



International Financial Reporting Standards



IASB update, with emphasis on the Conceptual Framework

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VMEBF
London, 8 July 2011

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Topics for discussion today 2

- Who uses IFRSs today?
- How is the IASB organised?
- IASB's current work plan
- IFRS for SMEs
- The Conceptual Framework
 - What is its role?
 - What is its current status?
 - Applying it to a real world situation now

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Use of IFRSs Around the World Today 3

For domestic <u>listed</u> companies:	Number of Jurisdictions
IFRSs required for all	93
IFRSs required for some	6
IFRSs permitted	24


Today, IFRSs are used by listed companies in 123 jurisdictions.

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Use of IFRSs Around the World Today 4


For domestic <u>unlisted</u> (private) companies:	Number of Jurisdictions
IFRSs required for all	25
IFRSs required for some	29
IFRSs permitted	44

Today, IFRSs are used by unlisted companies in 98 jurisdictions.

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Fortune Global 500 (July 2010) 5


Which GAAP?	Based on announced plans		
	2010	2013	If Japan 2016
IFRS and word-for-word equivalents	39%	46%	60%
US GAAP	31%	31%	28%
National GAAP	30%	23%	12%
Totals	100%	100%	100%

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Fortune Global 500 (July 2010) 6

Increases from 2010 to 2013 (listed companies):

	Switch to IFRSs	No. G500 co's
Brazil	2010	7
Canada	2011	11
Malaysia	2012	1
Mexico	2012	2
Singapore	2012 (nearly IFRS now)	2
S. Korea	2011	10
Taiwan	2013	8

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Fortune Global 500 (July 2010)

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After 2013, remaining non-IFRS (listed companies):

	Comments	No. G500 co's
China	Adopted main IFRS principles	46
India	Proposed many modifications to IFRSs. Would not be IFRS.	8
Japan	Considering for 2016 or later	71 (54 J-GAAP & 17 US GAAP)
Russia		6
Saudi Arabia		1
Thailand		1
USA	SEC Roadmap + Work Plan	139

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What about the United States?

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2011 is a key year regarding IFRSs in the USA:

- Completion of nine-year joint IASB-FASB convergence programme
- US SEC will make a decision regarding use of IFRSs by US public companies

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About the IFRS Foundation and IASB

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Governance structure

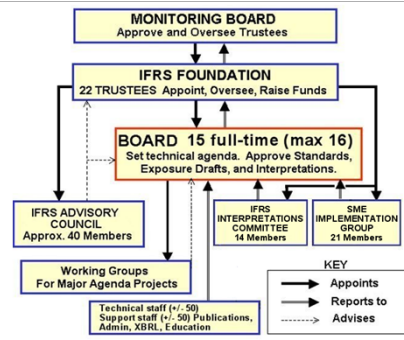
- Independent standard-setting body (IASB)
- Overseen by 22 Trustees with international investor, business, government, and regulatory experience (IFRS Foundation)
- Accountable to a Monitoring Board of public capital market authorities (EC is a member)
- Open and transparent due process

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Our structure

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IASB work plan – four types of projects

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1. Financial crisis related projects (most joint with FASB)
2. IASB-FASB MoU projects (joint with FASB)
3. Other projects
 - Some are joint with FASB
 - Others are IASB alone
4. Conceptual Framework (joint with FASB)

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IASB work plan – four types of projects

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1. Financial crisis related projects (most joint with FASB)

- Financial instruments – at the moment the two Boards do not agree on the answers:
 - Classification and measurement
 - IASB mixed measurement
 - FASB proposed full fair value
 - Impairment – Boards agree on 'expected loss' rather than 'incurred loss' model
 - Offsetting – gross or net on the balance sheet
 - Hedge accounting – IASB alone

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IASB work plan – four types of projects

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1. Financial crisis related projects (most joint with FASB) – continued

- Consolidation and off-balance sheet items – IASB finished May 2011
 - New consolidation standard
 - New comprehensive standard on disclosures of interests in other entities
- Fair value measurement – finished May 2011
- Derecognition disclosures – finished Oct 2010

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IASB work plan – four types of projects

