2007. The IASB had begun considering the comments to the proposal soon and expects to release a final standard at beginning of 2009. The IASB planned to publish a proposed standard on income taxes that would have improved IAS 12 and eliminate certain differences between IFRS and U.S. GAAP. The FASB had planned to publish proposed standards on accounting and reporting for subsequent events in the second half of 2008.
- ✓ Short-term convergence work deferred: the Boards had chosen to defer completing projects on government grants and impairment until other work would have completed.

Major Joint Projects

In seven of the 11 areas identified by the MoU, the Boards had either completed a common standard, reached similar conclusions, or were working jointly to develop a common high quality standard. In the other four

⁵ SFAS 159

⁶ SFAS 141R

⁷ IAS 23 revised

⁸ IFRS 8

⁹ IFRS 11

areas, the Boards were at different stages of developing their approach to the topic to address immediate areas of concern. The following table summarizes the status of the main joint projects.

topics already being researched, but not yet on an Active Agenda			
convergence topic	progress expected to be achieved by 2008, as stated in the 2006	status	estimated completion date
1. business combination	to have issued converged standards (projected for 2007).	project completed and common standards were published	project completed in 2007. FAS 141 R was issued in 2007. the revisions to IFRS 3 were issued in 2008
2. financial instruments	to have issued one or more due process documents relating to the accounting for financial instruments	IASB: discussion paper published in 2008. FASB: invitation to comment published on IASB discussion paper FASB: issued exposure draft to simplify hedge accounting	non defined
3. financial statement presentation	to have issued one or more due process documents on the full range of topics in this projects	IASB: issued a revision to IAS 1 in 2007. Joint Board deliberations are on-going	2011
4. intangible assets	to have considered the results of the IASB's research project and made a decision about the scope and timing of a potential agenda project	Inactive - the Boards decided in 2007 not to add a project to their joint agenda	not part of the active agenda
5. leases	to have considered and made a decision about the scope and timing of a potential agenda project	project added to the joint agenda. Board deliberations are ongoing	2011
6. liabilities and equity distinctions	to have issued one or more due process documents relating to a proposed standard	preliminary views/discussion paper published in the first half of 2008	2011
7. revenue recognition	to have issued one or more due process documents relating to a proposed comprehensive standard	joint board deliberation were on going	2011

areas identified for improvement in IFRS and US GAAP, where the Boards were at different stages in standard development			
convergence topic	progress expected to be achieved by 2008, as stated in the 2006	status	estimated completion date
8. consolidations	to implement work aimed at the completed development of converged standards as a matter of high priority	both Boards to publish exposure drafts in 2008	Both Boards to issue final standards in 2009-2010
9. derecognition	to have issued a due process document relating to the results of staff research efforts	both Boards to publish exposure drafts in 2008 or 2009	Both Boards to issue final standards in 2009-2010
10. fair value	to have issued converged guidance aimed at providing consistency in the application of existing fair value requirements	FASB: standard issued in 2006 IASB: discussion paper issued in 2008	IASB: 2011
11. post-employment benefits	to have issued one or more due process documents relating to a proposed standard	FASB: completed first staff IASB: discussion paper issued in 2008	IASB: 2011

In November 2008, the SEC published comment a proposed Roadmap to the possible use of IFRS by U.S. issuers beginning in 2014. Under the proposed Roadmap, the SEC would decide by 2011 whether adoption of IFRS would be in the public interest and would benefit investors. The proposed Roadmap identified several milestones that, if achieved, could lead to the use of IFRS by U.S. issuers. The SEC also proposed that U.S. issuers meeting certain criteria be given the option of filing financial statements prepared using IFRS issued by the IASB as early as years ending after December 15, 2009.

The 2009 – the G20 Leaders Push for Rapid International Convergence of Accounting Standards.

It is also noteworthy that the official declarations coming out of meetings of the G20, that were held in response to the global financial crisis, included comments urging expeditious international convergence of accounting standards and exhortations to international standard setters to work together and with regulators and supervisors to quickly develop common responses to financial reporting issues emanating from the financial crisis. For example, the communiqué issued following the April 2009 G20 Meeting in London called on accounting standard setters “to work urgently with supervisors and regulators to improve standards on valuation and provisioning and achieve a single set of high-quality global accounting standards”. That communiqué also included a number of recommendations on specific accounting standard-setting actions,

calling for them to be achieved by the end of 2009. These recommendations seemed to largely mirror those made by the Financial Stability Forum (which then became the Financial Stability Board of G20¹⁰).

In contrast, the communiqué issued following the September 2009 G20 meeting in Pittsburgh, called upon “international accounting bodies to redouble their efforts to achieve a single set of high-quality, global accounting standards within the context of their independent standard setting process, and complete their convergence project by June 2011¹¹.”

The FASB and IASB respond to the G20 call by more than redoubling the convergence effort

Prior to the G20 call to redouble, the FASB and IASB had been meeting three times per year in multiday, full board to board meetings. More frequent meetings had been occurring between small groups of board members, and their staffs had been working together for several years on major projects. In this way, by September 2009, they had been successfully in jointly issuing a number of important documents on major projects, including discussion documents on accounting for financial instruments, revenue recognition, lease accounting and financial statement presentation.

Responding to the call from G20 would require them to meet more frequently. The Boards discussed the joint efforts at length at their meeting in October 2009. They came to a number of agreements regarding the path forward that were described in a joint communiqué issued November 5, 2009. That document provided a status report on the MoU projects and forward plans for completing them by June 2011. It noted that in order to expedite the process, the Boards had agreed to begin meeting together each month. Very importantly, it described a number of shared goals, values and priorities, among these that convergence for the sake of convergence was not their goal and the standards under development needed to result in improvement to their existing standards.

The 2010 – the Boards report periodically on the status of their project to improve and converge U.S. GAAP and IFRS.

In April 2010, the FASB and IASB published a first-quarter progress report on their work to improve and achieve convergence of U.S. GAAP and IFRS.

In June 2010, the FASB and IASB agreed to modify their joint work plan to i) prioritize the major projects in the MoU to permit a sharper focus on issues and projects for which the need for improvement is most urgent and ii) phase the publication of exposure drafts and related consultations to enable the broad-based and effective stakeholder participation that is critically important to the quality of the standards. In June, 2010, the Boards issued a quarterly joint progress report that describe that modified work plan.

¹⁰ See the “Accounting Standards” section of the April 2, 2009, *G20 Declaration on Strengthening the Financial System*.

¹¹ Paragraph 14 on the “Strengthening the International Financial Regulatory System” section of September 25, 2009, G20 Leaders’ Statement: The Pittsburgh Summit.

The 2011 – progress report on IASB-FASB convergence work.

In April, the Boards reported on their progress toward completion of the convergence work program. The Boards were giving priority to three remaining projects on their MoU (financial instruments, revenue recognition and leases) as well as their joint project on insurance. The Boards also agreed to extend the timetable for those priority projects beyond June 2011 to permit further work and consultation with stakeholders in a manner consistent with an open and inclusive due process. The Boards issued a progress report that provides details on the timeline for completion of the MoU projects.

The 2012 – SEC “Final Report” on work plan

In July 2012, the SEC staff issued its final staff report on the “Work Plan for Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers”. The report was the final phase of a work plan, initiated in February 2010, to consider specific issues relevant to the Commission’s determination as to where, when and how the current financial reporting system for U.S. issuers should be transitioned to a system incorporating IFRS. The 2012 staff report summarized the staff’s findings regarding key issues surrounding the potential incorporation of IFRS into U.S. financial reporting, but did not make any recommendation to the Commission. In the report, the SEC staff examined a number of unresolved issues relating to the potential incorporation of IFRS into US. These issues include, among others, the diversity in how accounting standards, including IFRS, are interpreted, applied and enforced in various jurisdictions around the world; the potential cost to U.S. issuers of adopting or incorporating IFRS; investors education; and governance.

The 2013 – IFRS foundation establishes Accounting Standards Advisory Forum

The International Financial Reporting Standards Foundation in early 2013 established the Accounting Standards Advisory Forum (“**ASAF**”) to improve cooperation among worldwide standard setters and advise the IASB as it develops IFRS. The FASB was selected as one of the ASAF’s twelve members. The FASB’s membership on the ASAF is an opportunity to represent U.S. interests in the IASB’s standard-setting process and to continue the process of improving and converging U.S. GAAP and IFRS. The FASB was nominated for membership on the ASAF by the FAF Board of Trustees, which oversees both FASB and its sister standard-setting board, the Governmental Accounting Standards Board (“**GASB**”).

3.3 The status of the project on the main topics

3.3.1 Stock options

Background

On February 19, 2004, the IASB issued IFRS 2 Share-based payment that requires share-based payments to be recognized as an expense. This is the first major standard which the IASB itself had developed and was designed to take a leadership position in what had historically been a difficult area for standard setters.

The amount charged as expense is measured at fair value of the goods or services or acquires goods or services either as consideration for its equity instruments or by incurring liabilities for amounts based on the price of the entity's share or other equity instruments of the entity. The accounting requirements for the share-based payment depend on how the transaction will be settled (i.e. by issuance of i) equity, ii) cash, or iii) equity or cash).

Overview

Definition of share-based payment

A share-based payment is a transaction in which the entity receives goods or services either as consideration for its equity instruments or by incurring liabilities for amounts based on the price of the entity's shares or other equity instrument of the entity.

Scope

The concept of share-based payments is broader than employee share options. IFRS 2 encompasses the issuance of shares, or rights to shares, in return for services and goods.

IFRS 2 applies to all entities. There is no exemption for private or smaller entities. Furthermore, subsidiaries using their parent's or fellow subsidiary's equity as consideration for goods or services are within the scope of the standard.

Recognition and measurement

The issuance of shares or rights to shares requires an increase in a component of equity. IFRS 2 requires the offsetting debit entry to be expensed when the payment for goods or services does not represent an asset. The expense should be recognized as the goods or services are consumed.

The issuance of fully vested shares, or rights to shares, is presumed to relate to past service, requiring the full amount of the grant-date fair value to be expensed immediately. The issuance of shares to employee with, say, a three-year vesting period is considered to relate to services over the vesting period. Therefore, the fair value of the share-based payment, determined at the grant date, should be expensed over the vesting period.

As a general principle, the total expense related to equity-settled share-based payments will equal the multiple of the total instruments that vest and the grant-date fair value of those instruments. In short, there is true-up to reflect what happens during the vesting period. However, if the equity-settled share-based payment has a market related performance condition, the expense would still be recognized if all other vesting conditions are met.

Measurement guidance

Depending on the type of share-based payment, the fair value may be determined by the value of the shares or rights to shares given up, or by the value of the goods or services received:

- ✓ general fair value measurement principle – the transaction in which goods or services are received as consideration for equity instruments of the entity should be measured at the fair value of the goods or services received. Only if the fair value of the goods or services cannot be measured reliably would the fair value of the equity instruments granted be used;
- ✓ measuring employee share options – for transactions with employees and others providing similar services, the entity is required to measure the fair value of the equity instruments granted, because it is typically not possible to estimate reliably the fair value of employee services received;
- ✓ when to measure fair value options – for transactions measured at the fair value of the equity instruments granted, fair value should be estimated at grant date;
- ✓ when to measure fair value goods and services. For transaction measured at the fair value of goods or services received, fair value should be estimated at the date of receipt of those goods or services;
- ✓ measurement guidance – for goods or services measured by reference to the fair value of equity instruments granted, IFRS 2 specifies that, in general, vesting conditions are not taken into account when estimating the fair value of the shares or options at the relevant measurement date. Instead, vesting conditions are taken into account by adjusting the number or equity instruments included in the measurement of the transaction amount so that the amount recognized for goods or services received as consideration for the equity instruments granted is based on the number of equity instruments that eventually vest:
- ✓ performance conditions – the standard makes a distinction between the handling of market based performance conditions from non-market performance conditions. Market conditions are those related to the market price of an entity's equity, such as achieving a specified share price or a specified target based on a comparison of the entity's share price with an index of share prices of other entities. Market based performance conditions are included in the grant-date fair value measurement. However, the fair value of the equity instruments is not adjusted to take into consideration non-market based performance features these are instead taken into account by adjusting the number of equity instruments included in the measurement of the share-based payment number of equity instruments included in the measurement of the share-based payment transaction and are adjusted each period until such time as the equity instruments vest.

Modifications, cancellations and settlements

The determination of whether a change in terms and conditions has an effect on the amount recognized depends on whether the fair value of the new instruments is greater than the fair value of the original instruments.

Modifications of the terms on which equity instruments were granted may have an effect on the expense that will be recorded. IFRS 2 clarifies that the guidance on modification also applies to instruments modified after

their vesting date. If the fair value of the new instruments is more than the fair value of the old instruments, the incremental amount is recognized over the remaining vesting period in a manner similar to the original amount. If the modification occurs after the vesting period, the incremental amount is recognized immediately. If the fair value of the new instruments is less than the fair value of the old instruments, the original value of the equity instruments granted should be expensed as if the modification never occurred.

The cancellation or settlement of equity instruments is accounted for as an acceleration of the vesting period and therefore any amount unrecognized that would otherwise have been charged should be recognized immediately. Any payments made with the cancellation or settlement should be accounted for as the repurchase of an equity interest. Any payment in excess of the fair value of the equity instruments granted is recognized as an expense.

New equity instruments granted may be identified as a replacement of cancelled equity instruments. In those cases, the replacement equity instruments are accounted for as a modification. The fair value of the replacement equity instruments is determined at grant date, while the fair value of the cancelled instruments is determined at the date of cancellation, less any cash payments on cancellation that is accounted for as a deduction from equity.

Subject	IFRS	U.S. GAAP
scope	equity instruments issued by an employer and held by an ESOP are accounted for in the same manner as share-based payment awards	ASC 718.40 specifies the accounting for equity instruments issued by employer and held by an ESOP
scope	share-based payment awards issued to parties that have supplied goods or services to an entity from another group entity are within the scope of IFRS 2 unless the transfer is clearly for purposes other than payment for goods or services supplied to the entity	share-based payment awards issued to employees of an entity from related parties or other economic interest holders are within the scope of standard unless the transfer is clearly for purpose other than compensation for services to the entity
recognition	granted vesting awards may only be attributed as, in substance, multiple awards	a choice of attribution policy is allowed for granted vesting share-based payment awards as either a single awards or, in substance, multiple awards.
recognition	a specific discussion of "other" conditions is not included	conditions that are not considered service, performance, or market condition are considered "other" conditions. Share-based payments awards that include other conditions are accounted for as share-based liabilities.
recognition: definition of the grant date	the holder is not required to begin to benefit from, or adversely from affected by, subsequent changes in the price of the underlying equity shares	the holder must begin to benefit from, or be adversely affected by, subsequent changes in the price of the underlying equity shares
classification: risks and rewards for a reasonable period	a share-based payment award that can be redeemed for cash at fair value at the employee's option must be classified as a liability	a share-based payment award that can be redeemed for cash at fair value at the employee's option is not classified as a liability if the award requires the employee to bear the risks and rewards of share ownership for a reasonable period
classification: temporary equity	there is no concept of temporary equity. Share-based payment awards are classified as either equity or liability award	SEC registrants must classify redeemable share-based payment awards that would otherwise have been recorded in permanent equity as temporary equity
measurement: employee share purchase plans	compensation cost must be recognized for all share-based payment awards	compensation cost does not have to be recognized that meet certain criteria
measurement: simplified method for determining expected term	there is no convention to the simplified method for an entity to use in establishing expected term when determining the grant-date fair value based measure	under certain circumstances, it is acceptable for an entity to use a simplified method to establish an expected term when determining the grant date fair value
modification: improbable to probable	for share-based awards that were originally not expected to vest but that are now expected to vest as a result of a modification, compensation cost is the higher of the modified award's fair value or the grant date fair value measure of the original award	for share-based payment awards that were originally not expected to vest but that are now expected to vest as a result of a modification, compensation cost is based on the modified award's fair value measure
nonemployees: measurement date	nonemployee share-based payment awards must be measured on the date on which the entity obtains the goods or the counterparty renders service	nonemployee share-based payment awards must be measured on the earlier of i) the performance commitment date or ii) the date on which counterparty performance is complete

3.3.2 Business combinations

Background

On January 10, 2008, the IASB issued IFRS 3 (revised 2008) Business Combination and IAS 27 (revised 2008) Consolidated and Separate Financial Statements. The revisions were resulted in a high degree of convergence between IFRS and U.S. GAAP, although some inconsistencies remain, which may result in significantly different financial reporting.

