

Presentation Material

Joint IAAER-IFRS Foundation  
IFRS Teaching  
Special Interest Session

4 November 2010 – Singapore, Singapore





Joint IAAER-IFRS Foundation

# IFRS Teaching Special Interest Session

4 November 2010  
Singapore

## Programme

- 10:00 **Introduction**  
**Donna Street**  
*Professor of Accounting, University of Dayton and President, IAAER*
- 10:10 **The Framework**  
**Mary Barth**  
*Professor of Accounting, Stanford University and Academic Advisor to the IASB*
- 10:40 **Framework-based teaching of principle-based accounting standards**  
**Michael Wells**  
*Director of IFRS Education Initiative, IFRS Foundation*
- 11:10 **Understanding IFRS measurements (cross-cutting issues)**  
**Katherine Schipper**  
*Professor of Accounting, Duke University and former Member, FASB*
- 11:40 **Roundtable Q&A**  
Panellists:  
**Holger Erchinger, Partner, KPMG LLP**  
**Katherine Schipper, Professor of Accounting, Duke University and former Member, FASB**  
**Michael Wells, Director of IFRS Education Initiative, IFRS Foundation**  
**Mary Barth, Professor of Accounting, Stanford University and Academic Advisor to the IASB**  
**Donna Street, Professor of Accounting, University of Dayton and President, IAAER**
- 12:30 Lunch break
- 13:30 **IFRS judgments in impairment testing**  
**Holger Erchinger**  
*Partner, KPMG LLP*
- 14:00 **IFRS curriculum development and IFRS resources**  
**Donna Street**  
*Professor of Accounting, University of Dayton and President, IAAER*
- 14:30 **Roundtable Q&A**  
Panellists:  
**Mary Barth, Professor of Accounting, Stanford University and Academic Advisor to the IASB**  
**Holger Erchinger, Partner, KPMG LLP**  
**Katherine Schipper, Professor of Accounting, Duke University and former Member, FASB**  
**Donna Street, Professor of Accounting, University of Dayton and President, IAAER**  
**Michael Wells, Director of IFRS Education Initiative, IFRS Foundation**
- 15:00 Close



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The Framework

**Mary Barth**  
*Professor of Accounting,*  
**Stanford University** and  
*Academic Advisor to the IASB*





# Conceptual Framework

Mary Barth  
Stanford University  
Academic Advisor, IASB

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## Agenda

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- Importance of a Conceptual Framework
- Current FASB and IASB Conceptual Frameworks
- Conceptual Framework Project
  - History of Project
  - Active Phases
  - Key decisions reached to date
- Next Steps

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## Importance of a Conceptual Framework

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- Individual concepts held by each member
  - Agreement would require intersection of personal frameworks
  - Compounded by changes in board membership
  - Greater risk of
    - Transitory concepts & resulting standards
    - Different conclusions on identical issues
    - Ad hoc decisions leading to inconsistent standards
- Converged Framework would facilitate converged and improved global standards

## Current FASB and IASB Frameworks

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- Basic structure of both frameworks is the same
  - Objective of financial reporting
  - Qualitative characteristics
  - Elements of financial statements
  - Recognition
  - Measurement
  - Display and disclosure
- There are some differences in the frameworks:
  - FASB: ‘relevance’ is a recognition criterion
  - Role of “probable” in recognition (IASB) and definition (FASB)

## FASB/IASB Frameworks

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- FASB has seven Statement of Financial Accounting Concepts
  - First six issued between 1978 and 1985
  - Last issued in 2000
  - Directed at financial reporting
  - Not authoritative
- IASB has Framework for the Preparation and Presentation of Financial Statements
  - Developed by IASC; Adopted by IASB in April 2001
  - Directed at financial statements
  - Authoritative via IAS 8

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## Joint Conceptual Framework Project

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- Added to agenda in October 2004
- Objective:
  - To develop an improved and common conceptual framework that will provide a sound foundation for the development of accounting standards

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## Project Plan

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- Eight phases:
  - Objective of financial reporting and qualitative characteristics of financial reporting information
  - Elements of financial statements and recognition
  - Measurement
  - Reporting entity
  - Presentation and disclosure, including reporting boundaries
  - Purpose and status in GAAP hierarchy
  - Applicability to the not-for-profit sector
  - Entire framework, remaining issues if any

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## Project Plan

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- The project focus is on:
  - Omissions in the original frameworks
  - Concepts applicable to private sector business entities
- Not intended to be a fundamental rethink of the existing frameworks

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## Objective of Financial Reporting and Qualitative Characteristics

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- First phase to start
- Discussion Paper in July 2006
- Exposure Draft in May 2008
- Final Chapters issued September 2010

## 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.”

Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans or other forms of credit

## 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
  - Efficient and effective use of resources

## Qualitative Characteristics

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

## Qualitative Characteristics

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- Enhancing Qualitative Characteristics
  - Comparability
  - Verifiability
  - Timeliness
  - Understandability
- Pervasive Constraint
  - Cost

## Elements and Recognition

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- Also in process
- Key focus is definitions of assets, liabilities, income, and expense
- Known problems with current definitions
  - Asset: Resource controlled as result of past events from which expect future benefits
  - Liability: Present obligation arising from past events, settlement is expected to result in outflow of resources
  - Probable? Past event? Expect?
- Not anticipating major change to meaning

## Elements and Recognition

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- How many elements?

FASB (10)		IASB (5)
Assets	Gains	Assets
Liabilities	Losses	Liabilities
Equity	Revenue	Equity
Investments by owners	Comprehensive Income	Income
Distributions to owners	Expenses	Expenses

- Recognition and derecognition criteria?

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## Measurement

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- What is the most appropriate measurement attribute for a particular asset or liability?
- Started in 2007
- New approach in November 2008:
  - Standards-level decisions in multiple-measurement environment
  - Qualitative characteristics and cost constraint are measurement selection factors
  - Value realisation connects relevance to objective?
- May 2010: Develop a DP with a PV?

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## Current staff thinking

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- What should measurement chapter accomplish?
- Implications of the objective of financial reporting
  - Statement of financial position (sfp) view
  - Income statement view
  - Holistic view (both sfp and income statement)
- Need more than relevance and faithful representation?
  - Implications of those views, fundamental QCs on historic cost and fair value
- DP expected Q1 2011

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## Reporting Entity

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- No reporting entity concept to guide
  - Yet we report about it
- Objective of reporting entity phase:
  - To determine what constitutes a reporting entity for the purposes of financial reporting
- Published Discussion Paper in mid-2008
- Published Exposure Draft in March 2010
- Expect Final Chapter Q1 2011

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## What is a Reporting Entity?

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- Circumscribed area of economic activity
  - Activities are being conducted, have been conducted, or will be conducted
  - Activities can be objectively distinguished
  - Provides information for users to make decisions
- Implications of description
  - Legal entity not necessary
  - A branch or segment of a legal entity could meet the description of a reporting entity

## Reporting Entity

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- Consolidated financial statements are general purpose
- May also be a group of entities under common control
- Parent-only financial statements useful with consolidated financial statements

## Questions or comments?

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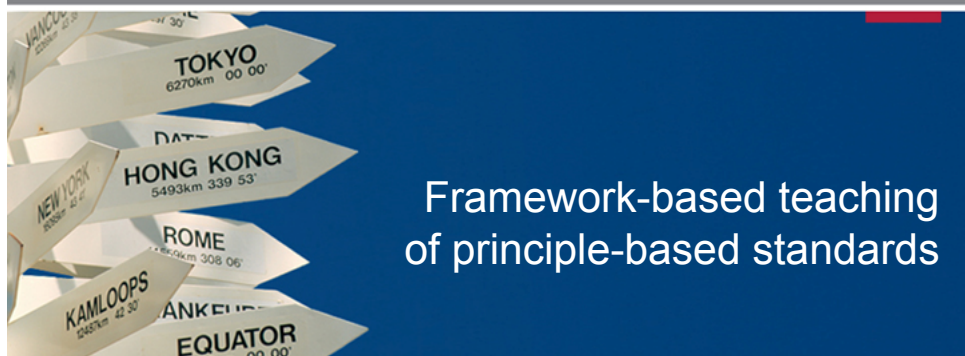
Framework-based Teaching of Principle-based  
Accounting Standards

