FINANCIAL ACCOUNTING
WEEK 4 (LECTURE FOUR)

REGULATIONS AND INFLUENCES ON FINANCIAL REPORTING

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Learning Objectives:
Upon completion of this chapter, you will be able to:
Explain Regulatory Framework
Explain the Financial Reporting Standards (IFRS)and use

THE REGULATORY FRAMEWORK

A regulatory framework for the preparation of financial statements is necessary for a number of reasons:

- To ensure that the needs of the users of financial statements are met with at least a basic minimum of information.
- To ensure that all the information provided in the relevant economic arena is both comparable and consistent. Given the growth in multinational companies and global investment this arena is an increasing international one.
- To increase users' confidence in the financial reporting process.
- To regulate the behaviour of companies and directors towards their investors.

Financial reporting standards on their own would not be sufficient to achieve these aims. In addition, there must be some legal and market-based regulation.

The International Accounting Standards Board (IASB) issued its framework for the Preparation and Presentation of Financial Statements in 1989. This is referred to as its conceptual framework. The framework sets out the concepts that shape the preparation and presentation of financial statements for external users. The framework does not have the status of an accounting standard as also is the case with the ASB’s Statement of Principles.

The IASB framework assists the IASB:

- In the development of future International Accounting Standards and in its review of existing International Accounting Standards; and
- In promoting the harmonization of regulations, accounting standards and procedures relating presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by International Accounting Standards.

In addition, the framework also assists:

- Preparers of financial statements in applying International Accounting Standards and in dealing with topics that have yet to form the subject of an International Accounting Standard;
- Auditors in forming an opinion as to whether financial statements conform with International Accounting Standards;
- Users of financial statements in interpreting the information contained in financial statements prepared in conformity with International Accounting Standards; and
- Those who are interested in the work of IASB, providing them with information about its approach to the formulation of accounting standards.

The framework comprises seven sections which cover areas as:

1. The objective of financial statements;
2. Underlying assumptions;
3. Qualitative characteristics of financial information;
4. The elements of financial statements;
5. Recognition of the elements of financial statements;
6. Measurement of the elements of financial statements;
7. Concepts of capital maintenance.

The Objective of general-purpose financial reporting

The primary users of general-purpose financial reporting are present and potential investors, lenders and other creditors, who use that information to make decisions about buying, selling or holding equity or debt instruments and providing or settling loans or other forms of credit. The primary users need information about the resources of the entity not only to assess an entity's prospects for future net cash inflows but also how effectively and efficiently management has discharged their responsibilities to use the entity's existing resources.

The IFRS Framework notes that general purpose financial reports cannot provide all the information that users may need to make economic decisions. They will need to consider pertinent information from other sources as well. The IFRS Framework notes that other parties, including prudential and market regulators, may find general purpose financial reports useful. However, the Board considered that the objectives of general-purpose financial reporting and the objectives of financial regulation may not be consistent. Hence, regulators are not considered a primary user and general-purpose financial reports are not primarily directed to regulators or other parties.

STANDARD SETTING BODIES

The accounting standard setting bodies are at national and international organisations that have been given responsibility for setting generally Accepted Accounting Principles (GAAPS) by a statute in a country or jurisdiction.

In the international arena, there is the International Accounting Standards Board (IASB) which is the independent standard setting body of the International Financial Reporting Standards (IFRS) foundation. IASB has a membership of 14 down from 15 through revision of the membership. The IASB issues the IFRS which govern globally on how financial reporting is done. The IFRS standards are currently 17 in number and they address various issues in the accounting practice. This lesson takes a point to illustrate the IFRS later by providing the role of each of the standards.

Apart form the IFRS, there is the International Accounting Standards (IAS) which are 41 (forty-one) in total as per today. The difference between the IAS and the IFRS is that, the IAS is the earlier version of the accounting standards while the IFRS is a more pronounced and up to date and widely used version of the accounting standards globally.

THE STANDARD SETTING PROCESS

International Financial Reporting Standards (IFRSs) are developed through an international consultation process, which involves interested individuals and organizations from around the world. The due process comprises six stages, with the Trustees having the opportunity to ensure compliance at various points throughout. The stages involved includes:

1. Setting the agenda
2. Planning the project
3. Developing and publishing the discussion paper
4. Developing and publishing the exposure draft

5. Developing and publishing the standard
6. After the standard is issued

Stage 1: Setting the agenda

The IASB, by developing high quality accounting standards, seeks to address a demand for better quality information that is of value to all users of financial statements. Users include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. Better quality information will also be of value to preparers of financial statements.