Overview

The revised standard defined significant changes, including:

- ✓ a greater emphasis on the use of fair value, potentially increasing the judgment and subjectivity around business combination accounting and requiring greater input by valuation experts;
- ✓ focusing on changes in control as a significant economic event, introducing requirements to remeasure interest to fair value at the time when control is achieved or lost, and recognizing directly in equity the impact of all transaction between controlling and non-controlling shareholders not involving a loss of control; and
- ✓ focusing on what is given to the vendor as consideration, rather than what is spent to achieve the acquisition. Transaction costs, changes in the value of contingent consideration, settlement of pre-existing contracts, share-based payments and similar items will generally be accounted for separately from business combinations and will generally be accounted for separately from business combinations and will generally affect profit or loss.

The revised standards resolve many of the more contentious aspects of business combination accounting by restricting options or allowable methods.

Overview

Scope

IFRS 3 must be applied when accounting for business combination, but does not apply to:

- ✓ the acquisition of an asset or group of assets that is not a business, although general guidance is provided on how such transaction should be accounted for;
- ✓ combinations of entities or business under common control;
- ✓ acquisition by an investment entity of a subsidiary that is required to be measured at fair value through profit or loss under IFRS 10.

Determining whether a transaction is a business combination

IFRS 3 provides additional guidance on determining whether a transaction meets the definition of a business combination and so accounted for in accordance with its requirements. This guidance includes:

- ✓ business combination can occur in various ways, such as by transferring cash, incurring liabilities, issuing equity instruments;
- ✓ business combination can be structured in various ways to satisfy legal, taxation or other objectives, including one entity becoming a subsidiary of another, the transfer of net assets from one entity to another or to a new entity;
- ✓ the business combination must involve the acquisition of a business, which generally has three elements:
 - inputs, an economic resource that creates outputs when one or more processes are applied to it;
 - process, a system, standard, protocol, convention or rule that when applied to an input or inputs, creates outputs;
 - output, the result of inputs and processes applied to those inputs.

Method of accounting for business combinations

Acquisition method

The acquisition method is used for all business combinations.

Steps in applying the acquisition method are:

- ✓ identification of the “acquirer”;
- ✓ determination of the “acquisition date”;
- ✓ recognition and measurement of the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquire;
- ✓ recognition and measurement of a goodwill or a gain from a bargain purchase.

Identifying an acquirer

The guidance in IFRS 10 is used to identify an acquirer in a business combination.

If the guidance in IFRS 10 does not clearly indicate which of the combining entities is an acquirer, IFRS 3 provides additional guidance which is then considered:

- ✓ the acquirer is usually the entity that transfers cash or other assets where the business combination is effected in this manner;
- ✓ the acquirer is usually, but not always, the entity issuing equity interest where the transaction is effected in this manner, however the entity also considers other pertinent facts and circumstances;
- ✓ the acquirer is usually the entity with the largest relative size;
- ✓ for business combinations involving multiple entities, consideration is given to the entity initiating the combination and the relative sizes of the combining entities.

Acquisition date

An acquirer considers all pertinent facts and circumstances when determining the acquisition date. The acquisition date may be a date that is earlier or later than the closing date.

Acquired assets and liabilities

IFRS 3 establishes the following principles in relation to the recognition and measurement of items arising in a business combination:

- ✓ recognition principle, identifiable assets acquired, liabilities assumed and non-controlling interest in the acquiree are recognized separately from goodwill;
- ✓ measurement principle, all assets acquired and liabilities assumed in a business combination are measured at acquisition date at fair value.

Goodwill

Goodwill is measured as the difference between: the aggregate of i) the value of the consideration transferred; ii) the amount of any non-controlling interest; iii) in a business combination achieved in stages, the acquisition date of the acquirer's previously held equity interest in the acquire and i) the net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed

If the difference above is negative, the resulting gain is a bargain purchase in profit or loss, which may arise in circumstances such as a forced seller acting under compulsion.

Choice in the measurement of non-controlling interest

IFRS 3 allows an accounting policy choice, available on a transaction by transaction basis, to measure non-controlling interest either at:

- ✓ fair value; or
- ✓ the non-controlling interest's proportion share of net assets of the acquire.

The choice in accounting policy applies only to present ownership interests in the acquire that entitle holders to a proportionate share of the entity's net assets in the event of a liquidation. Other components of a non-controlling interest at must be measured at acquisition date fair value or in accordance with other applicable IFRS.

Business combination achieved in stages

Prior to control being obtained, an acquirer accounts for its investment in the equity interests of an acquire in accordance with the nature of the investment by applying the relevant standard. As part of accounting for the business combination, the acquirer remeasures any previously held interest at fair value and takes this amount into account in the determination of goodwill. Any resultant gain or loss is recognized in profit or loss or other comprehensive income as appropriate.

Related transaction and subsequent accounting

General principles

In general:

- ✓ transaction that are not part of what the acquirer and acquire exchanged in the business combination are identified and accounted for separately from business combination;
- ✓ the recognition and measurement of assets and liabilities arising in a business combination after the initial accounting for the business is dealt with under other relevant standards.

When determining whether a particular items is part of the exchange for the acquire or whether it is separate from the business combination, an acquirer considers the reason for the transactions, who initiated the transaction and the timing of the transaction.

Contingent consideration

Contingent consideration must be measured at fair value at the time of the business combination and is taken into account in the determination of goodwill. If the amount of contingent consideration changes as a result of a post-acquisition event, accounting for the change in consideration depends on whether the additional consideration is classified as equity instrument or an asset or liability.

Where a change in the fair value of contingent consideration is the result of additional information about facts and circumstances that existed at the acquisition date, these changes are accounted for as measurement period adjustments if they arise during the measurement period.

Differences remaining between IFRS and U.S. GAAP

With the release of IFRS 3 and ASC 805 the basic principles governing business combination and related transaction will be mostly converged. However, some important differences remain. These differences are largely, although not exclusively, a result of existing differences within the body of IFRS and U.S. generally that were no addressed by the IASB and FASB as part of the business combinations project.

Subject	IFRS	U.S. GAAP
Scope	No scope exception for combination between not-for-profit organizations or acquisition of a for-profit business by a not-for-profit organization	Scope exception for combination between not-for-profit entities or acquisition of a for-profit business by a not-for-profit entity
Non-controlling interest – initial measurement	Non-controlling interest components that “are present ownership interest and entitle their holder to a proportionate share of the entity’s net assets in the event of liquidation” are measured at either at fair value or “at the non-controlling interest’s proportionate share of the acquiree’s identifiable net assets”	Measure at fair value. Disclose valuation techniques and significant inputs used.
Acquired contingencies – initial measurement	Recognize a contingent liability at fair value if i) is a present obligation that arise from a past event and ii) can be measured reliably	Amounts, including assumed warranty obligation, are recognized at fair value, if determinable, during the measurement period. If fair value is not determinable, ASC 450 is followed if the recognition criteria are met as of the acquisition date
Acquired contingencies recognized as of the acquisition date – subsequent measurement	For a contingent liability, until the liability is settled, cancelled, or has expired, record the higher of the amount calculated under IAS 37, or the acquisition date fair value less cumulative amortization recognized under IAS 18	No specific guidance is provided. However the standard states that an acquirer “shall develop a systematic and rational basis” for subsequently accounting for pre-acquisition contingencies recognized as of the acquisition date
Operating leases in which the acquire is the lessor	Recognize favorable or unfavorable terms of the operating lease, relative to current market terms or prices, as part of the fair value of the acquired asset; the acquirer does not present a separate intangible asset or liability.	Recognize an intangible asset or liability apart from the acquired asset if the terms of the lease are favorable or unfavorable, respectively, relative to current market terms or prices
Disclosure – pro forma financial information	Required for all acquires for the current period only, unless impracticable to do so.	Required only for public business enterprises; comparable prior-period disclosures must be presented
Disclosure – goodwill	No requirement to disclose goodwill allocated to each cash-generating unit as of the acquisition date, but IAS 36 requires all entities to disclose goodwill for each cash generating unit as of the balance sheet date, if the amounts are significant relative to the entity’s total goodwill	Entities that apply segment reporting are required to disclose the amount of goodwill allocated to each segment, as of the acquisition date, for each material business combination.

3.3.3 Financial statements

Background

The objective of the financial statement presentation project is to establish a global standard that will guide the organization and presentation of information in the financial statements. The Boards’ goal is to improve the usefulness of the financial information provided in an entity’s financial statements to assist management to better communicate its financial information to the users of its financial statements and to help users in their decision-making. This is a joint project between IASB and FASB.

The IASB is conducting the project in three main phases: phase A, IAS 1 presentation of financial statement (completed); phase B (in progress)

Overview

IAS 1 presentation of financial statements sets out the overall requirements for financial statements, including how they should be structured, the minimum requirements for their content and overriding concepts such as going concern, the accrual basis of accounting and the current/non current distinction. The standard requires a complete set of financial statements to comprise a statement of financial position, a statement of profit or loss and other comprehensive income, a statement of changes in equity and a statement of cash flows.

IAS 1 was reissued in September 2007 and applies to annual periods beginning on or after January 1, 2009.

Objective of financial statements

The objective of general purpose financial statements 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. To meet that objective, financial statements provide information about an entity's:

- ✓ assets;
- ✓ liabilities;
- ✓ equity;
- ✓ income and expenses, including gains and losses;
- ✓ contribution by any distribution to owners;
- ✓ cash flows.

A complete set of financial statements includes:

- ✓ a statement of financial position at the end of the period;
- ✓ a statement of profit or loss and other comprehensive income for the period (presented as a single statement, or by presenting the profit or loss section in a separate statement of profit or loss, immediately followed by a statement presenting comprehensive income beginning with profit or loss);
- ✓ a statement of changes in equity for the period;
- ✓ a statement of cash flows for the period;
- ✓ notes, comprising a summary of significant accounting policies and other explanatory notes;
- ✓ comparative information prescribed by the standard.

An entity may use titles for the statements other than those stated above. All financial statements are required to be presented with equal prominence.

When an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements, it must also present a statement of financial position as the beginning of the earliest comparative period.

Fair presentation

The financial statements must “present fairly” the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses 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.

Going concern

The conceptual framework notes that financial statements are normally prepared assuming the entity is a going concern and will continue in operation for the foreseeable future.

IAS 1 requires management to make an assessment of an entity’s ability to continue as a going concern. If management has significant concerns about the entity’s ability to continue as a going concern, the uncertainties must be disclosed. If management concludes that the entity is not a going concern, the financial statements should not be prepared on a going concerns basis, in which case IAS 1 requires a series of disclosures.

Accruals basis of accounting

IAS 1 requires that an entity prepare its financial statements, except for cash flow information, using the accruals basis accounting.

Consistency of presentation

The presentation and classification of items in the financial statements shall be retained from one period to the next unless a change is justified either by a change in circumstances or a requirement of a new IFRS.

Materiality and aggregation

Each material class of similar items must be presented separately in the financial statements. Dissimilar items may be aggregated only if they are individually immaterial.

Offsetting

Assets, liabilities and income and expenses, may not be offset unless required or permitted by an IFRS.

Comparative information

IAS 1 requires that comparative information to be disclosed in respect of the previous period for all amounts reported in the financial statements and in the notes, unless another standard require otherwise. Comparative information is provided for narrative and descriptive where it is relevant to understanding the financial statements of the current period.

Statement of financial position

Current and non-current classification

An entity must normally present a classified statement of financial position, separating current and non-current assets and liabilities, unless presentation based on liquidity provides information that is reliable. In either case, if an asset (liability) category combines amounts that will be received (settled) after 12 months with assets (liabilities) that will be received (settled) within 12 months, note disclosure is required that separates the longer-term amounts from the 12-month amounts

Other

The standard requires a minimum line items to be included on the face of the statement of financial position. Additional line items, headings and subtotals may be needed to fairly present the entity's financial position. Further sub-classification of line items presented are made in the statement or in the notes.

IAS 1 does not prescribe the format of the statement of financial position. Assets can be presented current and non-current, or viceversa, and liabilities and equity can be presented current then non-current then equity, or vice versa. A net asset presentation allowed. The long-term financing approach

Statement of profit or loss and other comprehensive income

Concepts of profit or loss and comprehensive income

Profit or loss is defined as “the total of income less expenses, excluding the components of other comprehensive income”. Other comprehensive income is defined as comprising “items of income and expense that are not recognized in profit or loss as required or permitted by other IFRS”. Total comprehensive income is defined as “the change in equity during a period resulting from transaction and other events, other than those changes resulting from transaction with owners in their capacity as owners”.

All items of income and expense recognized in a period must be included in profit or loss unless a standard or an interpretation requires otherwise. Some IFRS requires or permit that some components to be excluded from profit or loss and instead to be included in other comprehensive income

Choice in presentation and basic requirements

An entity has a choice of presenting:

- ✓ a single statement of profit or loss and other comprehensive income, with profit or loss and other comprehensive income presented in two sections; or
- ✓ two statements: i) a separate statement of profit or loss; ii) a statement of comprehensive income, immediately following the statement of profit or loss and beginning with profit or loss.

The standard requires a minimum items must be presented in the profit or loss section. Expenses recognized in profit or loss should be analyzed either by nature or by function. If an entity categories by function, then

additional information on the nature of expenses – at a minimum depreciation, amortization and employee benefits expense – must be disclosed.

Other comprehensive income section

The other comprehensive income section is required to present line items which are classified by their nature and grouped between those items that will or will not be reclassified to profit or loss in subsequent periods.

Statement of changes in equity

IAS 1 requires an entity to present a separate statement of changes in equity. The statement must show:

- ✓ total comprehensive income for the period, showing separately amounts attributable to owners of the parent and to non-controlling interests;
- ✓ the effects of any retrospective application of accounting policies or restatements made in accordance with IAS 8, separately for each component of other comprehensive income;
- ✓ reconciliation between the carrying amounts at the beginning and the end of the period for each component of equity, separately disclosing: i) profit or loss; ii) other comprehensive income; iii) transaction with owners, showing separately contributions by and distributions to owners and changes in ownerships interests in subsidiaries that do not result in a loss of control.

Notes to the financial statements

The notes must:

- ✓ present information about the basis of preparation of the financial statements and the specific accounting policies used;
- ✓ disclose information required by IFRS that is not presented elsewhere in the financial statements; and
- ✓ provided additional information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them.

Judgment and key assumptions

An entity must disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations, the management has made in the process of applying the entity's accounting policies that have most significant effect on the amounts recognized in the financial statements.

An entity must also disclose information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Dividends

In addition to the distribution information in the statement of changes in equity, the following must be disclosed in the notes:

- ✓ the amount of dividends proposed or declared before the financial statements were authorized for issue but which were not recognized as a distribution to owners during the period and the related amount per share;
- ✓ the amount of any cumulative preference dividends not recognized.

Capital disclosures

An entity discloses information about its objectives, policies and process for managing capital. To comply with this, the disclosures include: i) qualitative information about the entity's objective, policies and process for managing capital; ii) description of capital it manages; iii) nature of external capital requirements; iv) how it is meeting its objectives; v) quantitative data about what the entity regards as capital.

If entity has puttable financial instruments classified as equity, the IAS 1 requires additional disclosures.

Difference between IFRS and U.S. GAAP

There has not been identified significant difference between the IFRS and U.S. GAAP for the financial statements.

3.3.4 Consolidation

Background

On May 12, 2011, the IASB issued IFRS 10 Consolidated financial statements, which is replacement of IAS 27 Consolidated and separate financial statements and SIC-12 Consolidation – special purpose entities. Concurrent with the issuance of IFRS 10, the IASB also issued:

- ✓ IFRS 11 Joint arrangements;
- ✓ IFRS 12 Disclosures of involvement with other entities;
- ✓ IAS 27 Separate financial statements, has been amended for the issuance of IFRS 10 but retains the current guidance for separate financial statements; and
- ✓ IAS 28 Investments in associates and joint ventures, has been amended for conforming changes based on the issuance of IFRS 10 and IFRS 11.

Each standards had an effective date for annual periods beginning on or after January 1, 2013. The European Union permitted the application starting January 1, 2014.

Overview of significant changes

IFRS 10 uses control as the single basis for consolidation, irrespective of the nature of the investee, eliminating the risks and rewards approach included in SIC 12.

IFRS 10 identifies the following three elements of control:

- ✓ power over the investee;
- ✓ exposure, or rights, to variable returns from involvement with the investee; and
- ✓ the ability to use power over the investee to affect the amount of the investor's returns.

An investor must possess all three elements to conclude it controls an investee. The assessment of control is based all facts and circumstances and the conclusion is reassessed if there is an indication that there are changes to at least of the three elements of control.