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2. IASB-FASB MoU projects (joint with FASB)

- Revenue – will re-expose
 - Basic principle: recognise revenue when a performance obligation is satisfied
- Leases – will re-expose
 - Basic principle: reflect rights and obligations from leases on the balance sheet
- Joint ventures – finished May 2011
 - Proportionate consolidation eliminated

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IASB work plan – four types of projects

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2. IASB-FASB MoU projects (joint with FASB) – continued

- Presentation of OCI – finished June 2011
 - One or two performance statements, but no income or expense direct to equity
- Pensions – finished June 2011
 - No deferral of actuarial gains or losses
- Investment entities – ED expected shortly
 - Propose to carry investments at fair value even if > 50% owned

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IASB work plan – four types of projects

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3. Other projects

- Insurance (joint with FASB)
 - Expect to ballot final standard in 4Q 2011
 - Balance sheet reflects net contract liability
- Consultation on future agenda (IASB)
 - Every three years. IASB will do in 3Q 2011
- Post-implementation review (IASB)
 - Will begin with IFRS 3 and IFRS 8 in 2H 2011
- Annual improvements (IASB)
 - Ongoing minor amendments

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IASB work plan – four types of projects

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4. Conceptual Framework (joint with FASB)

- Objective and Qualitative Characteristics – completed Sept 2010
- Still to be done:
 - Definitions of elements
 - Recognition and derecognition
 - Measurement
 - Reporting entity
 - Boundaries of financial reporting
 - Presentation and Disclosure

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Work deferred – for now

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IASB-FASB MoU projects

- Comprehensive project on financial statement presentation
- Comprehensive project on income taxes
- Liability-equity distinction

IASB non-MoU projects

- Emissions trading
- Rate regulated entities
- Common control transactions

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A few words about SMEs*

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* Nicht kapitalmarkt-orientierte Unternehmen



The IFRS for SMEs

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Good Financial Reporting Made Simple.

- 230 pages (full IFRSs are 3,000+)
- Simplified IFRSs – built on an IFRS foundation
- Completely stand-alone
- Why? Designed specifically for SMEs
 - User needs for information about short-term cash flows, liquidity, and solvency
 - Costs and SME capabilities
- Final standard issued July 2009

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Who is eligible to use it (if jurisdiction permits)?

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Any entity that does not have public accountability...

- securities not publicly traded
- not a financial institution

... and is required or chooses to produce General Purpose Financial Statements (GPFS)

- Over 99% of all business entities in every country have fewer than 50 employees

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How did we simplify?

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1. Some topics in IFRSs omitted if irrelevant to private entities
2. Where IFRSs have options, include only simpler option
3. Recognition and measurement simplifications
4. Reduced disclosures
5. Simplified drafting

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Jurisdiction plans for adoption

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Today (July 2011), to the best of our knowledge:

- **73 jurisdictions** have either adopted the IFRS for SMEs or stated a plan to adopt it within the next three years

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Adoptions: some examples

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- **South America:** Argentina, Brazil, Chile, Guyana, Peru, Suriname, Venezuela
- **Caribbean:** Antigua & Barbuda, Aruba, Bermuda, Bahamas, Barbados, Cayman, Dominica, Dominican Republic, Guadeloupe, Jamaica, Montserrat, St Kitts-Nevis, St Lucia, Trinidad
- **Central America:** Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama
- **Africa:** South Africa, Botswana, Egypt, Ethiopia, Ghana, Kenya, Lesotho, Malawi, Mauritius, Namibia, Nigeria, Sierra Leone, Tanzania, Swaziland, Uganda, Zimbabwe

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Adoptions: some examples

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- **Asia:** Cambodia, Fiji, Hong Kong, Malaysia, Myanmar, Nepal, Philippines, Singapore, Sri Lanka
- **Middle East:** Jordan, Lebanon, Palestine, Qatar
- **Eurasia:** Azerbaijan, Kyrgyzstan, Moldova, Turkey
- **Europe:** Switzerland. Planned: United Kingdom, Ireland, Denmark, Latvia. Others studying. Note that European Commission is currently consulting on the IFRS for SMEs.
- **Available for use:** United States, Canada