**Michael Wells**

*Director*

**IFRS Education Initiative, IFRS Foundation**





## Framework-based teaching of principle-based standards

Michael Wells, Director IFRS Education Initiative, IFRS Foundation

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## Role of IASB *Framework*

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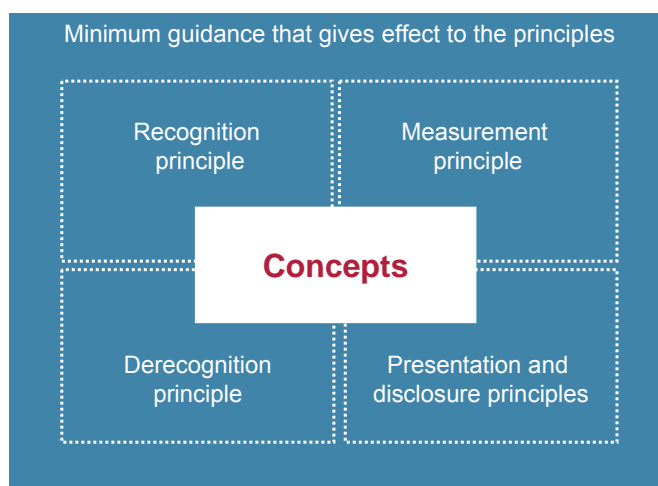
- *Framework* sets out agreed concepts that underlie financial reporting
  - Objective, qualitative characteristics, element definitions, ...
- IASB uses *Framework* to set standards
  - Enhances consistency across standards
  - Enhances consistency across time as Board members change
  - Provides benchmark for judgments
- Preparers use *Framework* to develop accounting policies in the absence of specific standard
  - IAS 8 hierarchy

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## Structure of a principle-based standard

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## The ideal principle-based standard

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- Scope
  - no exceptions
- Principles
  - derived from conceptual framework
  - reliance on professional judgement to apply principles in business context
- Application guidance
  - explains application of principles

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## Get rule-based standards if

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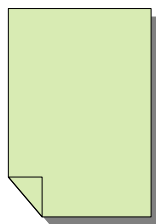
- Preparers and auditors
  - refuse to exercise professional judgement
  - don't act with integrity
  - ask for detailed interpretations
  - refuse to accept raw economic facts
- Regulators
  - want one answer in spite of different economic facts
- Courts
  - lawyers fail to defend reasonable judgements

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## From concepts to principles to rules

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Concepts



Principles



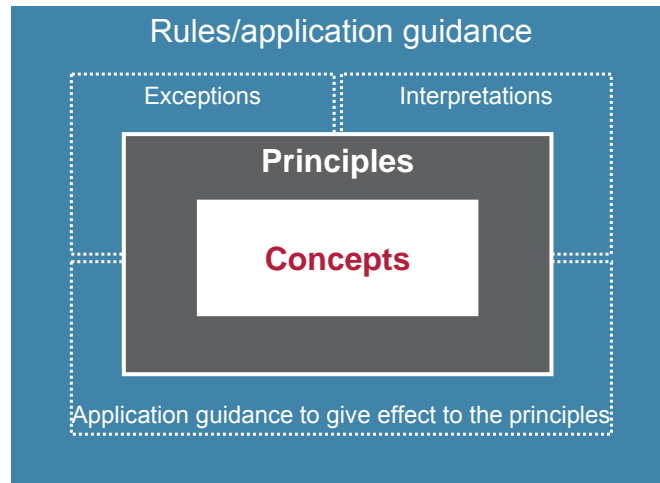
Rules

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## Structure of some IFRSs

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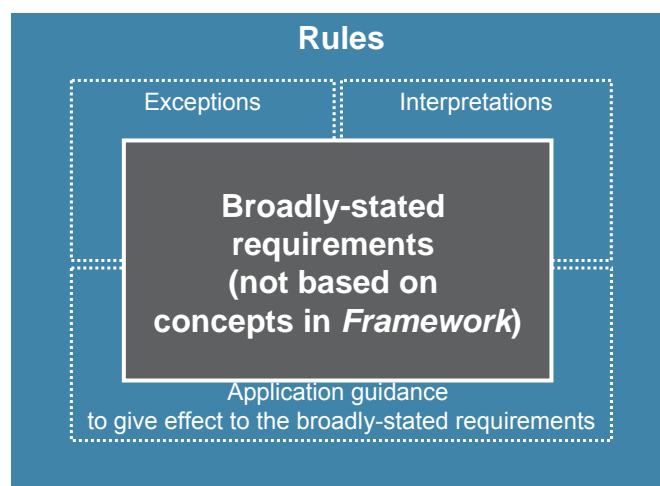


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## Structure of other IFRSs

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## Concepts that underlie IFRSs

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- Objective of **general purpose financial statements**
- Qualitative characteristics
- Elements
- Recognition and measurement
- Presentation and disclosure

### Teaching suggestions:

- Identify which concepts are robust (and which are not)
- Relate the requirements back to the robust concepts in *Framework*
- Explain reasons when requirements inconsistent with *Framework*
- Debunk myths, eg myth: *Framework* = IFRS constitution

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## Objective

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### Objective of IFRS financial statements

- to provide financial information about the reporting entity
- that is useful to existing and potential investors, lenders and other creditors
- in making capital allocation decisions
  - buy, sell or hold debt and equity instruments
  - provide or settle loans and other form of credit

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### Teaching suggestions:

- Contrast objective of IFRS financial statements with other objectives of financial statements
- Debunk myths
  - Myth 1: objective = record of historical costs
  - Myth 2: objective = support tax return
  - Myth 3: financial statements are designed to meet all the information needs of all users

- fundamental QCs
  - relevance
    - predictive value, feedback value, materiality (entity-specific)
  - faithful representation
    - completeness, neutrality, free from error
- enhancing QCs
  - comparable
  - verifiable
  - timely
  - understandable

## Elements

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### Current framework

- 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

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### Framework project

- Asset
  - a present
  - economic resource
  - to which the entity has a right or other access that others do not have
- Liability
  - a present
  - economic obligation
  - for which the entity is the obligor



## Elements continued

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### Current framework

- $\text{Equity} = \text{Assets} - \text{Liabilities}$  (ie a residual)
- Income and expenses = changes in assets and liabilities...

#### Teaching suggestions:

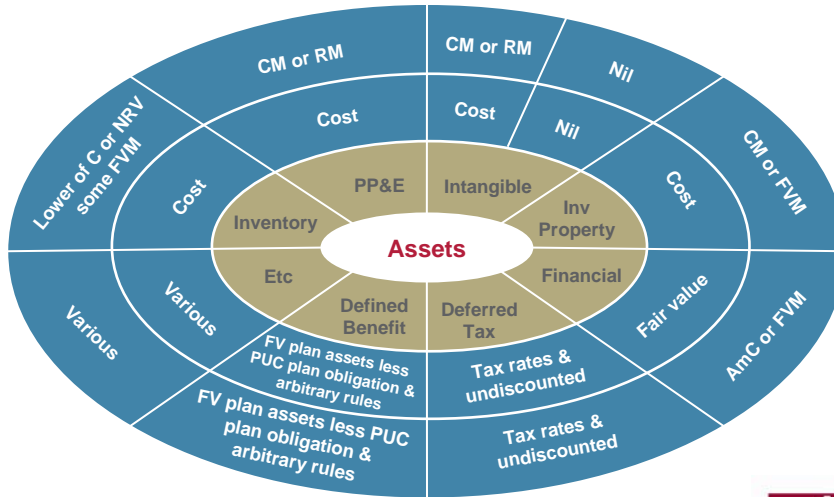
- asset is the cornerstone of element
- defining income and expenses with reference to assets & liabilities = robust framework for measuring performance