Element of control: power

Power exists when the investor has existing rights that give it the current ability to direct the activities that significantly affect the investee's returns. Power most commonly arises through voting rights granted by equity instruments, but can also arise through other contractual arrangements. Rights to direct the relevant activities do not need to be exercised for them to provide an investor power. If two or more investors have rights to direct different relevant activities, the investors must decide which of the relevant activities most significantly affects the returns of the investee.

The following factors should be considered in determining whether an investor has power over an investee:

- ✓ the purpose and design of the investee;
- ✓ the relevant activities of the investee and how decisions are made about those activities;
- ✓ whether the investor's right give it the current ability to direct the relevant activities;
- ✓ whether the investor is exposed, or has rights, to variable returns from its involvement with the investee;
- ✓ whether the investor has the ability to use its power over the investee to affect the amount of the investor's returns; and
- ✓ relationships with other parties.

The relevant activities for entities whose operations are directed through voting rights will generally be its operating and financing activities.

There may be situations where voting rights are less relevant because the rights relate to administrative tasks only. In these cases, a careful analysis of the investor's contractual and non-contractual rights as well as its related party relationships is necessary.

An investor may have a special relationship with an investee that indicates that it has power over the investee. IFRS 10 provides the following example of special relationships between an investor and investee that may indicate power:

- ✓ the investee's key management personnel are current or previous employees of the investor;
- ✓ the investee's operations are dependent on the investor;

- ✓ a significant portion of the investee's activities either involves or is conducted on behalf of the investor; and
- ✓ the investor's exposure, or rights, to investee returns is disproportionately greater than its voting or similar rights.

IFRS 10 acknowledges that there is a correlation between an investor's exposure, or rights, to variability of investee returns and its ability to direct the investee's relevant activities. However, the extent of the investor's exposure is not determinative in the power analysis.

There may be situations where an investee is designed so that its relevant activities occur or arise only upon a change in circumstances or the occurrence of a future event. IFRS 10 indicates that the circumstances or events do not need to have occurred for the relevant activities to be considered.

IFRS 10 specifies that only substantive rights and rights that are not protective are considered in assessing power. For a right to be substantive, it must give its holder the practical ability to exercise the right when the decision about the relevant activities of the investee need to be made. Rights do not need to be currently exercisable to be substantive. Also, substantive rights held by other parties may prevent the investor from controlling the investee.

Factors to consider in assessing whether a right is substantive include whether there is a:

- ✓ barriers that would prevent the holder from exercising the right (e.g., incurring a substantial penalty or fee if the right were exercised);
- ✓ mechanism that provides parties with the practical ability to permit the investor to exercise its right; or
- ✓ benefit from the investor exercising that right.

Protective rights

IFRS 10 distinguishes between substantive rights and protective rights. An investor who holds only protective rights would not have power over an investee and could not prevent another party from having power over an investee. Protective rights relate to "fundamental changes to the activities of an investee or apply in exceptional circumstances".

Control with less than a majority of voting rights

IFRS 10 clarifies that an investor can have power over an investee even though it does not hold a majority of the voting rights.

A contractual arrangement between an investor and other can give the investor the right to exercise voting rights sufficient to give the investor power, even if the investor itself does not have sufficient voting rights to give it power.

An investor that holds less than a majority of the voting rights should also consider the size of their holding of voting rights relative to the size and dispersion of holdings of the other vote holders and any additional facts and circumstances that may be relevant.

An investor would also need to consider potential voting rights held either by itself or by other parties. Potential voting rights are considered only when they are substantive and can, alone or in combination with other rights, give the current ability to direct relevant activities.

Principal versus agent relationship

IFRS 10 introduces guidance on assessing whether an entity with decision making rights is a principal or an agent. The standard describes an “agent” as a party who has been engaged to act on behalf, and for the benefit, of another party (the “principal”). However, the standard clarifies that an investor is not an agent simply because other parties can benefit from their decision making.

In determining whether a decision maker is an agent, the following factors should be considered, along with any other relevant elements of relationship between the decision maker, the investee and other parties involved with the investee:

- ✓ the scope of their decision making authority over the investee;
- ✓ rights held by other parties;
- ✓ the remuneration to which it is entitled;
- ✓ their exposure to variability of returns from other interests held in the investee; and
- ✓ the rights of a single party to remove the decision maker.

The standard does not provide guidance on how to weight each of the above criteria, except when a single party has the unilateral ability to remove the decision maker without cause. In those cases, the decision maker would be deemed the principal. However, if removal rights were shared among multiple investors, then each of the factors above would need to be considered in making the principal/agent assessment. IFRS 10 indicates that the greater number of parties require to act together to remove the decision maker, the less weighting that should be placed on the factor.

Relationships with other parties

IFRS 10 also provides guidance on when an investor may have a relationship with another party such that the investor may direct the other party in acting on the investor’s behalf. Examples of de facto agents include:

- ✓ related parties;
- ✓ an investor who received their interest in the investee as a result of a loan or contribution from the investor;
- ✓ an investor who has agreed not to sell, transfer or encumber their interest in the investee without prior approval of another investor;

- ✓ a party that cannot finance its operations without subordinated financial support from the investor;
- ✓ an investee who shares a majority of their board or key management personnel with an investor; and
- ✓ a party with a close business relationship with the investor.

Elements of control: exposure, or rights, to variable returns

The second criterion in the consolidation assessment is that the investor has exposure, or rights, to variable returns of the investee. IFRS 10 uses the term “returns” rather than “benefit” to clarify that the economic exposure to an investee may be either positive, negative or both.

IFRS 10 clarifies that although certain economic interests may be fixed they might still result in variable returns as they expose the investor to variability such as credit risk from the debt instrument and performance risk from the asset management arrangement.

Elements of controls: ability to use power to affect returns

The third pillar in the assessment of control considers the interaction between the first two control components. To have control over an investee, an investor must not only have power over an investee and exposure or rights to variable returns from its involvement with the investee, but also have the ability to use its power over the investee to affect its returns from its involvement with the investee.

Other considerations

Continuous assessment

IFRS 10 requires a continuous assessment of control of an investee. This continuous reassessment would consider both changes in an investor’s power over the investee and changes in the investor’s exposure or rights to variable returns. This assessment will be made on changes in facts and circumstances but would be revisited at least at each reporting period.

Subject	IFRS	U.S. GAAP
determining when to consolidate an entity	there is one model for determining whether consolidation is appropriate that encompass the guidance in IFRS 10. In this case, an entity considers: i) the purpose of the design of the investee; ii) what the relevant activities are and how decisions about those activities are made; iii) whether the rights of the investor give the current ability to direct the relevant activities; iv) whether the investor is exposed, or has rights, to variable returns from its involvement with the investee; v) whether the investor has the ability to use its power over the investee to affect the amount of the investor's returns.	there are two different models for determining when consolidation is appropriate. If a reporting entity has an interest in a variable interest entity (VIE), it must apply the VIE consolidation model, which is based on power and economics. If a reporting entity has an interest in an entity that is not a VIE, it must apply the control-based consolidation model
definition of control	Under IFRS 10 an investor controls when: i) has power over investee; ii) has exposure to variable returns; iii) has the ability to use power over the investee to affect the amount of the investor's returns.	under the voting interest model in the standard, a controlling financial interest is defined as "ownership of a majority voting interest" in another entity. ASC further indicates that the power to control another entity may exist in other contracts or agreements outside of a controlling financial interest. The VIE model states that a reporting entity has a CFI if it is both of the following characteristics: i) the power to direct the activities of the entity that most significantly affect the entity's economic performance; ii) the obligation to absorb losses of the entity could potentially be significant to the entity or the right to receive benefits from the entity that could potentially be significant to the entity
consideration of potential voting rights	the entity has to consider if the potential voting rights are substantive. In case they are considered substantive the entity has to assess them.	an entity is not required to consider potential voting rights when determining whether control is present; rather, such potential voting rights may indicate control. The VIE model does not specifically address the impact of potential voting rights on the determination of which party has the power to direct the most significant activities of an entity.
exception for preparing consolidated financial statements	an entity has not to present consolidated financial statement if it is an "investment entity", in this case it has to evaluate all investments at fair value	no exception is provided for preparing consolidating financial statements when either i) a parent control a subsidiary or; ii) a reporting entity is determined to be the primary beneficiary of a VIE
presentation requirements for certain consolidated entities	presentation requirements for special-purpose entities are not specifically addressed.	the primary beneficiary of a VIE is required to separately present on the face of the balance sheet i) assets of the consolidated VIE that can only be used to settle obligations of the VIE and ii) liabilities of the consolidated VIE for which creditors do not have recourse to the general credit of the primary beneficiary.
consolidated accounting policy	in the consolidated financial statements, the accounting policies of a subsidiary must be conformed with the accounting policies of a parent.	in the consolidated financial statements, a reporting entity is not required to conform the accounting policies of a subsidiary with the accounting policy of a parent.

3.3.5 Financial instruments

Background

The IASB's project to replace IAS 39 *Financial Instruments: Recognition and Measurement* started in 2008 and has been completed in 2008 and has been completed in phases. The IASB first issued IFRS 9 in 2009 with a new classification and measurement model for financial assets followed by requirements for financial liabilities and derecognition added in 2010. Subsequently, IFRS 9 was amended in 2013 to add new general hedge accounting requirements.

The standard has a mandatory effective date for annual periods beginning on or after January 1, 2018, with earlier application permitted. The standard is applied retrospectively with some exceptions (e.g. most of the hedge accounting requirements apply prospectively) but entities need not restate prior periods in relation to classification and measurement.

The IASB decided to issue the full version of IFRS 9 which will supersede all previous version of the standard. However, for annual periods beginning before January 1, 2018, an entity may elect to apply those earlier versions of IFRS 9 if the entity's relevant date of initial application is before February 1, 2015.

IAS 39

Scope

Scope exclusions

IAS 39 applies to all types of financial instruments except for the following, which are scoped out of IAS 39

- ✓ Interest in subsidiaries, associates and joint ventures that are accounted for under IFRS 10 Consolidated Financial Statements, IAS 27 Separate Financial Statements and IAS 28 Investment in Associates and Joint Ventures; however, IAS 39 applies in cases where under those standards such interests are to be accounted for under IAS 39. The standard also applies to most derivatives on an interest to be accounted for under IAS 39. The standard also applies to most derivatives on an interest in a subsidiary, associate or joint venture.
- ✓ employers' rights and obligations under employee benefit plans to which IAS 19 *Employee Benefits* applies.
- ✓ forward contracts between an acquirer and selling shareholder to buy or sell an acquiree that will result in a business combination at a future acquisition date.
- ✓ rights and obligations under insurance contracts, except IAS 39 does not apply to financial instruments that take the form of an insurance (or reinsurance) contract but that principally involve the transfer of financial risks and derivatives embedded in insurance contracts

- ✓ financial instruments that meet the definition of own equity under IAS 32 *Financial Instruments: Presentation*.
- ✓ financial instruments, contracts and obligations under share-based payment transactions to which IFRS 2 *Share-based Payment* applies.
- ✓ rights to reimbursement payments to which IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* applies.

Leases

IAS 39 applies to lease receivables and payables only limited respects:

- ✓ IAS 39 applies to lease receivables with respect to the derecognition and impairment provisions;
- ✓ IAS 39 applies to lease payables with respect to the derecognition provision;
- ✓ IAS 39 applies to derivatives embedded in leases.

Financial guarantees

IAS 39 applies to financial guarantee contracts issued. However, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either IAS 39 or IFRS 4 *Insurance Contracts* to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable.

Accounting by the holder is excluded from the scope of IAS 39 and IFRS 4 (unless the contract is a reinsurance contract). Therefore, paragraphs 10-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* apply. Those paragraphs specify criteria to use in developing an accounting policy if no IFRS applies specifically to an item.

Loan commitments

Loan commitments are outside the scope of IAS 39 if they cannot be settled net in cash or another financial instrument, they are not designated as financial liabilities at fair value through profit or loss, and the entity does not have a past practice of selling the loans that resulted from the commitment shortly after origination. An issuer of a commitment to provide a loan at a below-market interest rate is required initially to recognise the commitment at its fair value; subsequently, the issuer will remeasure it at the higher of (a) the amount recognised under IAS 37 and (b) the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with IAS 18. An issuer of loan commitments must apply IAS 37 to other loan

commitments that are not within the scope of IAS 39 (that is, those made at market or above). Loan commitments are subject to the derecognition provisions of IAS 39.

Contracts to buy or sell non-financial items

Contracts to buy or sell financial items are always within the scope of IAS 39 (unless one of the other exceptions applies).

Contracts to buy or sell non-financial items are within the scope of IAS 39 if they can be settled net in cash or another financial asset and are not entered into and held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements. Contracts to buy or sell non-financial items are inside the scope if net settlement occurs.

The following situations constitute net settlement:

- ✓ The terms of the contract permit either counterparty to settle net;
- ✓ There is a past practice of net settling similar contracts;
- ✓ There is a past practice, for similar contracts, of taking delivery of the underlying and selling it within a short period after delivery to generate a profit from short-term fluctuations in price, or from a dealer's margin; or
- ✓ The non-financial item is readily convertible to cash.

Weather derivatives

Although contracts requiring payment based on climatic, geological, or other physical variable were generally excluded from the original version of IAS 39, they were added to the scope of the revised IAS 39 in December 2003 if they are not in the scope of IFRS 4.

Definitions

IAS 39 incorporates the definitions of the following items from IAS 32 *Financial Instruments*:

Presentation:

- ✓ Financial instrument;
- ✓ Financial asset;
- ✓ Financial liability;
- ✓ Equity instrument.

A derivative is a financial instrument:

- ✓ Whose value changes in response to the change in an underlying variable such as an interest rate, commodity or security price, or index;
- ✓ That requires no initial investment, or one that is smaller than would be required for a contract with similar response to changes in market factors; and
- ✓ That is settled at a future date.

Embedded derivatives

Some contracts that themselves are not financial instruments may nonetheless have financial instruments embedded in them. For example, a contract to purchase a commodity at a fixed price for delivery at a future date has embedded in it a derivative that is indexed to the price of the commodity.

An embedded derivative is a feature within a contract, such that the cash flows associated with that feature behave in a similar fashion to a stand-alone derivative. In the same way that derivatives must be accounted for at fair value on the balance sheet with changes recognised in the income statement, so must some embedded derivatives. IAS 39 requires that an embedded derivative be separated from its host contract and accounted for as a derivative when:

- ✓ The economic risks and characteristics of the embedded derivative are not closely related to those of the host contract;
- ✓ A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- ✓ The entire instrument is not measured at fair value with changes in fair value recognised in the income statement.

If an embedded derivative is separated, the host contract is accounted for under the appropriate standard (for instance, under IAS 39 if the host is a financial instrument). Appendix A to IAS 39 provides examples of embedded derivatives that are closely related to their hosts, and of those that are not.

Examples of embedded derivatives that are not closely related to their hosts (and therefore must be separately accounted for) include:

- ✓ The equity conversion option in debt convertible to ordinary shares (from the perspective of the holder only);
- ✓ Commodity indexed interest or principal payments in host debt contracts;
- ✓ Cap and floor options in host debt contracts that are in-the-money when the instrument was issued;

- ✓ Leveraged inflation adjustments to lease payments;
- ✓ Currency derivatives in purchase or sale contracts for non-financial items where the foreign currency is not that of either counterparty to the contract, is not the currency in which the related good or services is routinely denominated in commercial transaction around the world and is not the currency that is commonly used in such contracts in the economic environment in which the transaction takes place.

If IAS 39 requires that an embedded derivative be separated from its host contract, but the entity is unable to measure the embedded derivative separately, the entire combined contract must be designated as a financial asset as at fair value through profit or loss.

Classification as liability or equity

Since IAS 39 does not address accounting for equity instruments issued by the reporting enterprise but it does deal with accounting for financial liabilities, classification of an instrument as liability or as equity is critical. IAS 32 *Financial Instruments: Presentation* addresses the classification question.

Classification of financial assets

IAS 39 requires financial assets to be classified in one of the following categories:

- ✓ Financial assets at fair value through profit or loss;
- ✓ Available-for-sale financial assets;
- ✓ Loans and receivables;
- ✓ Held-to-maturity investments.

Those categories are used to determine how a particular financial asset is recognised and measured in the financial statements.

Financial assets at fair value through profit or loss. This category has two subcategories:

- ✓ **Designated.** The first includes any financial asset that is designated on initial recognition as one to be measured at fair value with fair value changes in profit or loss.
- ✓ **Held for trading.** The second category includes financial assets that are held for trading. All derivatives (except those designated hedging instruments) and financial assets acquired or held for the purpose of selling in the short term or for which there is a recent pattern of short-term profit taking are held for trading.