Although not all of the information needs of these users can be met by financial statements, there are common needs for all users. As investors are providers of risk capital to the entity, the provision of financial statements that meet their needs will also meet most of the needs of other users. The IASB therefore evaluates the merits of adding a potential item to its agenda mainly by reference to the needs of investors.

When deciding whether a proposed agenda item will address users' needs the IASB considers:

(a) The relevance to users of the information and the reliability of information that could be provided
(b) Existing guidance available
(c) the possibility of increasing convergence
(d) The quality of the standard to be developed
(e) Resource constraints.

To help the IASB in considering its future agenda, its staff are asked to identify, review and raise issues that might warrant the IASB's attention. New issues may also arise from a change in the IASB's conceptual framework. In addition, the IASB raises and discusses potential agenda items in the light of comments from other standard-setters and other interested parties, the SAC and the IFRIC, and staff research and other recommendations.

The IASB receives requests from constituents to interpret, review or amend existing publications. The staff consider all such requests, Summarise major or common issues raised, and present them to the IASB from time to time as candidates for when the IASB is next considering its agenda

The IASB's discussion of potential projects and its decisions to adopt new projects take place in public IASB meetings. Before reaching such decisions the IASB consults the SAC and accounting standard-setting bodies on proposed agenda items and setting priorities. In making decisions regarding its agenda priorities, the IASB also considers factors related to its convergence initiatives with accounting standard-setters. The IASB's approval to add agenda items, as well as its decisions on their priority, is by a simple majority vote at an IASB meeting.

When the IASB considers potential agenda items, it may decide that some issues require additional research before it can take a decision on whether to add the item to its active agenda. Such issues may be addressed as research projects on the IASB's research agenda. A research project normally requires extensive background information that other standard-setters or similar organisations with sufficient expertise, time and staff resources could provide.

Research projects are normally carried out by other standard-setters under the supervision of, and in collaboration with, the IASB. In the light of the result of the research project (normally a discussion paper, see paragraph 32), the IASB may decide, in its public meetings, to move an issue from the research project to its active agenda.

Stage 2: Project planning

When adding an item to its active agenda, the IASB also decides whether to conduct the project alone, or jointly with another standard-setter. Similar due process is followed under both approaches. After considering the nature of the issues and the level of interest among constituents, the IASB may establish a working group at this stage.

The Director of Technical Activities and the Director of Research, the two most senior members of the technical staff, select a project team for the project, and the project manager draws up a project plan under the supervision of those Directors. The project team may also include members of staff from other accounting standard-setters, as deemed appropriate by the IASB.

Stage 3: Development and publication of a discussion paper

Although a discussion paper is not a mandatory step in its due process, the IASB normally publishes a discussion paper as its first publication on any major new topic as a vehicle to explain the issue and solicit early comment from constituents. If the IASB decides to omit this step, it will state its reasons.

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. This approach may differ if another accounting standard-setter develops the research paper.

Discussion papers may result either from a research project being conducted by another accounting standard-setter or as the first stage of an active agenda project carried out by the IASB. In the first case, the discussion paper is drafted by another accounting standard-setter and published by the IASB. Issues related to the discussion paper are discussed in IASB meetings, and publication of such a paper requires a simple majority vote by the IASB. If the discussion paper includes the preliminary views of other authors, the IASB reviews the draft discussion paper to ensure that its analysis is an appropriate basis on which to invite public comments.

For discussion papers on agenda items that are under the IASB's direction, or include the IASB's preliminary views, the IASB develops the paper or its views on the basis of analysis drawn from staff research and recommendations, as well as suggestions made by the SAC, working groups and accounting standard-setters and presentations from invited parties. All discussions of technical issues related to the draft paper take place in public sessions.

When the draft is completed and the IASB has approved it for publication the discussion paper is published to invite public comment.

The IASB normally allows a period of 120 days for comment on a discussion paper, but may allow a longer period on major projects (which are those projects involving pervasive or difficult conceptual or practical issues).