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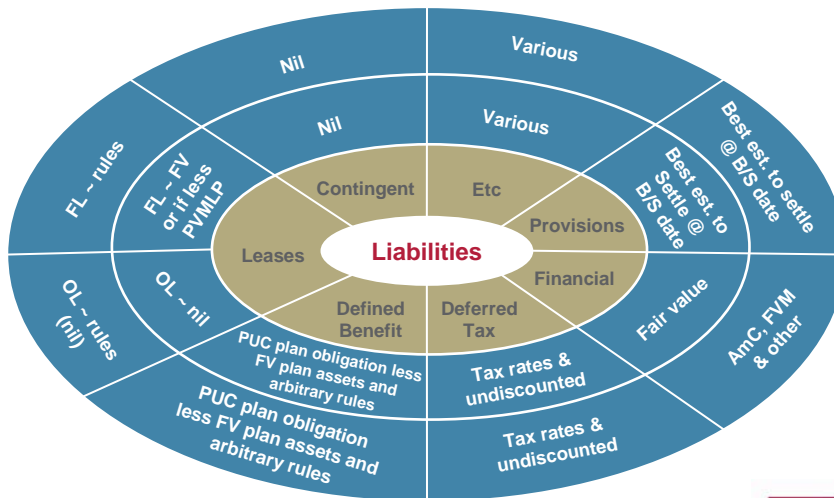
# Asset

## Classification, recognition and measurement



# Liability

## Classification, recognition and measurement



## Keys to teaching IFRSs

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- Students need to understand IFRSs, not simply memorise their requirements (open-book exams might help)
- Most requirements in IFRSs are based on the concepts in the *Framework* and require judgment to apply
- Develop capacity to make judgments
  - first step is to understand the *Framework*
  - then need practice – Case method teaching?
- Basis for Conclusions can be instructive
  - explains IASB’s reasoning
  - describes rejected alternatives and explains why they were rejected

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## From concepts to principles to rules

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### Teaching suggestions

- build from concepts to principles
- explain
  - need for judgement in applying principles
  - how application guidance gives effect to principles
  - how other rules create exceptions and other departures from the principles
  - how interpretations can create more rules
- test understanding, eg use integrated case studies

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## Examples 1a, b and c: Errors and changes in policies and estimates

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- Objective
- Concepts
  - faithful representation
  - comparability
- Principle
  - **1a Prior period error**: retrospective restatement
  - **1b Change in policy**: retrospective application
  - **1c Change in estimate**: prospective application
- Rules
  - impracticable exception
  - specified disclosures

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## Examples 1a,b and c: continued

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### Teaching suggestions:

- build from objective to concepts to principles and rules
- explain how specified disclosures give effect to principle
- focus on judgements
  - eg differentiating changes in accounting estimates from changes in accounting policies and correction of prior period errors
- test understanding, eg use integrated case studies

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## Example 2: Lease classification

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- Objective
- Concepts
  - faithful representation
- Broadly-stated lease classification requirement
  - capitalise in-substance purchases (finance leases)
  - other leases = executory contracts (operating leases)
  - is this requirement principle-based?
- Rules
  - guidance, eg contingent rentals
  - specified disclosures

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## Example 2: Lease classification continued

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### Teaching suggestions:

- explain broadly-stated requirement is weak/inconsistent with the framework
- discuss what a principle-based leased classification principle could be,  
eg see ED *Leases*
- focus on judgements,  
eg classification operating or finance lease
- test understanding,  
eg use an integrated case study

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## Example 3: Business combinations

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- Objective
- Concepts
  - elements definitions
  - representational faithfulness
- Core principle
  - an acquirer of a business (scope)
  - recognises assets acquired and liabilities assumed (recognition principle)
  - at their acquisition-date fair values (measurement principle)
  - discloses information that enables users to evaluate the nature and financial effects of the acquisition (disclosure principle)

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## Example 3: Business combinations continued

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- Rules
  - exceptions to the recognition principle
  - exceptions to the measurement principle
  - specified disclosures

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### Example 3: Business combinations continued

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#### Teaching suggestions:

- build from objective through concepts to core principle and rules
- recognition—explain reason for removing
  - (i) the probability criterion; and
  - (ii) the explicit reliability of measurement criteria (see Basis for Conclusions on IFRS 3 paragraphs BC125–BC130)
- explain reasons for exceptions to IFRS 3:
  - recognition principle
  - measurement principle (see Basis for Conclusions on IFRS 3)

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### Example 3: Business combinations continued

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#### Teaching suggestions (continued):

Focus on judgements, eg

- identifying a business, measuring fair value in the absence of an active market etc

Test understanding, eg:

- integrated case studies
- discuss with reference to the objective and QCs whether uncertainty should enter recognition or measurement (for business combinations and then extend the discussion to other transactions and elements)

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## Common misunderstandings

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The <i>Framework</i> does <b>not</b> ...	Clarification—the <i>Framework</i> includes
include a matching concept	accrual basis of accounting—recognise elements when satisfy definition and recognition criteria
include prudence/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	

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## Common misunderstandings *continued*

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Misunderstanding	Clarification
Principle 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 etc PP&E, eg costs to dismantle/restore site, useful life, residual value, depreciation method etc Provisions, eg uncertain timing and amount of expected future cash flows

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## Questions or comments?

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Understanding IFRS Measurements  
(Cross-cutting Issues)

**Katherine Schipper**  
*Professor of Accounting,*  
**Duke University** and  
*former Member,*  
**FASB**



# Understanding IFRS Measurements (Cross-cutting Issues)

IFRS Teaching Special Interest Section  
November, 2010

Katherine Schipper  
Duke University

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## Introduction

- Measurement in financial reporting
  - Critical aspect of the reporting process, viewed by some as underdeveloped conceptually
  - Existing conceptual guidance tends toward lists of measurement attributes (dating from the mid 1980s)
- Goal of the joint IASB/FASB conceptual framework project (phase C) as it relates to measurement
  - Analyze the properties, including strengths and weaknesses, of various measurement attributes (or bases)
    - Provide definitions, when there might not be a common understanding of the terms used to describe (or name) certain attributes (bases)
    - Distinguish between a measurement technique and a measurement attribute (basis)
  - Provide guidance for choosing a measurement attribute (basis)

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## Examples of questions to consider

- Mixed attribute or one measurement basis for all assets and liabilities
  - If more than one measurement basis, necessary to devise criteria for determining which basis (or bases) to require (or permit)
- How to consider and apply relevance and representational faithfulness to select measurements
  - How to consider and apply other factors such as comparability and cost constraints
- If items are remeasured, how to display the effects of changes in a measurement in a statement of comprehensive income

### *Observation:*

During summer 2010 the IASB and FASB both reached a tentative decision that:

- the objective of selecting a measurement for an item is to maximize the information about the reporting entity's prospects for future cash flows
- subject to the ability to faithfully represent the item
- at a cost that is justified by the benefits

The Boards have also concluded that it is necessary to consider the effects of measurements and measurement changes on all financial statements

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## Available measures

### Current measures

- Current entry price (actual or estimated)
- Current exit price (estimated)
- Present value calculations
  - Value in use
  - Fair value based amounts
  - Other

*Source:* Table 1, June 2009 IASB Staff Paper providing a sample measurement chapter for the conceptual framework project, discussed in December 2009.

### Non-current measures

- Past entry price (actual or estimated)
- Past exit price (estimated)
- Adjusted past prices
  - Accumulated or accreted
  - Allocated or amortized
  - Some combination of these
- Undiscounted future cash flows

### *Observations:*

- Some items arise without a specific entry price, e.g., assets/liabilities acquired in a business combination
- Some reported numbers do not seem to qualify as a measure, e.g., equity method reported on the balance sheet

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## Factors to consider in selecting a measurement identified as part of the joint project

Decision factors derived from the qualitative characteristics of decision-useful information in the Boards' conceptual frameworks and described in the IASB staff paper

- Level of confidence (easily and precisely verifiable)
- Consistency of measurement for similar items and items used together
- Separability of income components of measure changes
  - Separate components with different effects on cash flow prospects
- How value will be realized from the item (value realization method)
- Cost constraints (compliance burden on preparers and auditors)

### *Observations:*

- Qualitative characteristics: relevance, faithful representation, comparability, verifiability, understandability, subject to cost constraints
- Of the five decision factors, primacy is accorded to cost constraints and value realization method

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## More on value realization

- Value realization = Conversion of the economic value of an asset or liability to cash, other assets, services or release from obligation
  - *Direct* value realization occurs in one step, one item at a time
    - *Examples:* Financial instruments, assets (e.g., certain metals or commodities) that will be sold without further processing
  - *Indirect* value realization occurs in multiple steps, often involving other items
    - *Example:* Combine physical assets and other items to create inventory to be sold
  - Value realization is linked to relevance in the Boards' discussions
    - A relevant measure contributes to the assessment of future cash flow prospects and to the evaluation of past performance
    - Therefore, a relevant measure would be based on how the flows an item will generate will arise (that is, how value will be realized)

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## More on value realization

### *Observations and questions to consider:*

- Direct vs. indirect realization distinction seems linked to distinctions sometimes seen in financial reporting, including accounting based on business models and management intent
  - Indirect realization is associated with obtaining (creating) items to be sold
    - Applies to assets, not liabilities
    - Are indirect assets (close to) analogous to “operating assets”?
  - Direct realization could be associated with holding (or owing) certain financial items to maturity or with transferring (settling) the items
    - Should measurement of direct realization items be affected by whether management intends to hold (owe) or transfer (settle)?
  - June 2009 staff paper suggests current measures are generally relevant for certain liabilities and direct realization assets, less so for indirect realization assets
    - Existing guidance requires current exit value measurements (e.g., fair value, net realizable value) for certain *impaired* indirect realization assets.
      - How would this kind of measurement (lower of noncurrent measure and current measure) be affected by the analysis in the staff paper?
      - *Example:* Is an impairment loss relevant if management does not intend to realize value by selling the item?