Available-for-sale financial assets (AFS) are any non-derivative financial assets designated on initial recognition as available for sale or any other instruments that are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss. [IAS 39.9] AFS assets are measured at fair value in the balance sheet. Fair value changes on AFS assets are recognised directly in equity, through the statement of changes in equity, except for interest on AFS assets (which is recognised in income on an effective yield basis), impairment losses and (for interest-bearing AFS debt instruments) foreign exchange gains or losses. The cumulative gain or loss that was recognised in equity is recognised in profit or loss when an available-for-sale financial asset is derecognised.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than held for trading or designated on initial recognition as assets at fair value through profit or loss or as available-for-sale. Loans and receivables for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, should be classified as available-for-sale.[IAS 39.9] Loans and receivables are measured at amortised cost.

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments that an entity intends and is able to hold to maturity and that do not meet the definition of loans and receivables and are not designated on initial recognition as assets at fair value through profit or loss or as available for sale. Held-to-maturity investments are measured at amortised cost. If an entity sells a held-to-maturity investment other than in insignificant amounts or as a consequence of a non-recurring, isolated event beyond its control that could not be reasonably anticipated, all of its other held-to-maturity investments must be reclassified as available-for-sale for the current and next two financial reporting years. [IAS 39.9] Held-to-maturity investments are measured at amortised cost.

Classification of financial liabilities

IAS 39 recognises two classes of financial liabilities: [IAS 39.47]

- ✓ Financial liabilities at fair value through profit or loss
- ✓ Other financial liabilities measured at amortised cost using the effective interest method

The category of financial liability at fair value through profit or loss has two subcategories:

- ✓ **Designated.** a financial liability that is designated by the entity as a liability at fair value through profit or loss upon initial recognition
- ✓ **Held for trading.** a financial liability classified as held for trading, such as an obligation for securities borrowed in a short sale, which have to be returned in the future

Initial recognition

IAS 39 requires recognition of a financial asset or a financial liability when, and only when, the entity becomes a party to the contractual provisions of the instrument, subject to the following provisions in respect of regular way purchases. [IAS 39.14]

Regular way purchases or sales of a financial asset. A regular way purchase or sale of financial assets is recognised and derecognised using either trade date or settlement date accounting. [IAS 39.38] The method used is to be applied consistently for all purchases and sales of financial assets that belong to the same category of financial asset as defined in IAS 39 (note that for this purpose assets held for trading form a different category from assets designated at fair value through profit or loss). The choice of method is an accounting policy.

IAS 39 requires that all financial assets and all financial liabilities be recognised on the balance sheet. That includes all derivatives. Historically, in many parts of the world, derivatives have not been recognised on company balance sheets. The argument has been that at the time the derivative contract was entered into, there was no amount of cash or other assets paid. Zero cost justified non-recognition, notwithstanding that as time passes and the value of the underlying variable (rate, price, or index) changes, the derivative has a positive (asset) or negative (liability) value.

Initial measurement

Initially, financial assets and liabilities should be measured at fair value (including transaction costs, for assets and liabilities not measured at fair value through profit or loss).

Measurement subsequent to initial recognition

Subsequently, financial assets and liabilities (including derivatives) should be measured at fair value, with the following exceptions: [IAS 39.46-47]

- ✓ Loans and receivables, held-to-maturity investments, and non-derivative financial liabilities should be measured at amortised cost using the effective interest method.
- ✓ Investments in equity instruments with no reliable fair value measurement (and derivatives indexed to such equity instruments) should be measured at cost.
- ✓ Financial assets and liabilities that are designated as a hedged item or hedging instrument are subject to measurement under the hedge accounting requirements of the IAS 39.
- ✓ Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition, or that are accounted for using the continuing-involvement method, are subject to particular measurement requirements

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. [IAS 39.9] IAS 39 provides a hierarchy to be used in determining the fair value for a financial instrument:

- ✓ Quoted market prices in an active market are the best evidence of fair value and should be used, where they exist, to measure the financial instrument.
- ✓ If a market for a financial instrument is not active, an entity establishes fair value by using a valuation technique that makes maximum use of market inputs and includes recent arm's length market transactions, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis, and option pricing models. An acceptable valuation technique incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments.
- ✓ If there is no active market for an equity instrument and the range of reasonable fair values is significant and these estimates cannot be made reliably, then an entity must measure the equity instrument at cost less impairment.

Amortised cost is calculated using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability. Financial assets that are not carried at fair value through profit and loss are subject to an impairment test. If expected life cannot be determined reliably, then the contractual life is used.

IAS 39 Fair value option

IAS 39 permits entities to designate, at the time of acquisition or issuance, any financial assets or financial liability to be measured at fair value, with value changes recognized in profit or loss. This option is available even if the financial asset or financial liability would ordinarily, by its nature, be measured at amortized, but only if fair value can be reliably measured.

In June 2005, the IASB issued its amendment to IAS 39 to restrict the use of the option to designate any financial assets or any financial liability to be measured at fair value through profit and loss (the fair value option). The revisions limit the use of the option to those financial instruments that meet certain conditions:

- ✓ The fair value option designation eliminates or significantly reduces an accounting mismatch;
or
- ✓ A group of financial assets, or financial liabilities or both is managed and its performance is evaluated on a fair value basis by entity's management.

Once an instrument is put in the fair-value-through-profit-and-loss category, it cannot be reclassified out with some exceptions. In October 2008, the IASB issued amendments to IAS 39. The amendments permit reclassification of some financial instruments out of the fair-value-through-profit-or-loss category (FVTPL) and out of the available-for-sale category. In the event of reclassification, additional disclosures are required under IFRS 7 Financial Instruments: disclosures. In March 2009, the IASB clarified that reclassifications of financial assets under October 2008 amendments: on reclassification of a financial assets out of the "fair value through profit or loss" category, all embedded derivatives have to be assessed and, if necessary, separately accounted for financial statements.

IAS 39 available for sale option for loans and receivables

IAS 39 permits entities to designate, at the time of acquisition, any loan or receivable as available for sale, in which case it is measured at fair value with changes in fair value recognised in equity.

Impairment

A financial asset or group of assets is impaired, and impairment losses are recognised, only if there is objective evidence as a result of one or more events that occurred after the initial recognition of the asset. An entity is required to assess at each balance sheet date whether there is any objective evidence of impairment. If any such evidence exists, the entity is required to do a detailed impairment calculation to determine whether an impairment loss should be recognised. [IAS 39.58]

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the financial asset's original effective interest rate. [IAS 39.63]

Assets that are individually assessed and for which no impairment exists are grouped with financial assets with similar credit risk statistics and collectively assessed for impairment. [IAS 39.64]

If, in a subsequent period, the amount of the impairment loss relating to a financial asset carried at amortised cost or a debt instrument carried as available-for-sale decreases due to an event occurring after the impairment was originally recognised, the previously recognised impairment loss is reversed through profit or loss. Impairments relating to investments in available-for-sale equity instruments are not reversed through profit or loss. [IAS 39.65]

Financial guarantees

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due. [IAS 39.9]

Under IAS 39 as amended, financial guarantee contracts are recognised:

- ✓ initially at fair value. If the financial guarantee contract was issued in a stand-alone arm's length transaction to an unrelated party, its fair value at inception is likely to equal the consideration received, unless there is evidence to the contrary.
- ✓ subsequently at the higher of (i) the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*. (If specified criteria are met, the issuer may use the fair value option in IAS 39. Furthermore, different requirements continue to apply in the specialised context of a 'failed' derecognition transaction.)

Some credit-related guarantees do not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a guarantee is a credit derivative that requires payments in response to changes in a specified credit rating or credit index. These are derivatives and they must be measured at fair value under IAS 39.

Derecognition of a financial asset

The basic premise for the derecognition model in IAS 39 is to determine whether the asset under consideration for derecognition is: [IAS 39.16]

- ✓ an asset in its entirety; or
- ✓ specifically identified cash flows from an asset; or
- ✓ a fully proportionate share of the cash flows from an asset; or
- ✓ a fully proportionate share of specifically identified cash flows from a financial asset.

Once the asset under consideration for derecognition has been determined, an assessment is made as to whether the asset has been transferred, and if so, whether the transfer of that asset is subsequently eligible for derecognition.

An asset is transferred if either the entity has transferred the contractual rights to receive the cash flows, or the entity has retained the contractual rights to receive the cash flows from the asset, but has assumed a contractual obligation to pass those cash flows on under an arrangement that meets the following three conditions: [IAS 39.17-19]

- ✓ the entity has no obligation to pay amounts to the eventual recipient unless it collects equivalent amounts on the original asset;
- ✓ the entity is prohibited from selling or pledging the original asset (other than as security to the eventual recipient);
- ✓ the entity has an obligation to remit those cash flows without material delay.

Once an entity has determined that the asset has been transferred, it then determines whether or not it has transferred substantially all of the risks and rewards of ownership of the asset. If substantially all the risks and rewards have been transferred, the asset is derecognised. If substantially all the risks and rewards have been retained, derecognition of the asset is precluded. [IAS 39.20]

If the entity has neither retained nor transferred substantially all of the risks and rewards of the asset, then the entity must assess whether it has relinquished control of the asset or not. If the entity does not control the asset then derecognition is appropriate; however if the entity has retained control of the asset, then the entity continues to recognise the asset to the extent to which it has a continuing involvement in the asset. [IAS 39.30]

These various derecognition steps are summarised in the decision tree in AG36.

Derecognition of a financial liability

A financial liability should be removed from the balance sheet when, and only when, it is extinguished, that is, when the obligation specified in the contract is either discharged or cancelled or expires. [IAS 39.39] Where there has been an exchange between an existing borrower and lender of debt instruments with substantially different terms, or there has been a substantial modification of the terms of an existing financial liability, this transaction is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. A gain or loss from extinguishment of the original financial liability is recognised in profit or loss.

Hedge accounting

IAS 39 permits hedge accounting under certain circumstances provided that the hedging relationship is: [IAS 39.88]

- ✓ formally designated and documented, including the entity's risk management objective and strategy for undertaking the hedge, identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and how the entity will assess the hedging instrument's effectiveness and
- ✓ expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk as designated and documented, and effectiveness can be reliably measured and
- ✓ assessed on an ongoing basis and determined to have been highly effective

Hedging instruments

Hedging instrument is an instrument whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item. [IAS 39.9]

All derivative contracts with an external counterparty may be designated as hedging instruments except for some written options. A non-derivative financial asset or liability may not be designated as a hedging instrument except as a hedge of foreign currency risk. [IAS 39.72]

For hedge accounting purposes, only instruments that involve a party external to the reporting entity can be designated as a hedging instrument. This applies to intragroup transactions as well (with the

exception of certain foreign currency hedges of forecast intragroup transactions – see below). However, they may qualify for hedge accounting in individual financial statements.

Hedged items

Hedged item is an item that exposes the entity to risk of changes in fair value or future cash flows and is designated as being hedged. [IAS 39.9]

A hedged item can be: [IAS 39.78-82]

- ✓ a single recognised asset or liability, firm commitment, highly probable transaction or a net investment in a foreign operation
- ✓ a group of assets, liabilities, firm commitments, highly probable forecast transactions or net investments in foreign operations with similar risk characteristics
- ✓ a held-to-maturity investment for foreign currency or credit risk (but not for interest risk or prepayment risk)
- ✓ a portion of the cash flows or fair value of a financial asset or financial liability or
- ✓ a non-financial item for foreign currency risk only for all risks of the entire item
- ✓ in a portfolio hedge of interest rate risk (Macro Hedge) only, a portion of the portfolio of financial assets or financial liabilities that share the risk being hedged

In April 2005, the IASB amended IAS 39 to permit the foreign currency risk of a highly probable intragroup forecast transaction to qualify as the hedged item in a cash flow hedge in consolidated financial statements – provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated financial statements. [IAS 39.80]

In 30 July 2008, the IASB amended IAS 39 to clarify two hedge accounting issues:

- ✓ inflation in a financial hedged item
- ✓ a one-sided risk in a hedged item.

Effectiveness

IAS 39 requires hedge effectiveness to be assessed both prospectively and retrospectively. To qualify for hedge accounting at the inception of a hedge and, at a minimum, at each reporting date, the changes in the fair value or cash flows of the hedged item attributable to the hedged risk must be

expected to be highly effective in offsetting the changes in the fair value or cash flows of the hedging instrument on a prospective basis, and on a retrospective basis where actual results are within a range of 80% to 125%.

All hedge ineffectiveness is recognised immediately in profit or loss (including ineffectiveness within the 80% to 125% window).

Categories of hedges

A **fair value hedge** is a hedge of the exposure to changes in fair value of a recognised asset or liability or a previously unrecognised firm commitment or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss. [IAS 39.86(a)] The gain or loss from the change in fair value of the hedging instrument is recognised immediately in profit or loss. At the same time the carrying amount of the hedged item is adjusted for the corresponding gain or loss with respect to the hedged risk, which is also recognised immediately in net profit or loss. [IAS 39.89]

A **cash flow hedge** is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss. [IAS 39.86(b)] The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in other comprehensive income. [IAS 39.95]

If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, any gain or loss on the hedging instrument that was previously recognised directly in equity is 'recycled' into profit or loss in the same period(s) in which the financial asset or liability affects profit or loss. [IAS 39.97]

If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, then the entity has an accounting policy option that must be applied to all such hedges of forecast transactions: [IAS 39.98]

- ✓ Same accounting as for recognition of a financial asset or financial liability – any gain or loss on the hedging instrument that was previously recognised in other comprehensive income is 'recycled' into profit or loss in the same period(s) in which the non-financial asset or liability affects profit or loss.

- ✓ 'Basis adjustment' of the acquired non-financial asset or liability – the gain or loss on the hedging instrument that was previously recognised in other comprehensive income is removed from equity and is included in the initial cost or other carrying amount of the acquired non-financial asset or liability.

A **hedge of a net investment in a foreign operation** as defined in IAS 21 *The Effects of Changes in Foreign Exchange Rates* is accounted for similarly to a cash flow hedge. [IAS 39.102]

A **hedge of the foreign currency risk of a firm commitment** may be accounted for as a fair value hedge or as a cash flow hedge.

Discontinuation of hedge accounting

Hedge accounting must be discontinued prospectively if: [IAS 39.91 and 39.101]

- ✓ the hedging instrument expires or is sold, terminated, or exercised
- ✓ the hedge no longer meets the hedge accounting criteria – for example it is no longer effective
- ✓ for cash flow hedges the forecast transaction is no longer expected to occur, or
- ✓ the entity revokes the hedge designation

In June 2013, the IASB amended IAS 39 to make it clear that there is no need to discontinue hedge accounting if a hedging derivative is novated, provided certain criteria are met. [IAS 39.91 and IAS 39.101]

For the purpose of measuring the carrying amount of the hedged item when fair value hedge accounting ceases, a revised effective interest rate is calculated. [IAS 39.BC35A]

If hedge accounting ceases for a cash flow hedge relationship because the forecast transaction is no longer expected to occur, gains and losses deferred in other comprehensive income must be taken to profit or loss immediately. If the transaction is still expected to occur and the hedge relationship ceases, the amounts accumulated in equity will be retained in equity until the hedged item affects profit or loss. [IAS 39.101(c)]

If a hedged financial instrument that is measured at amortised cost has been adjusted for the gain or loss attributable to the hedged risk in a fair value hedge, this adjustment is amortised to profit or loss based on a recalculated effective interest rate on this date such that the adjustment is fully amortised by the maturity of the instrument. Amortisation may begin as soon as an adjustment exists

and must begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risks being hedged.

Overview of IFRS 9

Initial measurement of financial instruments

All financial instruments are initially measured at fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs.

Subsequent measurement of financial assets

IFRS 9 divides all financial assets that are currently in the scope of IAS 39 into two classifications: those measured at amortized cost and those measured at fair value.

Where assets are measured at fair value, gains and losses are either recognized entirely in profit or loss (“**FVTPL**”), or recognized in other comprehensive income (“**FVTOCI**”).

For debt instruments the FVTOCI classification is mandatory for certain assets unless the fair value option is elected. Whilst for equity investments, the FVTOCI classification is an election. Furthermore, the requirements for classifying gains or losses recognized in other comprehensive income are different for debt instruments and equity instruments.

The classification of a financial asset is made at the time it is initially recognized, namely when the entity becomes a party to the contractual provisions of the instrument. If certain conditions are met, the classification of an asset may subsequently need to be reclassified.