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The Conceptual Framework

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- **Why do we need one**
- **Components of the Framework**
- **Using the Framework in setting standards**
- **Using the Framework in applying IFRSs**
- **A current, real-world example**

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Role of the Conceptual Framework

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- **IASB uses the Conceptual Framework to set standards**
 - Enhances consistency across standards
 - Enhances consistency across time as Board members change
 - Provides a starting point for judgments
- **Companies that follow IFRS use the Conceptual Framework to help make accounting policy choices**



The IASB's Conceptual Framework

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- **Conceptual Framework sets out agreed concepts that underlie IFRS**
 - The **objective** of general purpose financial reporting
 - Qualitative characteristics
 - Elements of financial statements
 - Recognition
 - Measurement
 - Presentation and disclosure
- **Other concepts all flow from the objective**



Objective of financial reporting

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“Provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.”



Objective of financial reporting

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- **Primary users**
 - Provide resources, but cannot demand information
 - Common information needs
- **Assess the prospects for future net cash inflows**
 - Buy, sell, hold
 - Lend, and at what price
 - Efficient and effective use of resources



Fundamental qualitative characteristics

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- **Relevance**
 - Predictive Value
 - Confirmatory Value
 - Materiality, entity-specific
- **Faithful representation** (replaces reliability)
 - Completeness
 - Neutrality
 - Free from error



Enhancing qualitative characteristics

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- **Comparability**
- **Verifiability**
- **Timeliness**
- **Understandability**



Pervasive constraint

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- **Cost-benefit**
 - IASB assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information.
 - Therefore: It is consistent with the Framework for an IFRS requirement not to maximise the qualitative characteristics of financial information when the costs of doing so would exceed the benefits.



Elements

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Asset

- resource controlled by the entity
- result of past event
- expected inflow of economic benefits

Liability

- present obligation
- arising from past event
- expected outflow of economic benefits

Equity = assets less liabilities

Income

- recognised increase in asset/decrease in liability in current reporting period
- that result in increased equity (except owner investments)

Expense

- recognised decrease in asset/increase in liability in current reporting period
- that result in decreased equity (except owner withdrawals)



Recognition

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- **Accrual basis of accounting**
 - Recognise an element (eg asset) when it satisfies the definition and recognition criteria
- **Recognise item that meets element definition when**
 - Probable that benefits will flow to/from the entity
 - Has cost or value that can measured reliably
- **What does 'probable' mean?**
 - Its meaning is determined at the standards level.
 - Therefore, inconsistent use across IFRSs



Common misunderstandings

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The Framework does not...	Clarification: The Framework does include...
Include a matching concept	Accrual basis of accounting — recognise elements when satisfy definition and recognition criteria
Include a prudence or conservatism concept	Neutrality concept
Include an element other comprehensive income (or a concept for OCI)	Only the following elements — asset, liability, equity, income, and expense
Mention management intent or business model	Representational faithfulness

Common misunderstandings continued

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Misunderstanding	Clarification
Principles are necessarily less rigorous than rules	Rules are the tools of financial engineers
There are few judgements and estimates in cost-based measurements	Inventory, eg allocate joint costs and production overheads PP&E, eg costs to dismantle/restore site, useful life, residual value, depreciation method Provisions, eg uncertain timing and amount of expected future cash flows

Measurement

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• Current Framework

- Simply notes that various measurement bases are used today (historical cost, current cost, selling price, present value)
- Not very helpful guidance

• An ideal Framework

- Describes different measurement bases
- Identifies circumstances when most useful
- Suggests when a measurement basis may be a reasonable proxy on a cost-benefit basis



Measurement – possible new Concepts

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Measurement Basis	When useful?
Expected value	If most relevant measure of an asset or liability is its current value in the market or to the entity. And if large number of recurring transactions
Maximum amount more likely than not to occur	If the transactions do not recur frequently enough for their average outcomes to approximate to the long-run average
Most likely outcome	Poor estimate if distributions are skewed or more than one peak. But easy to estimate and could reasonable proxy if the distribution of cash flows is approximately symmetrical about a single most likely outcome.
Minimum amount in the range of outcomes	Most useful measure if there is high degree of uncertainty about both the upper limit of the range and probabilities of various outcomes within the range.
Midpoint of the range of possible outcomes	Reasonable estimate if distribution of cash flows is approximately symmetrical about the midpoint of the range or there is no evidence of the probabilities of the various outcomes within the range.