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## More on value realization

- Applying the value realization factor suggests that *how* an item is used by management to create value is pertinent to its measurement
  - *Example 1:* An brand, acquired as part of a business combination, that management intends to discard (does not intend to use or sell)
  - *Example 2:* A financial obligation that management intends to owe to maturity
  - *Example 3:* A debt security that management intends to hold to maturity so as to collect all the contractual cash flows
  - *Example 4:* A nonfinancial asset that management intends to use until its service potential is exhausted

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## More on value realization

*Observations on the examples and a question to consider:*

- Does using something in a specific way alter its economic characteristics?
  - A faithful representation depicts the economic phenomenon
- A current exit value exists for each of these items (it may have to be estimated)
- The current exit value captures the opportunity cost of holding the asset or owing the obligation, given current market conditions
- Relevant information contributes to the assessment of future cash flow prospects and the evaluation of past performance
  - Is this opportunity cost relevant for:
    - Assessing an investment in the entity?
    - Assessing management's performance?
    - *Example:* If management collects all the contractual cash flows of a 4% debt security when the market rate is 5%, does the entity have a loss?
    - *Example:* What is the most relevant measure of assets in a calculation of Return on Assets (ROA)?

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## Applying the factors to IFRS 9 Description of the guidance

- IFRS 9 requires: Measure financial assets at amortized cost or fair value on the balance sheet
- *Except that* the fair value option in IAS 39 is retained
  - Fair value option: designate at initial recognition a qualifying financial asset to be measured at fair value with changes included in profit or loss if doing so eliminates or significantly reduces an inconsistency (accounting mismatch) that would otherwise arise
- *Except that* the equity method is retained (because equity method investments are not in the scope of IAS 39)

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## Applying the factors to IFRS 9 Description of the guidance

- IFRS 9: Measure financial assets at amortized cost or fair value
  - Amortized cost items must meet two criteria:
    - Business model test: Asset is held within a business model whose objective is to hold the assets to collect contractual cash flows
      - » Reclassification is required if the business model changes
      - » Analysis is neither at the individual instrument level nor at the reporting entity level (the portfolio level?)
      - » The entity need not hold the asset to maturity
    - Contractual cash flows test: Contractual terms of the asset specify principal and interest only
      - » *Except that* management must look to the assets and liabilities of the issuing entity if the financial asset is linked to other securities in a way that affects the concentration of credit risk (for example, arrangements that specify the order in which losses are allocated)
  - Initial measurement is fair value + transaction costs
  - Assets are subject to impairment (impairments can be reversed)
  - Application of the classification criteria is illustrated by examples <sup>11</sup>

## Applying the factors to IFRS 9 Description of the guidance

- IFRS 9: Measure financial assets at amortized cost or fair value
  - Fair value items:
    - Debt instruments held as assets and not classified as being measured at amortized cost (either because of not qualifying or because of applying the fair value option)
    - Equity instruments
      - » *Except*, possibly, equity instruments where cost might be the best estimate of fair value (refer to paragraphs B5.5 to B5.8)
    - Fair value changes included in net income
      - » *Except that* management can designate an equity instrument not held for trading as measured at fair value with changes included in OCI, with no recycling and with dividends included in profit and loss

### Observations:

- Equity method investments are not in the scope of the standard
- IFRS 9 eliminates the trading, AFS and HTM classifications, impairment testing except for items measured at amortized cost and the recycling of unrealized gains and losses when securities are sold
- Dividend and price change components of return on certain equity securities will be reported separately (dividends in profit/loss, price changes in OCI) <sup>12</sup>

## Applying the measurement factors to IFRS 9

- Value realization method: How value will be realized can affect the measurement
  - Management can determine measurement of certain financial assets by applying the fair value option or by applying the business model/contractual cash flows tests
  - The business model/cash flows tests are linked to the method of value realization; reclassifications are required if the business model changes
- Consistency of measurement for similar items
  - Similar items are expected to be measured differently
- Separability of income components
  - Dividend and price change components of return on certain equity instruments will be reported in two different places
- Cost constraints (cost to implement)
  - Application of the cash flows test requires analysis of the issuing entity, not just the issued instrument
  - Impairment testing
- Level of confidence
  - Addressed separately (next slide)

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## Concerning the level of confidence: IASB proposals on measurement uncertainty analysis disclosures

- June 2010 exposure draft, *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements* (limited re-exposure)
  - Related to the fair value hierarchy (exists in US GAAP, proposed for IFRS)
  - Proposed disclosures—all pertaining to unobservable (Level 3) inputs only
    - Disclose the effects of using different inputs (and how effects were calculated) if changing one or more inputs that could reasonably have been used would change the fair value measurement significantly
    - Ignore inputs associated with “remote scenarios”
    - Take into account the effects of correlations among inputs if relevant (new to the re-exposure)
      - *Example:* Prepayments of residential mortgages are correlated with changes in interest rates

### Observations:

- The analysis is *not* intended to predict how a measurement would change in the future because of changes in economic conditions (BC 10) or to provide users with information to ‘second guess’ reported measurements (BC16) or duplicate the IFRS 7 market risk exposure analysis (BC 22-24)
- No requirement to provide a quantitative correlation analysis (BC 20)

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### Questions related to measurement

- When should the method of value realization be determinative of measurement (or of accounting treatment generally)?
  - Could be linked to management intent, as in IFRS 9
  - Ignores opportunity cost and (probably) impairs comparability
  - In several uncontroversial settings, accounting treatment is linked to the entity's business model (method of value realization) or seems to result in a number that would not qualify as a measurement
    - *Example:* Heavy construction equipment is accounted for as inventory by a dealer and as fixed assets by a construction company
    - *Example:* Equity method accounting (would the balance sheet number qualify as a measurement)?
- What measurement costs should the standard setter consider?
  - Investments in information systems
  - Investments in valuation/measurement expertise
  - Investments in developing Level 3 (unobservable) inputs
- What is the maximum admissible level of measurement uncertainty?
  - Confidence interval so large that the point estimate is not interpretable?
  - What if there is no practicable alternative to an uncertain measure (e.g.,<sup>15</sup> uncertain fair value measurements for certain derivatives)?