Debt instruments

A debt instrument that meets the following two conditions must be measured at amortized cost unless the asset is designed at FVTPL under the fair value option:

- ✓ business model test: the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.
- ✓ cash flow characteristics test: the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

All other debt instruments must be measured at fair value through profit or loss.

Fair value option

Even if an instrument meets the two requirements to be measured at amortized cost or FVTOCI, IFRS 9 contains an option to designate, at initial recognition, a financial asset as measured at FVTPL if doing so eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases.

Equity instruments

All equity investments in scope of IFRS 9 are to be measured at fair value in the statement of financial position, with value changes recognized in profit or loss, except for those equity investments for which the entity has elected to present value changes in “other comprehensive income”. There is no “cost exception for unquoted equities”.

Other comprehensive income option

If an equity investment is not held for trading, an entity can make an irrevocable election at initial recognition to measure it at FVTOCI with only dividend income recognized in profit or loss.

Measurement guidance

Despite the fair value requirement for all equity investments, IFRS 9 contains guidance on when cost may be the best estimate of fair value and also when it might not be representative of fair value.

Subsequent measurement of financial liabilities

IFRS 9 doesn't change the basic accounting model for financial liabilities under IAS 39. Two measurement categories continue to exist FVTPL and amortized cost. Financial liabilities held for trading are measured at FVTPL, and all other financial liabilities are measured at amortized cost unless the fair value option is applied.

Fair value option

IFRS 9 contains an option to designate a financial liability as measured at FVTPL if:

- ✓ doing so eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases, or
- ✓ the liability is a part or a group of financial liabilities or financial assets and liabilities that is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel.

A financial liabilities which does not meet any of these criteria may still be designated as measured at FVTPL when it contains one or more embedded derivatives that sufficiently modify the cash flows of the liability and are not clearly closely related.

IFRS 9 requires gains and losses on financial liabilities designated as at FVTPL to be split into amount of change in fair value attributable to changes in credit risk of the liability, presented in other comprehensive income, and the remaining amount presented in profit or loss. The new guidance allows the recognition of the full amount of change in fair value in profit or loss only if the presentation of changes in liability's credit risk in

other comprehensive income would create or enlarge an accounting mismatch in profit or loss. The determination is made at initial recognition and is not reassessed.

Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss, the entity may only transfer the cumulative gain or loss within equity.

Derecognition of financial assets

The basic premise for the derecognition model in IFRS 9 is to determine whether the asset under consideration for derecognition is:

- ✓ an asset in its entirety; or
- ✓ specifically identified cash flows from an asset; or
- ✓ a fully proportionate share of cash flows from an asset; or
- ✓ a fully proportionate share of specifically identified cash flows form a financial assets.

Once the asset under consideration for derecognition has been determine, an assessment is made as to whether the asset has been transferred, and if so, whether the transfer of that asset is subsequently eligible for derecognition.

An asset is transferred if either the entity has transferred the contractual rights to receive the cash flows, or the entity has retained the contractual right to receive the cash flows from the asset, but has assumed a contractual obligation to pass those cash on under an arrangement that meets the following three conditions:

- ✓ the entity has no obligation to pay amounts to the eventual recipient unless it collects equivalent amount on the original asset;
- ✓ the entity is prohibited from selling or pledging the original asset;
- ✓ the entity has an obligation to remit those cash flows without material delay.

Once an entity has determined that the asset has been transferred, it then determines whether or not it has transferred substantially all of the risks and rewards of ownership of the asset. If substantially all the risk and rewards have been transferred, the asset is derecognized. If substantially all the risks and rewards have been retained, derecognition of the asset is precluded.

If the entity has neither retained nor transferred substantially all of the risks and rewards of the asset, then the entity must assess whether it has relinquished control of the asset or not. If the entity does not control the asset then derecognition is appropriate; however if the entity has retained control of the asset, then the entity continues to recognize the asset to the extent to which it has continuing involvement in the asset.

Derecognition of financial liabilities

A financial liabilities should be removed from the balance sheet when, and only when, it is extinguished, that is, when the obligation specified in the contract is either discharged or cancelled or expires. Where there has

been an exchange between an existing borrower and lender of debt instruments with substantially different terms, or there has been a substantial modification of the terms of an existing financial liability, this transaction is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. A gain or loss from extinguishment of the original financial liability is recognized in profit or loss.

Derivatives

All derivatives in scope of IFRS 9, including those linked to unquoted equity investments, are measured at fair value. Value changes are recognized in profit or loss unless the entity has elected to apply hedge accounting by designating the derivative as a hedging instrument in an eligible hedging relationship.

Embedded derivatives

An embedded derivative is a component of a hybrid contract that also includes a non-derivative host, with the effect that some of the cash flow of the combined instrument vary in a way similar to a stand-alone derivative. A derivative that is attached to a financial instrument but is contractually transferable independently of that instrument, or has a different counterparty, is not an embedded derivative, but a separate financial instrument.

The embedded derivative concept that existed in IAS 39 has been included in IFRS 9 to apply only to hosts that are not financial assets within the scope of the standard. Consequently, embedded derivatives that under IAS 39 would have been separately accounted for at FVTPL because they were not closely related to the host financial asset will no longer be separated. Instead, the contractual cash flows of the financial asset are assessed in their entirety, and the asset as a whole is measured at FVTPL if the contractual cash flows characteristics test is not passed.

Reclassification

For financial assets, reclassification is required between FVTPL, FVTOCI and amortized cost, if and only if the entity's business model objective for its financial assets changes so its previous model assessment would no longer apply.

If reclassification is appropriate, it must be done prospectively from the reclassification date which is defined as the first day of the first reporting period following the change in business model. An entity does not restate any previously recognized gains, losses, or interest.

IFRS 9 does not allow reclassification:

- ✓ for equity investment measured at FVTOCI; or
- ✓ where the fair value option has been exercised in any circumstance for a financial asset or financial liability.

Hedge accounting

The hedge accounting requirements in IFRS 9 are optional. If certain eligibility and qualification criteria are met, hedge accounting allows an entity to reflect risk management activities in the financial statements by matching gains or losses on financial hedging instruments with losses or gains on the risk exposure they hedge.

The hedge accounting model in IFRS 9 is not designed to accommodate hedging of open dynamic portfolios. As a result, for a fair value hedge of interest rate risk of a portfolio of financial assets or liabilities an entity can apply the hedge accounting requirements in IAS 39 instead of those IFRS 9.

Qualifying criteria for hedge accounting

A hedging relationship qualifies for hedge accounting only if all of the following criteria are met:

- ✓ the hedging relationship consists only of eligible hedging instruments and eligible hedged items;
- ✓ at the inception of the hedging relationship there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge;
- ✓ the hedging relationship meets all of the hedge effectiveness requirements.

Hedging instruments

Only contracts with a party external to the reporting entity may be designated as hedging instruments.

A hedging instrument may be derivative or non-derivative financial instruments at FVTPL unless it is a financial liability designated as a FVTPL for which changes due to credit risk are presented in OCI. For a hedge of foreign currency risk, the foreign currency risk component of a non-derivative financial instrument, except equity investments designated as FVTOCI, may be designated as the hedging instrument.

IFRS 9 allows a proportion but not a time portion of a hedging instrument to be designated as the hedging instrument. IFRS 9 also allows only the intrinsic value of an option, or the spot element of a forward to be designated as the hedging instrument. An entity may also exclude the foreign currency basis spread from a designated hedging instrument.

IFRS 9 allows combinations of derivatives and non-derivatives to be designated as the hedging instrument.

Combinations of purchased and written options do not qualify if they amount to a net written option at the date of designation.

Hedged items

A hedged item can be recognized asset or liability, an unrecognized firm commitment, a highly probable forecast transaction or a net investment in a foreign operation and must be reliably measurable.

An aggregate item can be a recognized asset or liability, an unrecognized firm commitment, a highly probable forecast transaction or a net investment in a foreign operation and must be reliably measurable.

The hedged item must generally be with a party external to the reporting entity, however, as an exception the foreign currency risk on an intragroup monetary item may qualify as a hedged item in the consolidated financial statements if it results in an exposure to foreign exchange rate gains or losses that are not fully eliminated on consolidation. In addition, the foreign currency risk of a highly probable forecast intragroup transaction may qualify as a hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss.

An entity may designate an item in its entirety or a component of an items as the hedged item. The component may be a risk component that is separately identifiable any reliably measurable; one or more selected contractual cash flows; or components of a nominal amount.

A group of items is an eligible hedged item only if:

- ✓ it consists of items individually, eligible hedged items;
- ✓ the items in the group are managed together on a group basis for risk management purposes; and
- ✓ in the case of a cash flow hedge of a group of items whose variabilities in cash flows are not expected to be approximately proportional to the overall variability in cash flows of the group:
 - it is a hedge of foreign currency risk; and
 - the designation of that net position specifies the reporting period in which the forecast transactions are expected to affect profit or loss, as well as their nature and volume.

For a hedge of a net position whose hedged risk affects different lines in the statement of profit or loss and other comprehensive income, any hedging gains or losses in that statement are presented in a separate line from those affected by the hedged items.

Accounting for qualifying hedging relationships

There are three types of hedging relationships:

Fair value hedge: a hedge of the exposure to changes in fair value of a recognized asset or liability or an unrecognized firm commitment, or a component of any such item, that is attributable to a particular risk and could affect profit or loss.

For a fair value hedge, the gain or loss on the hedging instrument is recognized in profit or loss (or OCI), if hedging an equity instrument at FVTOCI and the hedging gain or loss on the hedged item adjusts the carrying amount of the hedged item and is recognized in profit or loss. However, if the hedged item is an equity instrument at FVTOCI, those amounts remain in OCI. When a hedged item is an unrecognized firm commitment the cumulative hedging gain or loss is recognized as an asset or a liability with a corresponding gain or loss recognized in profit or loss.

If the hedged item is a debt instrument measured at amortized cost or FVTOCI any hedge adjustment is amortized to profit or loss based on a recalculated effective interest rate. Amortization may begin as soon as adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for hedging gains and losses.

Cash flow hedge: a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with all, or a component of, a recognized asset or liability or a highly probable forecast transaction, and could affect profit or loss.

For a cash flow hedge the cash flow hedge reserve in equity is adjusted to the lower of the following:

- ✓ the cumulative gain or loss on the hedging instrument from inception of the hedge; and
- ✓ the cumulative change in fair value of the hedged item from inception of the hedge.

The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized in OCI and any remaining gain or loss is hedge ineffectiveness that is recognized in profit or loss.

If a hedged forecast transaction subsequently results in the recognition of a non-financial item or becomes a firm commitment for which fair value hedge accounting is applied, the amount that has been accumulated in the cash flows hedge reserves is removed and included directly in the initial cost or other carrying amount of the asset or the liability. In other cases the amount that has been accumulated in the cash flow hedge reserves is reclassified to profit or loss in the same period as the hedged cash flows affect profit or loss.

When an entity discontinues hedge accounting for a cash flow hedge, if the hedged future cash flows are still expected to occur, the amount that has been accumulated in the cash flows hedge reserve remains there until future cash flows occur; if the hedged future cash flows are no longer expected to occur, that amount is immediately reclassified to profit or loss.

A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or a cash flow hedge.

Hedge of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as a part of the net investment, is accounted for similarly to cash flow hedges:

- ✓ the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized in OCI; and
- ✓ the ineffective portions is recognized in profit or loss.

The cumulative gain or loss on the hedging instrument relating to the effective portion of the hedge is reclassified to profit or loss on the disposal or partial disposal of the foreign operation.

Hedge effectiveness requirements

In order to qualify for hedge accounting, the hedge relationship must meet the following effectiveness criteria at the beginning of each hedged period:

- ✓ there is an economic relationship between the hedge item and the hedging instrument;
- ✓ the effect of a credit risk does not dominate the value changes that result from the economic relationship;
- and
- ✓ the hedge ration of the hedging relationship is the same as that actually used in the economic hedge.

Rebalancing and discontinuation

If a hedging relationship ceases to meet the hedge effectiveness requirements relating to the hedge ratio but the risk management objective for that designated hedging relationship remains the same, an entity adjusts the hedge ration of the hedging relationship so that it meets the qualifying criteria again.

An entity discontinues hedge accounting prospectively only when the hedging relationship ceases to meet the qualifying criteria. This includes instances when the hedging instrument expires or is sold, terminated or exercised. Discontinuing hedge accounting can either affect a hedging relationship in its entirety or only a part of it.

Impairment

The impairment model in IFRS 9 is based on the premise of providing for expected losses.

Scope

IFRS requires that the same impairment model apply to all of the following:

- ✓ financial assets measured at amortized cost;
- ✓ financial assets mandatorily measured at FVTOCI;
- ✓ loan commitments when there is a present obligation to extend credit;
- ✓ financial guarantee contracts to which IFRS 9 is applied;
- ✓ lease receivables within the scope of IAS 17;
- ✓ contract assets within the scope of IFRS 15.

General approach

With the exception of purchased or originated credit impaired financial assets, expected credit losses are required to be measured through a loss allowance an amount equal to:

- ✓ the 12-month expected credit losses (expected credit losses that result from those default events on the financial instrument that are possible within 12 months after the reporting date); or
- ✓ full lifetime expected credit losses (expected credit losses that result from all possible default events over the life of the financial instrument).

A loss allowance for the full lifetime expected credit losses is required for a financial instrument if the credit risk of that financial instrument has increased significantly since initial recognition, as well as to contract assets or trade receivables that do not constitute a financing transaction in accordance with IFRS 15.

Additional, entities can elect an accounting policy to recognize full lifetime expected losses for all contract assets and/or all trade receivables that do constitute a financing transaction in accordance with IFRS. The same election is also separately permitted for lease receivables.

For all other financial instruments, expected credit losses are measured at an amount equal to 12-month expected credit losses.

Significant increase in credit risk

With the exception of purchased or originated credit-impaired financial assets, the loss allowance for financial instruments is measured at an amount equal to lifetime expected losses if the credit risk of a financial instrument has increased significantly since initial recognition, unless the credit risk of the financial instrument is low at the reporting date in which case it can be assumed that credit risk on the financial instrument has not increased significantly since initial recognition.

The standard considers credit risk low if there is a low risk of default, the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations. The standard suggests that “investment grade” rating might be an indicator for a low credit risk.

The assessment of whether there has been a significant increase in credit risk is based on an increase in the probability of a default occurring since initial recognition. Under the standard, an entity may use various approaches to assess whether credit risk has increased significantly. An approach can be consistent with the requirements even if it does not include an explicit probability of default occurring as an input. The application guidance provides a list of factors that may assist an entity in making the assessment. Also, whilst in principle the assessment of whether a loss allowance should be based on lifetime expected credit losses is to be made on an individual basis, some factors or indicators might not be available at an instrument level. In this case, the entity should perform the assessment on appropriate groups or portions of a portfolio of financial instruments.

The requirements also contain a rebuttable presumption that the credit risk has increased significantly when the contractual payments are more than 30 days past due. IFRS 9 also requires that if a significant increase in credit risk that had taken place since initial recognition and has revert by a subsequent reporting period then the expected credit losses on the financial instrument revert to being measured based on an amount equal to the 12-month expected credit losses.

Purchase or originated credit-impaired financial assets

Purchased or originated credit-impaired financial assets are treated differently because the asset is credit-impaired at initial recognition. For these assets, an entity would recognize changes in lifetime expected losses since initial recognition as a loss allowance with any changes recognized in profit or loss. Under the requirements, any favourable changes for such assets are an impairment gain even if the resulting expected cash flows of a financial asset exceed the estimated cash flows on initial recognition.

Credit-impaired financial asset

Under IFRS 9 a financial asset is credit-impaired when one or more events that have occurred and have a significant impact on the expected future cash flows of the financial asset. It includes observable data that has come to the attention of the holder of a financial asset about the following events:

- ✓ significant financial difficulty of the issuer or borrower;
- ✓ a breach of contract, such as a default or past-due event;
- ✓ the lenders for economic or contractual reasons relating to the borrower's financial difficulty granted the borrower a concession that would not otherwise be considered;
- ✓ it becoming probable that the borrower will enter in bankruptcy or other financial reorganization;
- ✓ the disappearance of an active market for the financial asset because of financial difficulties; or
- ✓ the purchase or origination of a financial asset at a deep discount that reflects incurred credit losses.

Basis for estimating expected credit losses

Any measurement of expected credit losses under IFRS 9 shall reflect an unbiased an probability-weight amount that is determined by evaluating the range of possible outcomes as well as incorporating the time value of money. Also, the entity should consider reasonable and supportable information about past events, current conditions and reasonable and supportable forecasts of future economic conditions when measuring expected credit losses.