The ideal Framework-based standard

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• Scope

- No exceptions

• Principles

- Derived from the *Conceptual Framework*
- Judgement to apply principles in business context

• Application guidance

- Explains application of principles



Framework's role in interpreting IFRSs

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How does the Framework help in applying and interpreting IFRSs?

- Framework is in IAS 8 hierarchy (next slide)
 - Preparers use the Framework to make the judgements that are necessary to apply IFRSs
 - Auditors and regulators assess those judgements
 - Investors, lenders and others consider those judgements when using IFRS financial information to inform their decisions



Requirements of IAS 8

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- When an IFRS specifically applies to an event or transaction, must apply that IFRS
- If no specific IFRS requirement, use judgement to:
 - Develop a policy that results in relevant information that faithfully represents the event or transaction
 - Must apply the following hierarchy:
 1. IFRS dealing with similar and related issue (ie draw an analogy)
 2. Conceptual Framework definitions, recognition criteria, measurement concepts



In other words, if no IFRS requirement... 43

Framework-based approach asks:

- What is the economics of the transaction or event?
- What relevant information using the accrual basis of accounting faithfully presents the economics to inform decisions of investors and lenders (potential and existing)?
- Is there anything in IFRSs that prevents me from providing the most relevant information?



Example — Impairment of Greek debt 44

Greece bonds downgraded to C. Recent borrowings are over 20% interest. Daily news reports that default is imminent. Debt is 160% of GDP and repayment is unrealistic. Recognise impairment?

HOLDERS OF GREEK GOV'T BONDS AND DEBT (billion €)	
Greek Banks	56
Other European Banks	50
ECB (direct holdings, nominal value)	50
Central Bank of Greece	10
Greek Social securities/other government	30
Other Investors (only 10% outside Europe)	120
TOTAL GOVERNMENT BONDS	260
+ EU/IMF loans already disbursed	53
TOTAL DEBT	310

Example — Impairment of Greek debt 45

IAS 39 says: Is there objective evidence of impairment? If yes, write down carrying amount to PV of expected cash flows and recognise a loss.

IAS 39 includes as examples of impairment:

- Significant financial difficulty of issuer
- Lender granting concessions
- Downgrade of a rating

But IAS 39 does not address sovereign debt. Some say the power to tax means there is no objective evidence of impairment until an actual default.

Can the Framework help?



Example — Impairment of Greek debt 46

But first, there's always the politics:

22 June 2011: Chancellor Angela Merkel rejected on Wednesday pressure from some German lawmakers to hit private holders of Greek bonds harder, saying that forcing them to take losses could unleash contagion in Europe and beyond that was hard to control.

"Then we will have a situation in which other countries, but not Germany, are unable to recapitalise their banks without becoming targets of the markets, and we spark contagion in Europe that I don't want to be responsible for."



Example — Impairment of Greek debt 47

What is the economics of the transaction or event? Market price of Greek bonds has nosedived.

What is the relevant information for investors and lenders that faithfully represents the economics?

- If you owned shares or debt securities of a bank that is exposed to Greek debt, what would you want to know in deciding whether to hold or sell?

Do IFRSs prevent providing that information?

No. IAS 39 requires recognition of all incurred losses.

Therefore, the Framework suggests???



In conclusion 48

The Framework is not a machine where:

- You insert an accounting question
- And out comes the answer

The Framework can never replace judgement.

But the Framework provides help in making those judgements.

- Helps the standard setter
- Helps the company in applying the standards

And the Framework is essential to have principles-based standards with few rules.



Questions or comments?

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Thank you for your attention.



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Expressions of individual views by members of the IASB and its staff are encouraged.
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Official positions of the IASB on accounting matters are determined only after extensive
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