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**IFRS Teaching  
Special Interest Session**

4 November 2010 – Singapore, Singapore

**Roundtable Q&A**

**Panellists:**

**Holger Erchinger**

*Partner,*

**KPMG LLP**

**Katherine Schipper**

*Professor of Accounting,*

**Duke University** and

*former Member,*

**FASB**

**Michael Wells**

*Director*

**IFRS Education Initiative, IFRS Foundation**

**Mary Barth**

*Professor of Accounting,*

**Stanford University** and

*Academic Advisor to the IASB*

**Donna Street**

*Professor of Accounting,*

**University of Dayton** and

*President,*

**IAAER**



**Joint IAAER-IFRS Foundation**

**IFRS Teaching  
Special Interest Session**

4 November 2010 – Singapore, Singapore

IFRS Judgments in Impairment Testing

**Holger Erchinger**  
*Partner,*  
**KPMG LLP**





# IFRS Judgments in Impairment Testing

Singapore - 4 November 2010

KPMG LLP

AUDIT • TAX • ADVISORY

## KPMG Presenter

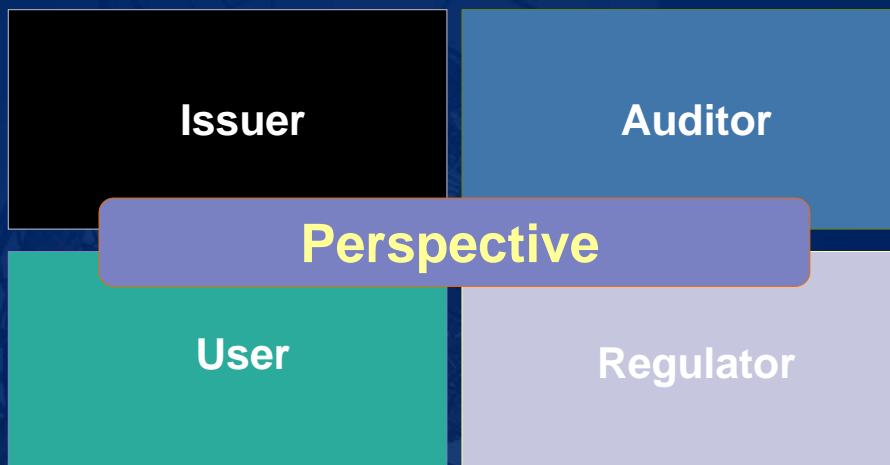
**Holger Erchinger**  
Audit Partner, KPMG LLP New York



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## Understanding IFRS Judgments



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## IAS 1 Presentation of Financial Statements

### IAS 1.122 (Disclosure of Accounting Policies)

*“An entity shall disclose, in the summary of significant accounting policies or other notes, the judgments, apart from those involving estimations, that management has made in the process of applying the entity’s accounting policies and that have the most significant effect on the amounts recognized in the financial statements.”*

IAS 1.123 provides examples of judgments to be made by management.



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# IAS 1 Presentation of Financial Statements

## IAS 1.125 (Sources of Estimation Uncertainty)

*“An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next fiscal year. In respect of those assets and liabilities, the notes shall include details of:*

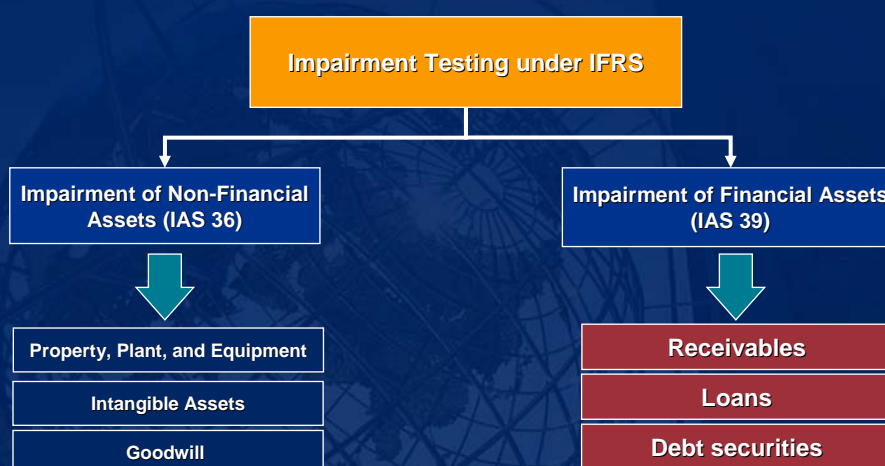
- (a) their nature, and*
- (b) their carrying amount as at the end of the reporting period.*



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# IFRS Judgments in Impairment Testing



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## Judgments related to the application of the IAS 36 impairment model

### Identifying an asset that may be impaired



Asset or Cash Generating Unit (CGU)



Indication of Impairment (external/internal sources)

### Measuring the recoverable amount



Fair value less costs to sell



Value in use



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## Judgments related to the application of the IAS 36 impairment model

### Goodwill



Allocation of goodwill to cash-generating units



Disposition or reorganization of an operation

### Reversing an impairment loss



Assessment for indication



Limitation of reversal

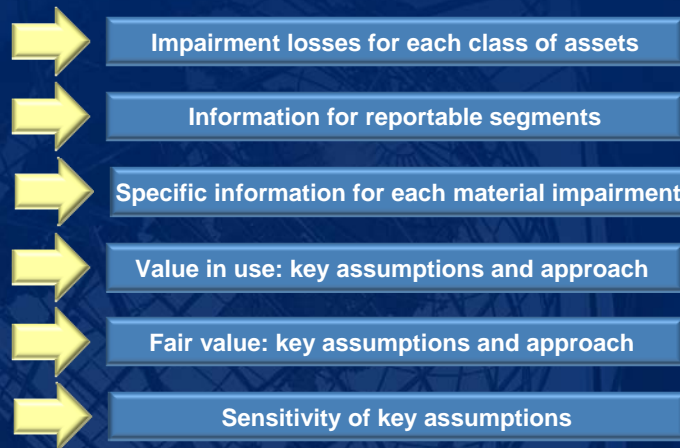


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## Judgments related to the application of the IAS 36 impairment model

### Disclosure requirements in accordance with IAS 36



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## Judgments related to the application of the IAS 39 impairment model

IAS 39.58 states:

***“An entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets measured at amortized cost is impaired.”***



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## Judgments related to the application of the IAS 39 impairment model

### Objective evidence

- Significant financial difficulty of the issuer
- Probable that the borrower will enter bankruptcy
- Disappearance of an active market for that asset



## Judgments related to the application of the IAS 39 impairment model

IAS 39.63 states:

*“If there is objective evidence that an impairment loss on financial assets measured at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows (excluding credit losses that have not been incurred) discounted at the financial asset’s original effective interest rate.”*



## Judgments related to the application of the IAS 39 impairment model

IFRS 7.37 states:

*“An entity shall disclose by class of financial asset an analysis of financial assets that are individually determined to be impaired as at the end of the reporting period, including the factors the entity considered in determining that they are impaired”.*



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## Committee of European Banking Supervisors (CEBS) Assessment of banks' transparency (30 June 2010)

### Disclosure areas for improvement



Impairment information



Fair values



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## Committee of European Securities Regulators (CESR) Activity Report on IFRS Enforcement 2009 (23 Sept 2010)

### Recurring Issues Identified

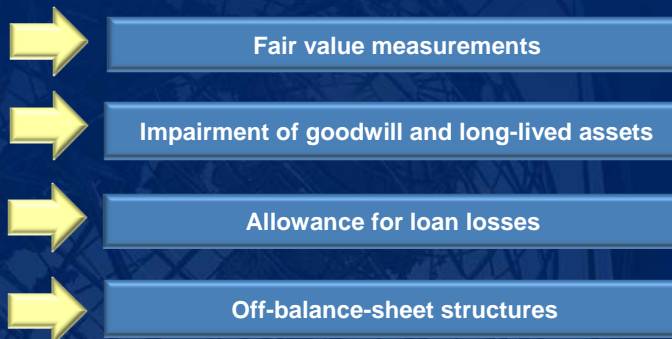


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## Public Company Accounting Oversight Board (PCAOB) Report on Inspection of Registered Accounting Firms (29 Sept 2010)

### Observations by the Board's Inspection Staff



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## Understanding IFRS Judgments

Experience

Critical Thinking

Transparency and Disclosure

Training and  
Education

Guidance



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**Joint IAAER-IFRS Foundation**

**IFRS Teaching  
Special Interest Session**

4 November 2010 – Singapore, Singapore

IFRS Curriculum Development and IFRS Resources

**Donna Street**  
*Professor of Accounting,*  
**University of Dayton** and  
*President,*  
**IAAER**



## **IFRS Foundation and IAAER IFRS Teaching Workshop**

### **IFRS Curriculum Development & Teaching Resources**

Professor Donna L. Street

Mahrt Chair in Accounting University of Dayton

IAAER President and Director of Research and  
Educational Activities

### **Approaches to teaching IFRS**

- Schipper: Ideas for Teaching IFRSs
  - [http://www.iasb.org/NR/rdonlyres/4F3A44D2-F6AB-4F36-84C3-0032B08870D9/0/France\\_draft2.pdf](http://www.iasb.org/NR/rdonlyres/4F3A44D2-F6AB-4F36-84C3-0032B08870D9/0/France_draft2.pdf)
- Pacter and Zeff: IFRS Is Here And What To Do About It
  - <http://www.iasplus.com/resource/0808aaa-ifrs-is-here.pdf>

## Recommendation

- Start IFRS coverage in principles (introductory) accounting & include in all financial reporting (& finance) classes
  - Should not be a one man/woman show
  - Need department buy in
  
  - IFRS is the global norm
  
  - For countries not adopting IFRS, accounting students need to be bi-lingual

## Elements of teaching IFRS reviewed today

- Teach understanding of *Framework*
  - on IASB website (<http://www.ifrs.org/IFRSs/IFRS.htm>)
  - with extensive cross-referencing and other annotations in eIFRS
- Teach foundational economic concepts
- Teach current requirements
- Teach how to make judgments
- Prepare students for global world
- Adopt global perspective

–What resources are available to help educators achieve above?