The standard defines expected credit losses as the weighted average of credit losses with the respective risks of default occurring as the weightings. Whilst an entity does not need to consider every possible scenario, it must consider the risk of probability that a credit loss occurs by considering the possibility that a credit loss occurs and the possibility than no credit loss occurs, even if the probability of a credit loss occurring is low.

For lifetime expected losses, an entity s required to estimate the risk of a default occurring on the financial instrument during its expected life. 12-month expected credit losses represent the lifetime cash shortfalls that will result if a default occurs in the 12 month after the reporting date, weighted by the probability of the default occurring.

An entity is required to incorporate reasonable and supportable information. Information is reasonably available if obtaining it does not involve undue cost or effort.

For applying the model to a loan commitment an entity will consider the risk of a default occurring under the loan to be advanced, whilst application of the model for financial guarantee contracts an entity considers the risk of a default occurring of the specified debtor.

To reflect time value, expected losses should be discounted to the reporting date using the effective interest rate of the asset that was determined at initial recognition. A “credit-adjusted effective interest” rate should be used for expected credit losses of purchased or originated credit-impaired financial assets. In contrast to the “effective interest rate”, the credit-adjusted effective interest rate reflects expected credit losses of the financial asset.

Expected credit losses of undrawn loan commitments should be discounted by using the effective interest rate that will be applied when recognizing the financial asset resulting from the commitment. If the effective interest rate of a loan commitment cannot be determined, if the discount rate should reflect the current market assessment of time value of money and the risks that are specific to the cash flows but only if, and to the extent that, such risks are not taken into account by adjusting the discount rate. This approach shall also be used to discount expected credit losses of financial guarantee contracts.

Subject	IFRS	U.S. GAAP
embedded derivatives: definition of a derivative and scope exceptions	an embedded derivative is not separated from a financial asset host contract that is within the scope of IFRS 9. Rather, the classification and measurement requirement of IFRS 9 are applied to entire hybrid contract. Conversely, IFRS 9 retains the requirements of IAS 39 to separate an embedded derivatives from a host contract that is other than an asset within the scope of IFRS 9 if the applicable criteria are met.	one condition for separating an embedded derivative is that it must meet the definition of a derivative
embedded derivatives: hybrid contracts measured at fair value through earnings	like IAS 39, IFRS 9 may differ from U.S. GAAP with respect to the conditions that such contracts need to meet to qualify for the fair value election	another condition for separating an embedded derivative is that the hybrid contract in which it is embedded must not be measured at fair value with changes in fair value reported in earnings
hedge accounting: assessing effectiveness of hedging relationship that use an option as a hedging instrument		an entity may exclude components of time value from an effectiveness assessment
designation of hedging instrument		an entity is prohibited from separating a compound derivative into different risk components that are designated as hedging instruments
hedgeable risks for hedges of non-financial items		an entity may hedge overall changes in fair value or cash flows for entire item. For cash flow hedges, the foreign exchange risk also can be designated as the hedged risk.
shortcut method		allowed for hedging relationship involving an interest rate swap an interest-bearing financial instrument that meet specific requirements
Foreign currency hedging		Either the operating unit that has the foreign currency exposure or another unit with the same functional currency as the operating unit must be a party to the hedging instrument. Also, the hedged transaction must be denominated in a currency other than the hedging unit's functional currency.

Subject	IFRS	U.S. GAAP
<i>requirements applicable to fair value hedges</i>		
held to maturity securities as a hedged item	IFRS eliminates the held to maturity classification and measurement category in IAS 39.	changes in total fair value of a prepayment option embedded in a held to maturity security can be designated as a hedged risk. Interest rate risk cannot be designated as the hedged risk
measurement of fair value changes in a hedged item that are attributable to changes in the benchmark interest rate	hedged item can be defined as a portion of the interest rate cash flows. Hedged item is not limited to all of the contractual cash flows.	for a fair value hedge, all contractual cash flows must be included when changes in fair value attributable to changes in benchmark interest rate calculated
portfolio hedge of interest rate risk	a special hedge accounting method is provided for a portfolio fair value hedge of interest rate risk.	portfolio hedges are permitted if individual items have generally proportionate exposure to hedged risk as the entire portfolio. A currency amount cannot be designated as the hedged item.
Requirements applicable to cash flow hedges		
Non-derivative financial instruments as hedging instruments		cannot be designated as hedging instruments in a cash flow hedge
basis adjustments when discontinuing a cash flow hedge involving a non financial asset or liability	upon occurrence of a forecasted transaction, an entity can choose to i) reclassify cumulative amounts recorded in equity in the same period in which the acquired asset or liability affects earnings; ii) include those amounts in the initial cost basis or other carrying amount of the acquired asset or liability	amounts in accumulated other comprehensive income must be reclassified into earnings in the same period in which the hedged forecasted transaction affects earnings
foreign currency cash flow hedge with an internal derivative	not permitted in consolidated financial statements, hedging instrument must involve external party	permitted in consolidated financial statements if certain conditions are met
forecasted transaction whose occurrence is no longer probable	if the transaction is no longer expected to occur, amounts recorded in equity should be recognized in profit or loss.	the cumulative gain or loss on a derivative should remain in accumulated other comprehensive income unless it becomes probable that the forecasted transaction will not occur by the end of the originally specified period or within an additional two-month period.
<i>Requirements applicable to Net Investment Hedges</i>		
compound derivatives with multiple underlyings as the hedging instrument	not prohibited under IFRS.	an entity may not designate a cross-currency interest rate with one fixed-rate leg and one floating rate leg as the hedging instrument in a hedge of a net investment
permissible hedged exposures	hedged risk may be designated as the foreign currency exposure arising between the functional currency of the foreign operation and the functional currency of the foreign operation and the functional currency of any parent entity	a parent has a functional currency different from that of its first-tier subsidiary may not hedge a net investment of that first-tier subsidiary in a second tier subsidiary
where the hedging instrument can be held	the hedging instruments for a net investment hedge may be held by any entity or entities within the consolidated group	either i) the operating unit that has the foreign currency exposure must be a party to the hedging instrument or ii) another member of the consolidated group that has the same functional currency as that operating unit must be a party to the hedging instrument, provided that there is no intervening subsidiary with a different functional currency

In addition, in December 2011, the IASB amended the accounting requirements and disclosures related to offsetting of financial assets and financial liabilities by issuing amendments to IAS 32 and IFRS 7. These amendments are the result of the IASB and FASB undertaking a joint project to address the differences in their respective accounting standards regarding offsetting of financial instruments. In January 2011, the Boards published their proposals with the IASB issuing ED 2011/1 Offsetting financial assets and financial liabilities. The proposals would have retained the previous model under IAS 32 but would have eliminated the exceptions in U.S. GAAP for conditional rights of offset. The FASB subsequently decided to retain those exceptions rather than to proceed with the proposals. As the Boards could not agree on the criteria for offset in the statement of financial position the Boards decided to develop converged disclosure requirements to allow comparison between financial statements prepared under IFRS and U.S. GAAP.

3.3.6 Leases

The object of the project

The objective of the project is to develop a new Leases Standard that establishes the principles that lessees and lessor should apply to report useful information to investors and analysts about the amount, timing and uncertainty of cash flows arising from a lease.

Leasing is an important activity for many entities. It is a means of gaining access to assets, of obtaining finance and of reducing an entity's exposure to the risks of asset ownership. The prevalence of leasing, therefore, means that it is important that investors and analysts have a complete and understandable picture of an entity's leasing activity. The existing accounting models for leases require lessees and lessors to classify their leases as either finance leases or operating leases. A lessee is not required to recognize lease assets or liabilities for operating leases. Those models have been criticized for failing to meet the needs of investors and analysts because they do not always provide a faithful representation of leasing transactions; in particular, they omit important information about significant assets and liabilities. As a result, most investor and analysts adjust the amounts presented in a lessee's balance sheet to reflect the assets and liabilities arising from off balance sheet leases.

As report in IASB's staff analysis, the existence rules for the accounting of the leasing have a lack of comparability; in particular the staff performed a comparisons between entities in financial difficult. The table sets out a real-life comparison of two entities in an industry that uses property, plant and equipment intensively. Entity 2 leases about 70% of its equipment and Entity 1 less than 10 %.

Important information used by investors and analysts (e.g., total assets and long term liabilities) can be significantly affected by the off balance sheet treatment of leases. The table below contrasts the figures reported by the entities with the figures adjusted for the effects of off balance sheet leases. The reported figures show the Entity 1 has higher leverage and a higher asset based compared to Entity 2, when in fact the opposite is true, taking into account the off balance sheet leases.

The absence of information about leases on the balance sheet means that investors and analysts cannot properly compares companies without adjustments.

	industry Entity 1		industry Entity 2	
	reported	proposal	reported	proposal
property, plant and equipment	16.908	19.926	15.748	24.020
non-current liabilities	13.232	16.567	9.615	18.320
equity	6.719	6.402	5.604	5.171
ratio of non-current liabilities	02,0:1	2,6:1	1.7:1	3,5:1

Project status

Leases is an important project that the IASB is undertaking with the FASB.

The Boards jointly published a revised Exposure Draft leases (the 2013 ED) in May 2013. During the first half of 2014 the Boards have redeliberated and reached tentative decisions on many aspects of the project. In the second half of 2014.

The new Standard Leases is expected in 2015.

Background

The IASB and FASB published a Discussion Paper (“DP”) setting out a proposed lessee accounting model in March 2009. The proposed accounting model has evolved since the issuance of the DP, although it has maintained the right of use model. The most significant developments to date in the project are:

- ✓ In August 2010, the IASB and FASB issued Exposure Draft Leases that proposed new accounting models for lessors and lessee. The comment period ended on December 15, 2010. Redeliberations on the proposal in the ED began in January 2011 and July 2011 the Boards announced their intention to issue a revised ED;
- ✓ In May 2013, a revised exposure draft was issued with a comment period ended in September 2013;
- ✓ In March 2014, the Boards made decision on i) the lessee accounting model; ii) the lessor accounting model; iii) small ticket leases and iv) the lease term and reassessment thereof by the lessee;
- ✓ in April 2014, the Boards made decisions on i) lease modifications and contract combinations; ii) variable lease payments; iii) in substance fixed payments and iv) discount rate; and
- ✓ in May 2014, the Boards made decisions on i) the definition of the lease; ii) separating lease and non-lease components and iii) initial direct costs.

Although the Boards did not fully converge on all the topics detailed above, they will continue redeliberations on a joint basis.

Tentative decision reached during deliberations process

The proposed changes to lease accounting will significantly improve the transparency of information about those off balance sheet leases. The Boards realize that such big changes in accounting, which would affect many entities, requires careful consideration. Particular efforts have been made to undertake outreach activities that enable a broad range of views to be heard.

All leases on the balance sheet

The Boards have both tentatively decided that a lessee would be required to recognize assets and liabilities arising from all leases, with some exemptions. The model reflects that, at the start of a lease, the lessee obtains a right to use an asset for a period of time and the lessor has provided or delivered that right.

Recognition of lease expenses

The Boards have made different tentative decisions regarding the recognition and presentation of lease expenses in a lessee's income statement. The IASB has tentatively decided to propose a single lessee model that would require the recognition of interest and amortization for all leases recognized on a lessee's balance sheet. The FASB has tentatively decided to propose a dual model that retains the existing distinction between finance leases and operating leases. This model would result in no change to a lessee's income statement, but recognizes all leases on the balance sheet.

The IASB returned a single model because the feed back received on the dual model was that the dual model proposed was too complex.

The Boards retain that the difference in single and dual model position is expected to result in little difference for many lessees for portfolios of leases.

Definition of a lease

Under existing standards, the accounting for off balance sheet leases and services is similar. Under the new Leases Standard, this will change. Consequently, the distinction between a lease and a service is critical, because that distinction would determine whether a lessee recognizes assets and liabilities.

The principle is clear: a lease exists when the customer controls the use of an identified asset; a service exists when the supplier controls the use of the assets.

In the vast majority of cases, this assessment is straightforward. However, in some scenario the distinction can be difficult to make and would require judgment.

Measurement of lease liabilities

A lessee would measure lease assets and liabilities at the present value of future lease payments. Lease assets also include any costs directly related to entering into lease. In response to concerns about cost and complexity, the Boards have simplified the measurement of lease assets and liabilities. Consequently, variable payments and most optional payments are excluded from that measurement. The Boards have also simplified the

reassessment requirements compared to those proposed in the 2013 ED, thereby reducing the cost and complexity of application; in addition the Boards have clarified that a lessee can apply the requirements to a portfolio of similar leases, rather than to each individual lease.

Cash flow presentation

To retain the link between the balance sheet, income statement and cash flow statement, a lessee would classify: i) cash payments for the principal portion of the lease liability within financing activities and ii) cash payments for the interest portion of the lease liability in accordance with the requirements relating to other interest paid.

3.3.7 Revenue recognition

On May 28, 2014, the FASB and IASB issued their final standard on revenue from contracts with customers. The standard, issued as ASU 2014-09¹² by the FASB and as IFRS 15¹³ by the IASB, outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance.

Background

The goals of the revenue recognition project are to clarify and converge the revenue recognition principles under U.S. GAAP and IFRS and to develop guidance that would streamline and enhance revenue recognition requirements while providing a more robust framework for addressing revenue issues. The Boards believe that the standard will improve the consistency of requirements, comparability of revenue recognition practices and usefulness of disclosures.

The Boards' 2008 discussion paper on revenue recognition represents a significant milestone in the project. The project picked up momentum with the issuance of the June 2010 exposure draft, for which the Boards received nearly 1,000 comment letters. Then, in November 2011, the Boards issued their revised ED after conducting extensive outreach and redeliberating almost every aspect of the original proposal. Since then, the revenue project has been one of the Boards' top priorities. After further outreach and deliberations, the Boards modified the proposal and issued the final standard. In addition, the Boards announced plans to create a "joint transition group" to research standard-related implementation issues. The resource group's input is intended to help the Boards resolve any diversity in practice. Therefore, the Boards may issue additional revenue guidance or interpretations before the standard will be effective January 1, 2017.

¹² FASB Accounting Standards Update No. 2014-09, Revenue from contracts with customers

¹³ IFRS 15, Revenue from contracts with customers.

IAS 18

IAS 18 *Revenue* was issued by the International Accounting Standards Committee in December 1993. It replaced IAS 18 *Revenue Recognition* (issued in December 1982).

IFRIC 13 *Customer Loyalty Programmes* was developed by the International Financial Reporting Interpretations Committee and issued by the International Accounting Standards Board in June 2007.

IFRIC 13 and its accompanying documents have been amended by *Improvements to IFRSs*, issued in May 2010.

SIC 31 *Barter Transactions Involving Advertising Services* was developed by the Standing Interpretations Committee and issued in December 2001. Since then, SIC 31 has been amended by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (issued December 2003).

This Standard shall be applied in accounting for revenue arising from the following three classes of transactions and events:

The sale of goods: Goods includes goods produced by the entity for the purpose of sale and goods purchased for resale, such as merchandise purchased by a retailer or land and other property held for resale.

The rendering of services: The rendering of services typically involves the performance by the entity of a contractually agreed task over an agreed period of time. The services may be rendered within a single period or over more than one period. Some contracts for the rendering of services are directly related to construction contracts, for example, those for the services of project managers and architects. Revenue arising from these contracts is not dealt with in this standard but it is dealt with in IAS 11 *Construction Contracts*.

The use by others of entity assets yielding interest, royalties and dividends: The use by others of entity assets gives rise to revenue in the form of:

- ✓ interest – charges for the use of cash or cash equivalents or amounts due to the entity;
- ✓ royalties – charges for the use of long-term assets of the entity, for example, patents, trademarks, copyrights and computer software; and
- ✓ dividends – distributions of profits to holders of equity investments in proportion to their holdings of a particular class of capital.

This Standard does not deal with revenue arising from:

- ✓ Lease agreements (IAS 17 *Leases*);
- ✓ Dividends arising from investments which are accounted for under the equity method (IAS 28 *Investments in Associates*);
- ✓ Insurance contracts within the scope of IFRS 4 *Insurance Contracts*;

- ✓ Changes in the fair value of financial assets and financial liabilities or their disposal (IAS 39 *Financial Instruments*);
- ✓ Changes in the value of other current assets;
- ✓ Initial recognition and changes in the fair value of biological assets related to agricultural activity (IAS 41 *Agriculture*);
- ✓ Initial recognition of agricultural produce (IAS 41); and
- ✓ The extraction of mineral ores.