After the comment period has ended the project team analyses and summarizes the comment letters for the IASB's consideration. Comment letters are posted on the Website. In addition, a summary of the comments is posted on the Website as a part of IASB meeting observer notes.

If the IASB decides to explore the issues further, it may seek additional comment and suggestions by conducting field visits, or by arranging public hearings and round-table meetings.

Stage 4: Development and publication of an exposure draft

Publication of an exposure draft is a mandatory step in due process. Irrespective of whether the IASB has published a discussion paper, an exposure draft is the IASB's main vehicle for consulting the public. Unlike a discussion paper, an exposure draft sets out a specific proposal in the form of a proposed standard (or amendment to an existing standard).

The development of an exposure draft begins with the IASB considering issues on the basis of staff research and recommendations, as well as comments received on any discussion paper, and suggestions made by the SAC, working groups and accounting standard-setters and arising from public education sessions. After resolving issues at its meetings, the IASB instructs the staff to draft the exposure draft. When the draft has been completed, and the IASB has balloted on it the IASB publishes it for public comment.

An exposure draft contains an invitation to comment on a draft standard, or amendment to a standard, that proposes requirements on recognition, measurement and disclosures. The draft may also include mandatory application guidance and implementation guidance, and will be accompanied by a basis for conclusions on the proposals and the alternative views of dissenting IASB members (if any).

The IASB normally allows a period of 120 days for comment on an exposure draft. If the matter is exceptionally urgent, the document is short, and the IASB believes that there is likely to be a broad consensus on the topic, the IASB may consider a comment period of no less than 30 days. For major projects, the IASB will normally allow a period of more than 120 days for comments. The project team collects, summarizes and analyses the comments received for the IASB's deliberation. A summary of the comments is posted on the Website as a part of IASB meeting observer notes.

After the comment period ends, the IASB reviews the comment letters received and the results of other consultations. As a means of exploring the issues further, and soliciting further comments and suggestions, the IASB may conduct field visits, or arrange public hearings and round-table meetings. The IASB is required to consult the SAC and maintains contact with various groups of constituents.

Stage 5: Development and publication of an IFRS

The development of an IFRS is carried out during IASB meetings, when the IASB considers the comments received on the exposure draft. Changes from the exposure draft are posted on the Website. After resolving issues arising from the exposure draft, the IASB considers whether it should expose its revised proposals for public comment, for example by publishing a second exposure draft.

In considering the need for re-exposure, the IASB

- identifies substantial issues that emerged during the comment period on the exposure draft that it had not previously considered.
- assesses the evidence that it has considered
- evaluates whether it has sufficiently understood the issues and actively sought the views of constituents
- considers whether the various viewpoints were aired in the exposure draft and adequately discussed and reviewed in the basis for conclusions on the exposure draft.

The IASB's decision on whether to publish its revised proposals for another round of comment is made in an IASB meeting. If the IASB decides that re-exposure is necessary, the due process to be followed is the same as for the first exposure draft.

When the IASB is satisfied that it has reached a conclusion on the issues arising from the exposure draft, it instructs the staff to draft the IFRS. A pre-ballot draft is usually subject to external review, normally by the IFRIC. Shortly before the IASB ballots the standard, a near-final draft is posted on its limited access Website for paying subscribers. Finally, after the due process is completed, all outstanding issues are resolved, and the IASB members have balloted in favour of publication, the IFRS is issued.

Stage 6: Procedures after an IFRS is issued

After an IFRS is issued, the staff and the IASB members hold regular meetings with interested parties, including other standard-setting bodies, to help understand unanticipated issues related to the practical implementation and potential impact of its proposals. The IASC Foundation also fosters educational activities to ensure consistency in the application of IFRSs.

After a suitable time, the IASB may consider initiating studies in the light of

a) Its review of the IFRS's application,

b) Changes in the financial reporting environment and regulatory requirements, and

c) Comments by the SAC, the IFRIC, standard-setters and constituents about the quality of the IFRS. Those studies may result in items being added to the IASB's agenda.

LIST OF THE INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

- **IFRS 1: First-time Adoption of International Financial Reporting Standards**-Sets Out the procedures that an entity must follow when it adopts IFRSs for the first time as the basis for preparing its general-purpose financial statements. The IFRS grants limited exemptions from the general requirement to comply with each IFRS effective at the end of its first IFRS reporting period.