## Some starting points

- <http://www.iasplus.com/resource/ifrsresources.pdf>
  - Paul Pacter’s list on iasplus (last update 23 February 2010)
- BDO IFRS Resource Centre
  - <http://www.bdo.com/ifrs/>
- GT Faculty Connection – resource website
  - <http://faculty.gtexperience.com>
- KPMG Faculty Portal
  - <https://www.amr.kpmg.com/facultyportal/>
- Deloitte IFRS University Consortium & iasplus
  - [www.deloitte.com/us/ifrs/consortium](http://www.deloitte.com/us/ifrs/consortium)
  - <http://www.iasplus.com>
- Ernst & Young IFRS website
  - [www.ey.com/ifrs](http://www.ey.com/ifrs)

## E&Y Academic Resource Center (EYARC)

- Curriculum modules include a user guide, lecture notes, slides, examples, homework problems, illustrative disclosures, behind the scenes (**conceptual classroom discussion tools**), case studies and international spotlights (cases focused on research and opinion sharing regarding current business issues and accounting standard-setting developments)
- **Emphasis on conceptual content to better develop critical thinking skills and judgment**
- Contact/more info: EYARC Program Director, Catherine Banks, at [catherine.banks@ey.com](mailto:catherine.banks@ey.com)

## IASB project summaries easily incorporated into existing classes

- [www.iasb.org](http://www.iasb.org)
  - **TEACH IASB AGENDA INCLUDING FRAMEWORK**
    - Examples of IASB ‘Snapshots’
      - Defined benefit pension plans
        - » <http://www.ifrs.org/NR/ronlyres/944C6CFC-1EC1-4796-BA560BCF590E9329/0/SnapshotAmendstoIAS19new.pdf>
      - Presentation of items of OCI
        - » <http://www.ifrs.org/NR/ronlyres/7C43E643-B2D3-447B-9854-C0E0C0F3A01E/0/SnapshotEDOCI.pdf>

## Pair snapshots with IASB webcasts

- Go to IASB work plan
  - <http://www.ifrs.org/Current+Projects/IASB+Projects/IASB+Work+Plan.htm>
- Select an exposure draft – leases
  - <http://www.ifrs.org/Current+Projects/IASB+Projects/Leases/Leases.htm>
- Have students read the snapshot
  - <http://www.ifrs.org/NR/ronlyres/FBE30248-225B-48AF-AAE5-96494D83A978/0/LeasesSnapShot0810.pdf>
- View the webcast announcing the exposure draft
  - <http://www.ifrs.org/Current+Projects/IASB+Projects/Leases/Webcast+Recordings+and+Q+and+A/Webcast+Recordings+and+Q+and+A.htm>
- Consider comment letters on the exposure draft – and consider the basis for conclusions
  - <http://www.ifrs.org/Current+Projects/IASB+Projects/Leases/ed10/cl/cl.htm>
  - <http://www.ifrs.org/NR/ronlyres/165478E5-02A8-4E19-A502-7B1CA48D495B/0/EDLeasesBasis0810.pdf>
- Add a large firm webcast to get a practice perspective
  - <http://webcast.ey.com/thoughtcenter/default.aspx?seriesunid=%7B0bacc43a-86f7-496d-9e5a-0d93f6d501a2%7D>

## Pair snapshots with IASB webcasts

- Go to IASB work plan
  - <http://www.ifrs.org/Current+Projects/IASB+Projects/IASB+Work+Plan.htm>
- Select an exposure draft – revenue recognition
  - <http://www.ifrs.org/Current+Projects/IASB+Projects/Revenue+Recognition/Revenue+Recognition.htm>
- Have students read the snapshot
  - <http://www.ifrs.org/NR/ronlyres/74E37A73-0A4D-447F-A8DF-3574002B7406/0/SnapshotRevCon.pdf>
- View the webcast announcing the exposure draft
- Consider comment letters on the exposure draft – and consider the basis for conclusions
  - <http://www.ifrs.org/Current+Projects/IASB+Projects/Revenue+Recognition/ed0610/Exposure+draft.htm>
  - <http://www.ifrs.org/NR/ronlyres/74EDB059-C251-495E-9CE3-B5D221CCC7BA/0/EDRevRecogBC0610.pdf>
  - Stress that the Framework is the vocabulary of the Board
- Have students write a comment letter using the language of the Framework

## IAAER & eIFRS

### Teach framework & current requirements

- IAAER membership includes free academic access to eIFRS. Annual IAAER membership
  - \$US25 faculty
  - \$US20 student
  - Special university rates start at \$US150 (for 10 faculty)
  - Membership forms available at [www.iaaer.org](http://www.iaaer.org)
    - Full cost of eIFRS for one user 200 UK pounds
- eIFRS includes - *A Guide Through IFRS*
  - Full text of standards & interpretations
  - Extensive cross-referencing and other annotations
  - Basis for conclusions & dissenting opinions



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eIFRS access for academics & students only

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- [ACCA and IAAER Sign Three-Year MOU to Sponsor Academic Research](#)
- [IAAER Representatives on IASB SAC, IAESB, IASC Foundation EAG,](#)

# A Guide Through IFRSs

Constitution, Framework, IFRSs, etc.

International Accounting Standards Board

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**Document**

- [Introduction to this Edition](#)
- [IASB Foundation Constitution](#)
- [Framework for the Preparation and Presentation of Financial Statements](#)
- [Preface to International Financial Reporting Standards including IFRIC and SIC Interpretations](#)
- [IFRS 1 First-time Adoption of International Financial Reporting Standards](#)
- [IFRS 2 Share-based Payment](#)
- [IFRS 3 Business Combinations](#)
- [IFRS 4 Insurance Contracts](#)
- [IFRS 5 Non-current Assets Held for Sale and Discontinued Operations](#)
- [IFRS 6 Exploration for and Evaluation of Mineral Resources](#)
- [IFRS 7 Financial Instruments: Disclosures](#)
- [IFRS 8 Operating Segments](#)
- [IAS 1 Presentation of Financial Statements](#)
- [IAS 2 Inventories](#)
- [IAS 7 Statement of Cash Flows](#)
- [IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors](#)

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# IFRS 3

**International Financial Reporting Standard 3  
Business Combinations**

This version was issued in January 2008. Its effective date is 1 July 2009.

IAS 22 Business Combinations was issued by the International Accounting Standards Committee in October 1998. It was a revision of IAS 22 Business Combinations (issued in December 1993), which replaced IAS 22 Accounting for Business Combinations (issued in November 1983).

In April 2001 the International Accounting Standards Board (IASB) resolved that all Standards and Interpretations issued under previous Constitutions continued to be applicable unless and until they were amended or withdrawn.

In March 2004 the IASB issued IFRS 3 Business Combinations. It replaced IAS 22 and three Interpretations:

- SIC-9 Business Combinations—Classification either as Acquisitions or Unwindings of Interests
- SIC-22 Business Combinations—Subsequent Adjustment of Fair Values and Goodwill Initially Reported
- SIC-28 Business Combinations—“Date of Exchange” and Fair Value of Equity Instruments.

IFRS 3 was amended by IFRS 5 Non-current Assets Held for Sale and Discontinued Operations (issued March 2004).

IAS 1 Presentation of Financial Statements (as revised in September 2007) amended the terminology used throughout IFRSs, including IFRS 3.