Indeed, according to IAS/IFRS, government grants, in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity, are not considered as revenues and they are accounted according to IAS 20.

Revenue recognition

Sale of goods and rendering of services

Revenue arising from the sale of goods and rendering of services shall be recognised when all the following conditions have been satisfied:

- a) **It is probable that the economic benefits associated with the transaction will flow to the entity.**
However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectible amount, or the amount in respect of which recovery has ceased to be probable, is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised;
- b) **The costs incurred or to be incurred in respect of the transaction can be measured reliably.**
Revenue and expenses that relate to the same transaction or other event are recognised simultaneously. This process is commonly referred to as the matching of revenues and expenses. Expenses, including warranties and other costs to be incurred after the shipment of the goods can normally be measured reliably when the other conditions for the recognition of revenue have been satisfied. However, revenue cannot be recognised when the expenses cannot be measured reliably. In such circumstances, any consideration already received for the sale of the goods is recognised as a liability;
- c) **The amount of revenue can be measured reliably:**
An entity is generally able to make reliable estimates after it has agreed to the following with the other parties of the transaction:
 - ✓ each party's enforceable rights regarding the service to be provided and received by the parties;
 - ✓ the consideration to be exchanged; and
 - ✓ the manner and terms of settlement.

It is also usually necessary for the entity to have an effective internal financial budgeting and reporting system. The entity reviews and, when necessary, revises the estimates of revenue as the service is performed. The need for such revisions does not necessarily indicate that the outcome of the transaction cannot be estimated reliably.

When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue shall be recognised only to the extent of the expenses recognised that are recoverable.

During the early stages of a transaction, the outcome of the transaction often cannot be estimated reliably. Nevertheless, it may be probable that the entity will recover the transaction costs incurred. Therefore, revenue is recognised only to the extent of costs incurred that are expected to be recoverable. As the outcome of the transaction cannot be estimated reliably, no profit is recognised.

When the outcome of a transaction cannot be estimated reliably and it is not probable that the costs incurred will be recovered, revenue is not recognised and the costs incurred are recognised as an expense.

Moreover, only in the case of sale of goods, to recognise the revenue the entity:

- ✓ has to have transferred to the buyer the significant risks and rewards of ownership of the goods;
- ✓ has to retain neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.

The assessment of when an entity has transferred the significant risks and rewards of ownership to the buyer requires an examination of the circumstances of the transaction. In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer. In other cases, the transfer of risks and rewards of ownership occurs at a different time from the transfer of legal title or the passing of possession.

If the entity retains significant risks of ownership, the transaction is not a sale and revenue is not recognised. An entity may retain a significant risk of ownership in a number of ways. Examples of situations in which the entity may retain the significant risks and rewards of ownership are:

- ✓ when the entity retains an obligation for unsatisfactory performance not covered by normal warranty provisions;
- ✓ when the receipt of the revenue from a particular sale is contingent on the derivation of revenue by the buyer from his sale of the goods;
- ✓ when the goods are shipped subject to installation and the installation is a significant part of the contract which has not yet been completed by the entity; and

- ✓ when the buyer has the right to rescind the purchase for a reason specified in the sales contract and the entity is uncertain about the probability of occurrence.

While, if an entity retains only an insignificant risk of ownership, the transaction is a sale and revenue is recognised.

For example, a seller may retain the legal title to the goods solely to protect the collectability of the amount due. In such a case, if the entity has transferred the significant risks and rewards of ownership, the transaction is a sale and revenue is recognised. Another example of an entity retaining only an insignificant risk of ownership may be a retail sale when a refund is offered if the customer is not satisfied. Revenue in such cases is recognised at the time of sale, provided the seller can reliably estimate future returns and recognises a liability for returns based on previous experience and other relevant factors.

Only in the case of rendering of services, for revenue recognition is necessary that the stage of completion of the transaction at the end of the reporting period can be measured reliably.

The recognition of revenue by reference to the stage of completion of a transaction is often referred to as the *percentage of completion method*. Under this method, revenue is recognised in the accounting periods in which the services are rendered. The recognition of revenue on this basis provides useful information on the extent of service activity and performance during a period.

The stage of completion of a transaction may be determined by a variety of methods. An entity uses the method that measures reliably the services performed. Depending on the nature of the transaction, the methods may include:

- ✓ surveys of work performed (if the service is measurable in terms of volume, the percentage of completion is the ratio between supplied volume and total volume);
- ✓ services performed to date as a percentage of total services to be performed or the proportion between costs incurred to date and estimated total costs of the transaction (the entity can use this method if it has an efficient administrative systems for planning and control).

Sometimes, the reliability and significance of the percentage of completion are determined more precisely using a reasoned average of results from various criteria.

Only costs that reflect services performed to date are included in costs incurred to date. Progress payments and advances received from customers often do not reflect the services performed. In particular, these should be recorded under liabilities, as advances from customers.

For practical purposes, when services are performed by an indeterminate number of acts over a specified period of time, revenue is recognised on a straight-line basis over the specified period unless there is evidence

that another method better represents the stage of completion. When a specific act is much more significant than any other acts, the recognition of revenue is postponed until the significant act is executed.

Interest, royalties and dividends

Revenue arising from the use by others of entity assets yielding interest, royalties and dividends shall be recognised when:

- ✓ it is probable that the economic benefits associated with the transaction will flow to the entity;
- ✓ the amount of the revenue can be measured reliably.

Revenue shall be recognised on the following bases:

- ✓ interest shall be recognised using the effective interest method as set out in IAS 39;
- ✓ royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement; and
- ✓ dividends shall be recognised when the shareholder's right to receive payment is established.

When unpaid interest has accrued before the acquisition of an interest-bearing investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods and only the post-acquisition portion is recognised as revenue.

Royalties accrue, in accordance with the terms of the relevant agreement, are usually recognised on that basis unless, having regard to the substance of the agreement, it is more appropriate to recognise revenue on some other systematic and rational basis.

Revenue recognition measurement

Once satisfied that all conditions for revenue recognition are met, the entity shall make the measurement of revenue. In particular, the amount of revenue arising on a transaction is usually determined by the agreement between the entity and the buyer or user of the asset.

It is measured at the fair value of the consideration received or receivable, taking into account the amount of any trade discounts and volume rebates allowed by the entity.

In most cases, the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. For example, an entity may provide interest-free credit to the buyer or accept a note receivable bearing a below-market interest rate from the buyer as consideration for the sale of goods.

When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest. The imputed rate of interest is the more clearly determinable of either: the prevailing rate for a similar instrument of an issuer with a similar credit rating or a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue in accordance with IAS 39.

This method of accounting treatment is generally known as amortized cost.

However, IAS 39 clarifies that if the discounting effect is not relevant, the credits can be shown on the balance sheet at their nominal value.

IFRS 15

Scope

The new revenue model applies to all contracts with customers except those that are within the scope of other IFRS, such as leases, insurance contracts and financial instruments. Transfers of assets that are not related to the entity's ordinary activities (such as the sale of property, plant and equipment, real estate or intangible assets) will also be required to follow some of the recognition and measurement requirements of the new model.

The recognition of interest and dividend income are not in the scope of the new standard. Furthermore, the new standard does not apply to non-monetary exchanges between entities in the same line of business where this is done to facilitate to customers, or potential customers.

When a contract includes multiple performance obligations, some of which are within the scope of other IFRS, any separation and initial measurement requirements of the other standard are applied first, and the deliverables within the scope of revenue model are ascribed any residual amount. If there are no separation or initial measurement requirements in those other standards, the requirements of IFRS 15 are applied.

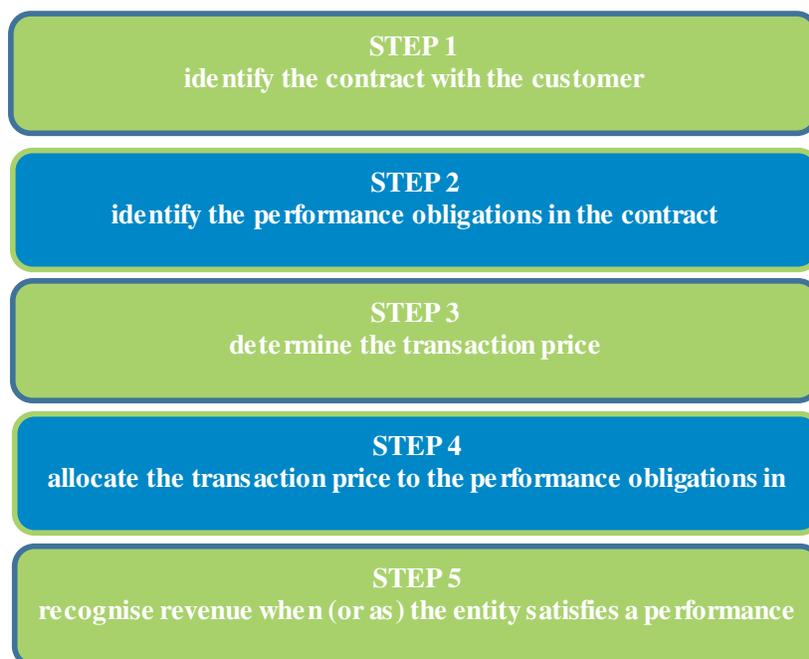
An entity may contract with a counterparty to participate in an activity or process in which the parties to the contract share the risks and benefits resulting from the activity or process, often referred to as a "collaborative agreement". Where this is the case, the entity will have to assess whether the other entity is its "customer" in order to establish whether the transactions with the other entity are within the scope of the new standard.

Overview of the new revenue model

The core principle is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for

those goods or services. The standard is to applied on an individual contract basis. However, a portfolio approach is permitted provided it is reasonably expected that the impact on the financial statements will not be materially different from applying the standard on an individual contract basis.

The steps to be applied in the model are as follows.



Step 1 – identify the contract with a customer

A contract can be written, verbal, or implied but for the standard to apply the following criteria must be met:

- ✓ the parties to the contract have approved the contract (in writing, orally, or in accordance with other company) and are committed to perform their respective obligations;
- ✓ the entity can identify each party's rights regarding the goods or services to be transferred;
- ✓ the entity can identify the payment terms for the goods or services to be transferred;
- ✓ the contract has a commercial substance (that is, the risk, timing, or amount of the entity's future cash flows is expected to change as a result of the contract); and
- ✓ it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

Although each contract would usually be accounted for separately, entities may be required to combine a group of contracts entered into at or near the same time with the same customers (or parties related to the customer) if:

- ✓ the contracts are negotiated as a package with a single commercial objective;

- ✓ the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
- ✓ the goods or services promised in the contracts (or some goods or services promised in the contracts) are single performance obligation.

Sometimes, prices or scope of a contract may be revised. A contract modification that has been “approved” is accounted for a separate contract if both: i) it results in a separate performance obligations that is “distinct” and ii) the additional price reflects the stand-alone selling price of the separate performance obligation. Otherwise, the modification is treated as an adjustment to the original contract. In many cases, the impact is accounted for prospectively, by allocating the remaining revised transaction price to the remaining performance obligation in the contract. However, for certain performance obligations that are satisfied over time, the impact is accounted for retrospectively, which results in a cumulative catch up adjustment to revenue.

Step 2 – identify the performance obligations in the contract

Step 5 requires that revenue should be recognized when, or as, the entity satisfies a performance obligation. It is therefore necessary first to identify the distinct performance obligations and this is done at inception of a contract.

Distinct performance obligations are goods or services promised in a contract that satisfy both of the following conditions:

- ✓ the customer can benefit from the good or service either on its own or in combination with other resources available to the customer; and
- ✓ the entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

In addition, if certain criteria are met, the standard requires a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer to be regarded as a single performance obligation.

Applying the second condition requires analysis of the contract terms and consideration of the specific facts and circumstances. Factors indicating that a promised good or service is separately identifiable from other promises include:

- ✓ the entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract with a bundle of goods or services that represent the combined output;
- ✓ the good or service is not significantly modifying or customizing another good or service promised in the contract;
- ✓ the good or service is not highly dependent on, or highly interrelated with, other promised goods or services in the contract.

Step 3 – determine the transaction price

An entity must determine the amount of consideration to which it expects to be entitled in exchange for the promised goods or services in the contract in order to recognize revenue. The transaction price can be a fixed amount or it can vary because of discounts, rebates, price concessions, refunds, credits, incentives, performance bonuses and other similar items. An entity estimates the transaction price by considering the effect of variable consideration, the time value of money, non-cash consideration and consideration payable to the customer. Entities should estimate the transaction price using either a probability-weighted approach (expected value) or an approach based on the single most likely amount – whichever is more predictive of the amount to which the entity expects to be entitled.

Variable consideration is only included in the transaction price if, and to the extent that, it is highly probable that its inclusion will not result in a “significant revenue reversal” in the future as a result of re-estimation. A significant revenue reversal occurs when a subsequent change in the estimate of variable consideration results in a significant reduction to the cumulative amount of revenue recognized from the customer. This constraint may have an impact when:

- ✓ the amount of consideration is susceptible to factors outside the entity’s influence;
- ✓ the uncertainty is not expected to be resolved for a long period of time;
- ✓ there is limited prior experience with similar performance obligations or there is a broad range of possible consideration amounts.

If an entity concludes, because of the potential for a significant revenue reversal, that it is not appropriate to include all of the variable consideration in the transaction price, it should assess whether it is instead appropriate to include part of the variable consideration. That lower amount of variable consideration should be included in the transaction price if it passes the constraint assessment.

However, the new standard introduces a separate rule in respect of sales – or usage – based royalties from licenses of intellectual property. An entity is not permitted to recognize revenue for such royalties until its customer has made the associate sale or usage that gives rise to the revenue. This restriction will apply when the entity has past evidence supporting the level of onward sales or usage made by a customer.

Under the new model, revenue reflects the amount to which an entity expects to be entitled under a contract with a customer, rather than the amount it expects actually to collect. However, if an entity anticipates that it may ultimately accept an amount lower than that initially promised in the contract with customer, perhaps based on past business practice, the entity would initially estimate revenue lower amount and assess the collectability of that lower amount. Subsequently, if there evidence to suggest that revenue already recognized is not collectable, the standard requires impairment losses to be presented separately as an expense in profit or loss.

When a contract contains a significant financing component, the effect of the time value of money are taken into account by adjusting the transaction price and recognizing interest income or expense over the financing period, as relevant. This is not required if the time period between the transfer of goods or services and payment is less than one year.

Step 4 – allocate the transaction price to the performance obligations in the contract

When a contract contains more than one distinct performance obligation, an entity allocates the transaction price to each distinct performance obligation on the basis of relative stand-alone selling price.

The best evidence of stand-alone selling price is the price at which the good or service is sold separately by the entity. If that is not available, an entity is required to estimate the stand-alone selling price using an approach that maximizes the use of observable inputs (e.g. adjusted market assessment, expected cost plus a margin, or using a residual approach).

Where the transaction price includes a variable amount, consideration needs to be given as to whether that variable amount relates to all or only some of the performance obligation in the contract. Unless the criteria in the standard for treating the variable amount as relating only to specific performance obligation are met, the variable amount should be allocated across all of the performance obligation in the contract.

Often, where an entity promises more than one distinct good or services within a contract, a discount is applied to the total contract price when compared to the amount that would have been charged to the customer if those goods or services were purchased separately. Unless the entity has observable evidence that the entire discount applies only to some of the distinct performance obligations, it is required to allocate that discount proportionally to all of the performance obligation in the contract.

Step 5 – recognize revenue when (or as) the entity satisfies a performance obligation

A performance obligation is satisfied when control of the underlying goods or services for the particular performance obligation is transferred to the customer. Control is defined as “the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset” underlying the good or service. This differs from the approach under IAS 18 where, for example, revenue in respect of good is recognized when the significant risks and rewards of ownership of the goods are transferred to the customer.

Furthermore, under IAS 18 different guidance is provided on when to account for revenue depending on whether a good or a service is being supplied to the customer. The new standard takes a different approach to assess whether revenue should be recognized at a point of time or over the time, through consistent guidance that applies equally to sales of goods and services.

Revenue recognized over time

A performance obligation is satisfied, and revenue should be recognized, over time when at least one of the following criteria is met:

- ✓ the customer receives and consumes the benefits of the entity's performance as the entity performs;
- ✓ the entity's performance creates or enhances an asset (e.g. work in progress) that the customer controls as the asset is created or enhanced;
- ✓ the entity's performance does not create an asset with an alternative use to the entity and the entity has a right to payment for performance completed to date.