- **IFRS 2: Share-based Payments:**
  Requires an entity to recognise share-based payment transactions (such as granted shares, share options, or share appreciation rights) in its financial statements, including transactions with employees or other parties to be settled in cash, other assets, or equity instruments of the entity.

- **IFRS 3: Business Combinations:**
  Outlines the accounting when an acquirer obtains control of a business (e.g. an acquisition or merger). Such business combinations are accounted for using the 'acquisition method', which generally requires assets acquired and liabilities assumed to be measured at their fair values at the acquisition date.

- **IFRS 4: Insurance Contracts:**
  Applies, with limited exceptions, to all insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds.

- **IFRS 5: Non-Current Assets Held for sale and Discontinued Operations:**
  Outlines how to account for non-current assets held for sale (or for distribution to owners). In general terms, assets (or disposal groups) held for sale are not depreciated, are measured at the lower of carrying amount and fair value less costs to sell, and are presented separately in the statement of financial position.

- **IFRS 6: Exploration for and Evaluation of Mineral Resources:**
  IFRS 6-has the effect of allowing entities adopting the standard for the first time to use accounting policies for exploration and evaluation assets that were applied before adopting IFRSs. It also modifies impairment testing of exploration and evaluation assets by introducing different impairment indicators and allowing the carrying amount to be tested at an aggregate level (not greater than a segment).

- **IFRS 7: Financial Instruments; Disclosure:**
  Requires disclosure of information about the significance of financial instruments to an entity, and the nature and extent of risks arising from those financial instruments, both in qualitative and quantitative terms. Specific disclosures are required in relation to transferred financial assets and a number of other matters.

- **IFRS 8: Operating Segments:**
  Requires particular classes of entities (essentially those with publicly traded securities) to disclose information about their operating segments, products and services, the geographical areas in which they operate, and their major customers. Information is based on internal management reports, both in the identification of operating segments and measurement of disclosed segment information.

- **IFRS 9: Financial Instruments:**
  Issued on 24 July 2014 is the IASB's replacement of IAS 39 *Financial Instruments: Recognition and Measurement*. The Standard includes requirements for recognition and measurement, impairment, derecognition and general hedge accounting.

- **IFRS 10: Consolidated Financial Statements:**
  Outlines the requirements for the preparation and presentation of consolidated financial statements, requiring entities to consolidate entities it controls. Control requires exposure or rights to variable returns and the ability to affect those returns through power over an investee.

- **IFRS 11: Joint Arrangements:**
  Outlines the accounting by entities that jointly control an arrangement. Joint control involves the contractually agreed sharing of control and arrangements subject to joint control are classified as either a joint venture (representing a share of net assets and equity accounted) or a joint operation (representing rights to assets and obligations for liabilities, accounted for accordingly).

- **IFRS 12: Disclosure of Interests in Other Entities:**
  This is a consolidated disclosure standard requiring a wide range of disclosures about an entity's interests in subsidiaries, joint arrangements, associates and unconsolidated 'structured entities'. Disclosures are presented as a series of objectives, with detailed guidance on satisfying those objectives.

- **IFRS 13: Fair Value Measurement:**
  Applies to IFRSs that require or permit fair value measurements or disclosures and provides a single IFRS framework for measuring fair value and requires disclosures about fair value measurement. The Standard defines fair value on the basis of an 'exit price' notion and uses a 'fair value hierarchy', which results in a market-based, rather than entity-specific, measurement.

- IFRS 14: Regulatory Deferral Accounts:
  Permits an entity which is a first-time adopter of International Financial Reporting Standards to continue to account, with some limited changes, for 'regulatory deferral account balances' in accordance with its previous GAAP, both on initial adoption of IFRS and in subsequent financial statements. Regulatory deferral account balances, and movements in them, are presented separately in the statement of financial position and statement of profit or loss and other comprehensive income, and specific

disclosures are required.

- IFRS 15: Revenue from Contracts with Customers:
  Specifies how and when an IFRS reporter will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. The standard provides a single, principles based five-step model to be applied to all contracts with customers.

- IFRS 16: Leases:
  Specifies how an IFRS reporter will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17.

- **IFRS 17: Insurance Contracts:**
  IFRS 17 Establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. The objective of IFRS 17 is to ensure that an entity provides relevant information that faithfully represents those contracts. This information gives a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows.

REFERENCES

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