1 effective date 1 January 2009

In January 2008 the IASB issued a revised IFRS 3.

The following Interpretations refer to IFRS 3:

- SIC-32 Intangible Assets—Web Site Costs (issued March 2002 and amended by IFRS 3 in March 2004)
- IFRIC 9 Reassessment of Embedded Derivatives (issued March 2006)
- IFRIC 17 Distributions of Non-cash Assets to Owners (issued November 2008) 2

2 effective date 1 July 2009

**CONTENTS**

paragraphs

INTRODUCTION IAS 3 IAS 19 2

# Interpretations Update

**Scope**

2 This IFRS applies to a transaction or other event that meets the definition of a business combination. This IFRS does not apply to:

- the formation of a joint venture [G] **Refer: Basis for Conclusions paragraphs BC59–BC61**
- the acquisition of an asset [G] or a group of assets that does not constitute a business. **Refer: Basis for Conclusions paragraph BC20** In such cases the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, intangible assets in IAS 38 Intangible Assets) and liabilities [G] assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill.
- a combination of entities or businesses under common control<sup>2</sup> (paragraphs B1–B4 provide related application guidance).

3 [IFRIC Update—March 2006: “Transitory” common control] The IFRIC considered whether a reorganisation involving the formation of a new entity to facilitate the sale of part of an organisation is a business combination within the scope of IFRS 3. IFRS 3 does not apply to business combinations in which all the combining entities or businesses are under common control both before and after the combination, unless that control is transitory. It was suggested to the IFRIC that, because control of the new entity is transitory, a combination involving that newly formed entity would be within the scope of IFRS 3. IFRS 3 paragraph 22 (now paragraph B18) states that when an entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the combination must be identified as the acquirer on the basis of the evidence available (now must be identified as the acquirer by applying the guidance in paragraphs B13–B17). The IFRIC noted that, to be consistent, the question of whether the entities or businesses are under common control applies to the combining entities that existed before the combination, excluding the newly formed entity. Accordingly, the IFRIC decided not to add this topic to its agenda. The IFRIC also considered a request for guidance on how to apply IFRS 3 to reorganisations in which control remains within the original group. The IFRIC decided not to add this topic to the agenda, since it was unlikely that it would reach agreement in a reasonable period, in the light of existing diversity in practice and the explicit exclusion of common control transactions from the scope of IFRS 3.]

**Refer: Basis for Conclusions paragraphs BC58–BC79**

**Identifying a business combination**

3 An entity shall determine whether a transaction or other event is a business combination by applying the definition in this IFRS, which requires that the assets [G] acquired and liabilities [G] assumed constitute a business. **Refer: Appendix A** If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition. Paragraphs B5–B12 provide guidance on identifying a business combination and the

# Basis for Conclusions

not included in free versions of IFRS

**Basis for Conclusions on IFRS 3 Business Combinations**

*This Basis for Conclusions and its appendix accompany, but are not part of, IFRS 3.*

**Background information**

In 2001 the International Accounting Standards Board began a project to review IAS 22 *Business Combinations* (revised in 1999) as part of its initial agenda, with the objective of improving the quality of, and seeking international convergence on, the accounting for business combinations. The Board decided to address the accounting for business combinations in two phases.

As part of the first phase, the Board published in December 2002 ED 3 *Business Combinations*, together with an exposure draft of proposed related amendments to IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*, with a comment deadline of 4 April 2003. The Board received 136 comment letters.

The Board concluded the first phase in March 2004 by issuing simultaneously IFRS 3 *Business Combinations* and revised versions of IAS 36 and IAS 38. The Board's primary conclusion in the first phase was that virtually all business combinations are acquisitions. Accordingly, the Board decided to require the use of one method of accounting for business combinations—the acquisition method.

The US Financial Accounting Standards Board (FASB) also conducted a project on business combinations in multiple phases. The FASB concluded its first phase in June 2001 by issuing FASB Statements No. 141 *Business Combinations* (SFAS 141) and No. 142 *Goodwill and Other Intangible Assets*. The scope of that first phase was similar to IFRS 3 and the FASB reached similar conclusions on the major issues.

The two boards began deliberating the second phase of their projects at about the same time. They decided that a significant improvement could be made to financial reporting if they had similar standards for accounting for business combinations. They therefore agreed to conduct the second phase of the project as a joint effort with the objective of reaching the same conclusions.

The second phase of the project addressed the guidance for applying the acquisition method. In June 2005 the boards published an exposure draft of revisions to IFRS 3 and SFAS 141, together with exposure drafts of related amendments to IAS 27 *Consolidated and Separate Financial Statements* and Accounting Research Bulletin No. 51 *Consolidated Financial Statements*, with a comment deadline of 28 October 2005. The boards received more than 280 comment letters.

# Dissenting opinions

students need to appreciate limitations of current standards

**Dissenting opinions on IFRS 3**

**Dissent of Mary E Barth, Robert P Garnett and John T Smith**

DO1 Professor Barth and Messrs Garnett and Smith dissent from the publication of IFRS 3 *Business Combinations* (as revised in 2003), for the reasons set out below.

**Measurement of non-controlling interest**

DO2 Professor Barth and Mr Smith disagree with the Board's decision to make an exception to the IFRS's measurement principle and permit acquirers a free choice, acquisition by acquisition, to measure any non-controlling interest in an acquiree as the non-controlling interest's proportionate share of the acquiree's identifiable net assets, rather than at fair value (paragraph 19 of the IFRS).

DO3 Professor Barth and Mr Smith agree with the measurement principle as explained in paragraph BC207 that the acquirer should recognise the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree at their acquisition-date fair values. Paragraph BC209 indicates that the Board also supports this principle, but decided to make an exception. Professor Barth and Mr Smith support the Board's general view that exceptions should be avoided because they undermine principle-based standards, but understand that they are necessary in well-justified circumstances. Professor Barth and Mr Smith do not believe that an exception to this principle, with a free choice in applying it, is justified in this situation.

DO4 First, Professor Barth and Mr Smith are among those Board members mentioned in paragraph BC213 who believe that non-controlling interests can be measured reliably. Second, Professor Barth and Mr Smith believe that the benefits of consistently measuring all assets acquired and liabilities assumed outweigh the costs involved in conducting the measurement. To address concerns about costs exceeding benefits in particular acquisitions, they would have supported an exception to the principle based on undue cost or effort. Such an exception would not have been a free choice, but would have required assessment of the facts and circumstances associated with the acquisition. Professor Barth and Mr Smith disagree with the Board's decision to permit a free choice, rather than to adopt such an exception. They also disagree with the Board's decision not to require fair value measurement even for acquisitions of listed acquirees, for which the cost would be nil. Third, a consequence of failure to measure non-controlling interests at fair value is that acquired goodwill is not measured at fair value. In addition to being an exception to the IFRS's measurement principle, this has several undesirable effects beyond the initial accounting for goodwill. The Board acknowledges these in paragraphs BC217 and BC218. In particular, if goodwill is impaired the impairment loss is understated, and if the acquirer subsequently purchases more of the non-controlling interests equity is reduced more than it would be had goodwill been measured initially at fair value. Fourth, based on staff research, the choice will benefit only a minority of acquirers because most acquisitions are for 100 per cent of the acquiree. As noted above, any benefit is reduced if such acquirers subsequently measure goodwill as more than the non-controlling interest because of the resulting impairment loss.

## eIFRS in several languages

The screenshot displays the eIFRS website interface. At the top left is the International Accounting Standards Board logo. A search bar is located at the top right. Below the logo is a navigation menu with links: Home, About Us, Jobs, FAQs, Contact Us, Sitemap, News, RSS. A secondary navigation bar contains links for issb.org, Shop, and eifrs home. The main header area features the text "electronic International Financial Reporting Standards (eIFRS)" and a login status: "Login status: Auto HTTP Login (IAAER)". Below this, there is a "Publication search:" field with a "Search" button. The left sidebar contains several sections: "Subscribers only" with links for "FRSs (All Languages)", "Additional Material", "Search", and "Terminology"; "Registered users" with links for "Unaccompanied IFRSs", "FRS for SMEs", "FRS Taxonomy", "Latest Additions", "FAQ", "Forthcoming Titles", "Other Products", and "Log Out"; and "Printable PDF language versions" with a "Folders:" section listing: "English" (Standards in English), "Deutsch" (Standards auf deutsch), "Español" (Las normas en español), "Français" (Les Normes en français), "Ελληνικά" (Τα Πρότυπα στα Ελληνικά), and "Italiano".