When considering whether an asset has an alternative use, a seller will need to assess at inception of the contract whether, both contractually and practically, it is able to use the asset for a purpose other than that set out in the contract with customer.

If any of the above criteria are met, an entity is required to recognize revenue over time in a manner that best depicts the transfer of goods or services to the customer.

Revenue recognized at a point in time

If a performance obligation does not meet the criteria to be satisfied over time, the following indicators are considered in evaluating the point in time at which control of the asset has been transferred to the customer.

- ✓ The entity has transferred physical possession of the asset.
- ✓ The entity has a present right to demand payment for the asset.
- ✓ The customer has accepted the asset.
- ✓ The customer has the significant risks and rewards of ownership of the asset.
- ✓ The customer has a legal title to the asset.

Difference between IFRS and US GAAP

The final IFRS 15 is nearly fully converged: the main differences related to:

- ✓ interim disclosures;
- ✓ the collectability threshold for contracts;
- ✓ timing of adoption.

3.4 Fundamental differences between IFRS and U.S. GAAP

Other than the short term projects and long term projects exist any differences between the IFRS and U.S. GAAP. These differences exist for various reasons. First, in some cases, the Boards had different objectives in developing the standards, either because the Boards reached different conclusion about how best to communicate the economics of a transaction to investors or because the standards were developed at different times when objective of standard setting in general were different. Second, in some cases, standard setting that has occurred by one Board or the other in response to market or regulatory structures has resulted in differences standards.

Below the main fundamental differences

Impairment

The impairment models for property, plant and equipment, inventory and intangible assets have different rules in IFRS and U.S. GAAP. The IFRS models allow for reversals of impairments up to a certain amount if there is an indication that an impairment loss has decreased; whereas, the U.S. GAAP models preclude reversal of impairments. This distinction could result in differences in the timing and extent of recognized impairment losses.

Certain non-financial liabilities

The recognition of certain non-financial liabilities is governed by the probability that a liability has been incurred under both U.S GAAP and IFRS. However, U.S GAAP and IFRS differ in their definition of what is “probable”. E.g. for contingencies, the IFRS defines probable as “more likely than not to occur”. By contrast, U.S. GAAP defines it as “the future event or events are likely to occur”. “likely” is considered to be a higher threshold than “more likely than not”. The impact is that a liability in IFRS is recognized earlier than U.S. GAAP.

Inventory

IFRS allow evaluate the inventory at weight cost or first in first out (“**FIFO**”) method. The IFRS does not allow the last in first out (“**LIFO**”) method, while the LIFO is allowed in U.S. GAAP.

Research and development

Costs for research and development activities are generally expensed as incurred under U.S. GAAP. Costs for research activities are expensed as incurred under IFRS, but costs for development activities that meet certain criteria are capitalized.

Property, plant and equipment

Under IFRS, each part of item of PP&E with a cost that is significant in relation to the total cost of the item is required to be depreciated separately. Under U.S. GAAP an item that has multiple parts is generally depreciated over a useful life attributed to the item as a whole. The approach required under IFRS is not precluded under U.S. GAAP.

3.5 Next steps

Situation of the IFRS in the world

The IFRS Foundation recently published the findings of a major research project led by Paul Pacter, a former Member of the IASB. That research, verified by the relevant jurisdictional authority in each of the 130 countries surveyed, showed that more than 100 countries, or 81% of those surveyed, now mandate the use of IFRS for all or most public companies.

Almost all of the remaining countries that have yet to require the use of IFRS for domestic purposes already permit its use in certain circumstances. Both India and Japan have for some time permitted voluntary use of IFRS, while the Japanese government views encouraging greater use of IFRS as a fundamental element of its recently announced growth strategy. Many of China's largest companies report using full IFRS for the purpose of their dual listing in Hong Kong, while the United States has since 2007 allowed non-US companies to report using IFRS as issued by the IASB.

Converged process IASB and FASB

It is clear that although both Board shared a commitment to a common goal, the fact that they were starting from two different points, they had to maintain existing standards, while also trying to converge those have complicated the matter. In addition, the new issues arising in different parts of the world and that for any changes the Boards have to evaluate benefits and costs have further complicated the question.

As reported by Bob Hertz (former Chairman of the FASB) "challenges in the convergence process also arise from the fact that there are significant differences around the world in the cultural, institutional, economic, business and legal system that surround the financial reporting system in different countries and jurisdictions"

Situation of the MoU

In August 2014, the IASB has ended eleven projects of the Memorandum of Understanding; in particular the IASB has completed the projects on business combinations, financial instruments (there is an open point on the Macro Hedge on this the IASB issued in April a discussion paper), financial statement presentation, revenue recognition, consolidation, disclosure on derecognition, fair value and post-employment benefits. The open projects are i) intangible asset (at the moment stopped); ii) leases (the re-deliberations are in progress); iii) liabilities and equity distinction (at the moment stopped).

Until now, SEC has not decided how to move to IFRS for U.S. issuers. In February 2010, the SEC issued "commission statement in support of convergence and global accounting standards", the SEC reiterated its long-standing support for the development of a single set of high-quality global accounting standards. It also stated that it planned to make a decision in 2011 on whether, when and how to incorporate IFRS into the U.S. financial reporting system. Probably the use of the word incorporation respect of the word adoption means a partial movement versus IFRS. In December 2010, a member of the SEC proposed a possible approach called "condorsement". This approach involves continued convergence through an endorsement mechanism, under which U.S. GAAP would continue to exist and the FASB would decide on a standard by standard basis whether the particular IFRS pronouncement is suitable for use in the United States¹⁴.

On 13 July 2012, the office of the Chief Accountant of the SEC issued the report "work plan for the consideration of incorporating International Financial Reporting Standards into the Financial Reporting

¹⁴ Work plan for the consideration of incorporating international Financial Reporting Standard into the Financial Reporting System for U.S. issuers: exploring a possible method of incorporation.

System for U.S. issuers”. It contains a comprehensive summary of the staff’s work, findings and observations, but this report does not indicate any recommendation to the SEC on whether, when and how to incorporate IFRS into the financial reporting system for U.S. issuers. In the first part there are any aspects about the factor to be considered to apply the IFRS for U.S. issuers: i) influence of standard setting – the report highlights that very few jurisdictions provide for the use of IFRS without measure to ensure the suitability of the standards; ii) burden of conversion – in the analysis the staff has found that the U.S. issuers thought that the benefits of the conversion do not cover the cost. In addition, the conversion could generate the confusion for investors; iii) reference to U.S. GAAP – the report indicates that the effort that would be required to change the references from U.S. GAAP to IFRS would be significant. In second part the report indicates the findings identified: i) in IFRS there are any areas underdeveloped (extractive industries, insurance and rate regulated act) and the distances between U.S. GAAP and IFRS is greater; ii) on the interpretative process the report indicates the IFRS IC should do more to address issues on timely basis; iii) the IASB should increase the role of the national standards setters. The national standards setters could a) assist with individual projects; b) perform outreach for individual project; c) identify areas in which there is a need to difference in practice; d) assist with post implantation review; iv) global application of IFRS could be improved to narrow diversity; v) may be necessary to put in place mechanism specifically to consider and protect the U.S. capital market; vi) should be improved the process for the funding of the IFRS foundation; vii) improve the process for the education session and changes of the standards.

At the end of 2012, the staff of the IFRS Foundation issued a report to the Trustees of the IFRS Foundation analyzing the findings in SEC’s report. In the report, there is a status on the findings and issues highlighted in the SEC staff’s report on IFRS, discusses actions that have already been undertaken in regard to a number of the findings, tactfully takes issues with certain findings and observations by providing additional information and perspectives on these matters.

3.6 Consideration

The convergence project has reached important goals. On the one hand, the main convergence projects have been terminated and the two set of standards are more near, although from the convergence projects are issued other differences (e.g. offsetting of financial instruments, lease accounting for the lessee); on the other hand, the SEC continues to postpone the decision about how, when and whether the U.S. capital market will move to IFRS. The international pressure on the Boards to reach an international convergence is increasing; it should stimulate the effort of the SEC to issue the decision. This decision is crucial for the application of the IFRS around the world. Although the U.S. capital market is declining the relative weight on the world capital market, U.S. capital market is the most important market in the world, so only when U.S. issuer will use IFRS in full, or with a “condorsement approach”, the international convergence will be achieved.

4. Conclusions

As wrote in this study, recently, the IFRS Foundation has been able to analyse 138 jurisdictions, out of the 197 that are recognized by the United Nations. In practically all of them, the relevant authority has taken a position in favour of IFRS as the sole global accounting standard for financial information. Hence, 126 jurisdictions have made a positive pronouncement, including all the countries represented at the G20. They represent 96 per cent of global Gross Domestic Product. In eight jurisdictions however, the relevant authority has not made a public announcement (Belize, Bermuda, Cayman Islands, Egypt, Macau, Surinam, Switzerland and Vietnam).

In addition to the declarations of intent, 114 jurisdictions (82 per cent) make IFRS compulsory for all or most of their publicly accountable companies. Among these jurisdictions, we do however note a degree of diversity. First of all, at the moment, for two jurisdictions, the decision has been taken but is not yet effective (Colombia and Bhutan will switch to IFRS in 2015 and 2021 respectively). Next, some jurisdictions apply IFRS, but have adopted previous versions of standards (Macedonia (2009), Myanmar (2010), Sri Lanka (2011) and Venezuela (2008)). According to the available information, these jurisdictions are working on getting up to date. Lastly, some, although very few, jurisdictions have made temporary modifications to certain provisions of IFRS standards. The most notable is the famous European “carve-out”, which involved slightly modifying IAS 39 at the time of its adoption in Europe, in order to delete certain paragraphs relating to hedge accounting.

The application of the carve-out only concerns around 20 banks, out of the 8000 publicly traded European entities that apply IFRS. Other temporary modifications made by some jurisdictions consisted of deferring the application dates of some Standards. Hence, Europe deferred the entry into obligatory effect of IFRSs 10, 11 and 12 until 2014. Among the 114 jurisdictions that apply IFRS, some have issued national standards that are identical to IFRS. The most notable are Australia, Hong Kong and New Zealand. In these jurisdictions, IFRS therefore applies to all companies, publicly traded or not, for both their consolidated and their individual financial statements.

They are the following: Bermuda, Cayman Islands, Guatemala, Honduras, India, Japan, Madagascar, Nicaragua, Panama, Paraguay, Surinam and Switzerland. IFRS is not obligatory in Switzerland, but is authorized and is widely used. Hence, in the international market segment, in other words the companies whose securities are likely to be acquired by foreign investors, 84 per cent of the companies apply IFRS, compared with 16 per cent that apply U.S. GAAP. The some does not apply to smaller companies that are not looking for international investors, in this domestic area, the use of national standards is most common (65 per cent), while IFRS is used only by a minority (7 per cent). U.S. GAAP is not used at all and 28 per cent apply banking law. Foreign companies that are publicly traded in Switzerland may also apply IFRS.

Similarly, in Japan, IFRS has been authorized since 2010, subject to certain conditions. In October 2013, the regulator relaxed the conditions for voluntary adoption of IFRS, which resulted in an increase from 600 eligible companies to more than 4.000, accounting for almost all the publicly traded companies. Hence, in February 2014, 34 companies had made the decision to use IFRS. This number is now currently estimated as having

risen to approximately 60 and represents a significant percentage of the total market capitalization. Furthermore, foreign companies publicly traded in Japan are also authorized to apply IFRS.

At present, India permits the application of IFRS, but only 11 companies have made that decision so far. These are essentially companies whose securities are also publicly traded in another country. For other companies, the national standards began their convergence with IFRS in 2007. 35 standards have already been published and correspond to IFRS that are in effect on 1 April 2011. Their official adoption is expected in the near future. It should be noted that this list excludes some areas that are considered to be “sensitive”. In particular, this applies to financial instruments (IFRS 9), agriculture (IAS 41) and service concession arrangements (IFRIC 12).

Bolivia, China, Egypt, Guinea-Bissau, Macau, Niger, United States and Vietnam apply their national rules. The two largest economies on the planet, China and the United States, have made a commitment in favour of IFRS, as have all the countries in the G20, but have not put it into effect. This is the reason why, although the jurisdictions which have made a commitment in favour of IFRS represent 96 per cent of global GDP, the score falls to 58 per cent when the jurisdictions that actually apply them are taken into consideration. However, there is no suggestion that IFRS is not applied there at all.

In the United States, IFRS is present in two ways. Firstly, there are approximately 500 publicly traded companies that apply IFRS. These are the Foreign Private Issuers, the non-U.S. companies that raise capital in the USA. One of the main benefits for these companies of the switch to IFRS has been the end of the obligation to prepare and publish a reconciliation between the financial statements published in their country of origin and the amounts that would have been reported under U.S. GAAP.

Looking forward, the U.S. standards are converging with IFRS standards. From a European perspective, there is a tendency to only see the efforts made by IASB to achieve convergence with U.S. GAAP, but U.S. GAAP is also converging with IFRS. For example, in May 2014, IFRS 15 Revenue from contracts with customers appeared at the same time as the new U.S. standard on revenue recognition. These two standards are very similar and there are only minor differences. Work is continuing on the subject of leasing contracts and on other subjects, even though there is no guarantee that the finished standards will be completely identical. Although the USA has not made a decision to switch to IFRS, work on convergence has continued and the differences between the two bodies of standards are being reduced. Lastly, it should not be forgotten that U.S. investors are major buyers of securities in companies that use IFRS and are therefore major users of IFRS.

The SEC is thinking to the possibility of a partial or piecemeal movement to IFRS by U.S. issuers. Incorporation could also be achieved by continuing to have U.S. GAAP as the legal name of the standards in the United States but with all or some of those standards being the same as, or based on, IFRS. In that regard, in December 2010, SEC Deputy Chief Accountant Paul Beswick, floated a possible approach called “condorsement”. This approach involves continued convergence through an endorsement mechanism, under which U.S. GAAP would continue to exist and the FASB would decide on a standard by standard basis whether

the particular IFRS pronouncement is suitable for use in the United States. So, U.S. adoption of such a process could not only create a U.S. version of international standards but might also encourage other countries and jurisdictions to maintain or put into place IFRS endorsement mechanism, thereby potentially further undermining the goal of achieving a single set of financial standards.

In China, the application of IFRS is more ambiguous. Indeed, IFRS is not authorized for companies that are publicly traded in China and foreign companies cannot raise capital there. But the leading market for the trading of Chinese companies remains Hong Kong have made the decision to apply IFRS. Furthermore, some of these companies already applied the Hong Kong standards, which are now exactly the same as IFRS. As a result, the great majority of Chinese companies publicly traded in Hong Kong (84 per cent by volume and 95 per cent by capitalisation) are now using IFRS. IFRS is indeed a significant accounting standard for China. In addition, China adopted a package of substantially converged accounting standards and, in 2010, adopted a roadmap for the continuation of convergence. The most important difference with Chinese standards are: i) the revaluation of fixed assets is not authorized, the reversal of an impairment charge is not authorized, the full goodwill method is not authorized (it is important to remember that, in IFRS, revaluation of fixed assets and the full goodwill method are only accounting options) and the restatement of financial assets at fair value by profit and loss is not authorized. These examples demonstrate that the difference are limited.

It is possible declare that while European Union played a decisive role in the adoption of IFRS and remains a major “customer”, it is not longer the majority customer, in fact, it represents \$ 17 billion of aggregated GDP out of a total of \$ 40 billion for the jurisdictions that now use IFRS.

The other lesson is that IFRS is the accounting standard for more than 52 per cent of the largest companies in the world, according to the fortune 500 listing. U.S. GAAP is the second largest accounting standard in the world, with 29 per cent of those companies using it.

Having a single set of high-quality accounting standards, or at least common standards, is just one part of getting to comparable, high-quality financial reporting across the global capital markets. Though not a sufficient condition for achieving the broader objective of high quality comparable financial reporting around the world, having common standards is a necessary and critical aspect of achieving that goal. So a great deal of time and effort has been devoted by accounting standard setters, regulators and many other participants in the financial reporting system and around the world the convergence of accounting standards and adoption of IFRS. Those activities continue, including major joint projects between the IASB and the FASB, but is seems the once powerful desire to converge U.S. GAAP and IFRS may be waning.

Stakeholders in the United States and around the world continue to wait for the SEC to decide on whether, when, and how IFRS will be incorporated into financial reporting by U.S. issuers and how this decision, if and when it comes, will affect the future of financial reporting in the United States and the continued movement to the IFRS across the globe.

However, the three largest countries in terms of national GDPs - the United States, China and Japan – have not yet adopted IFRS. Only when these important countries apply the IFRS, the international convergence will be reached.

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