## Free IFRS access on EU website

- IFRS in every official language of EU
  - Under heading: IAS / IFRS Standards and Interpretations
  - Includes (as adopted by EU):
    - International Accounting Standards (IAS)
    - International Financial Reporting Standards (IFRS) and related interpretations (SIC/IFRIC)
    - Information on temporary carve-out from IAS 39 and fair value/financial crisis debate
  - At [http://ec.europa.eu/internal\\_market/accounting/ias/index\\_en.htm](http://ec.europa.eu/internal_market/accounting/ias/index_en.htm)
    - 'ro' link for Romanian
    - 'fr' link for French
    - 'en' link for English

## Free IFRS access on IASB website

<http://www.ifrs.org/IFRSs/IFRS.htm>

- Access unaccompanied IFRSs
  - IFRS Foundation provides free access to current year's consolidated unaccompanied IFRSs (i.e. core standards, without implementation guidance & basis for conclusions) in English and IFRS for SMEs. However, access to full set of standards, including guidance & basis for conclusions, requires eIFRS subscription.

## Earn IFRS Certificate from ICAEW & 3 Hours College Credit

UD Department of Accounting offers, at graduate & undergraduate level, a class that includes completion of ICAEW IFRS Learning & Assessment Program

UD Department of Accounting an ICAEW **Approved Partner in Learning**

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- ICAEW designed IFRS learning & assessment program “for those looking to demonstrate their competence in IFRS or enhance their career prospects as an IFRS specialist. The programme has been developed by IFRS specialists...”
- Aims of ICAEW IFRS learning program include:
  - “broad knowledge and understanding of financial reporting across all international financial reporting standards, the ability to apply principles, concepts and knowledge from IFRS in simple business situations, understanding of financial information produced under IFRS”
- For more information contact [donna.street@notes.udayton.edu](mailto:donna.street@notes.udayton.edu) or [teresa.wehmeyer@notes.udayton.edu](mailto:teresa.wehmeyer@notes.udayton.edu)

## UD Course Description: International Accounting - IFRS Certificate and Research

- A comprehensive study of International Financial Reporting Standards (IFRS). Students will complete the Institute of Chartered Accountants in England and Wales' (ICAEW) IFRS learning and assessment program and upon successful completion earn an IFRS certificate. The ICAEW program is an e-learning program. The course also includes preparation of research paper(s) addressing contemporary topics in international financial reporting. A **significant tuition discount** is available for students **not** pursuing a degree at the University of Dayton. In addition to tuition, a course fee (of approximately £320) applies to cover ICAEW charges for the IFRS textbook, access to the e-learning modules, and assessment test.
- Prerequisite: Intermediate Financial Accounting II required, Advanced Financial Reporting strongly recommended, and permission of instructor.

## Other items on Paul's list

- AICPA's [www.ifrs.com](http://www.ifrs.com)
  - IFRS news clips
  - [http://ifrs.com/updates/aicpa/IFRS\\_news\\_stories.html](http://ifrs.com/updates/aicpa/IFRS_news_stories.html)
- <http://www.iasplus.com> (Deloitte)
  - TREMENDOUS, TIMELY UPDATES
    - Go to place for updates – worldwide coverage
  - Includes Deloitte IFRS e-learning (free downloads)
    - Independent study with quizzes provided
      - Easy add-on to Intermediate Accounting, etc
- *Issues in Accounting Education* 22(4) Nov **2007**
  - 17 international accounting cases
  - Special issue by International Accounting Section of AAA
    - EDUCATORS NEED MORE CASE STUDIES
    - IAAER WORKING ON IT!!!! STAY TUNED!

# Teach how to make judgments

Mike Wells' model of types of judgments

- **Pervasive issues**
  - Going concern
  - Materiality
  - Related disclosures
- **Applying most IFRSs**
  - Presentation and disclosure
  - Classification
  - Recognition
  - De-recognition
  - Measurement

## Pervasive issues: Going concern

- **Concept**
  - Framework (paragraph 23)
  - Financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future ...
- **Rule**
  - IAS 1 (paragraph 25)
  - An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so
- **Judgment**
  - **According to practicing auditors, consideration of a company's ability to continue as a going concern is particularly challenging in the current environment**

## Going concern

- Assessing whether the going concern assumption is appropriate **management considers all available information about the future ...**
- Degree of consideration depends on the facts in each case
  - Management may need to consider a wide range of factors relating to **current and expected profitability, debt repayment schedules and potential sources of replacement financing ...**

## Going concern teaching suggestions

- Integrate financial reporting judgments with auditing those judgments
  - IAASB Staff Audit Practice Alert (January 2009) *Audit Considerations in Respect of Going Concern in the Current Economic Environment*
  - [http://web.ifac.org/download/IAASB\\_Staff\\_Audit\\_Practice\\_Alerts\\_2009\\_01.pdf](http://web.ifac.org/download/IAASB_Staff_Audit_Practice_Alerts_2009_01.pdf)

## Going concern teaching suggestions

- Use real world examples and case studies
  - From annual reports including a discussion of the adequacy of the disclosures, if any
    - Austrian Airlines – going concern
      - <http://www.austrianairlines.co.at/NR/rdonlyres/2D8769E0-889D-461F-AEEB-BE49A26CE80C/0/KonzernGB08englischs.pdf>
    - Bradford and Bingley (credit crisis bank bail out)
      - [http://corporate.bbg.co.uk/en/~/\\_/media/Files/B/Bradford-And-Bingley-Corporate/pdf/results-and-publications/year-2008/ar2008\\_03\\_04\\_09.pdf](http://corporate.bbg.co.uk/en/~/_/media/Files/B/Bradford-And-Bingley-Corporate/pdf/results-and-publications/year-2008/ar2008_03_04_09.pdf)

## Real World Example: Austrian Airlines

### Notes to the Financials

- Due to the signing of the contractual agreements on 5.12.2008 to transfer to the Lufthansa Group the shareholding in the Austrian Airlines Group held by the state holding company ÖIAG, the implementation of which depends on several pre-requisites being fulfilled, such as the approval of the EU Commission and the carrying out of measures by the previous majority shareholder ÖIAG and the Lufthansa Group as the new majority shareholder designed to strengthen the liquidity and share capital of the Austrian Airlines Group, the **pre-requisites provide the basis for a positive going concern opinion**, due to the fact that no information is currently available to the management of the company about any circumstances which could forestall or impede the fulfilment of the contractual agreements. Accordingly, the company is operating on the assumption that additional capital resources will be made available to the Austrian Airlines Group upon fulfilment of the contractual agreements. ...

## CESR Enforcement Decisions

### Teach how to make IFRS judgments

- 16 Dec. 2009 – 7<sup>th</sup> extract from EECS's database of enforcement decisions
  - » <http://www.cesr-eu.org/popup2.php?id=6341>
- 26 Aug. 2009 - 6<sup>th</sup> extract from EECS's database of enforcement decisions
  - » <http://www.cesr.eu/popup2.php?id=5936>
- 24 Mar. 2009 - 5<sup>th</sup> extract from EECS's database of enforcement decisions
  - » <http://www.cesr.eu/popup2.php?id=5647>
- 23 Dec. 2008 - 4<sup>th</sup> extract from EECS's database of enforcement decisions
  - » <http://www.cesr.eu/popup2.php?id=5439>
- 19 May. 2008 - 3<sup>rd</sup> extract from EECS's database of enforcement decisions
  - » <http://www.cesr-eu.org/popup2.php?id=5053>
- 17 Dec. 2007- 2<sup>nd</sup> extract from EECS's database of enforcement decisions
  - » [http://www.cesr-eu.org/data/document/07\\_630.pdf](http://www.cesr-eu.org/data/document/07_630.pdf)
- 16 Apr. 2007 - Extract from EECS's database of enforcement decisions

[http://www.cmvm.pt/NR/rdonlyres/542657CE-77E4-47A2-BF28-2A18F392C8C7/7866/07\\_120.pdf](http://www.cmvm.pt/NR/rdonlyres/542657CE-77E4-47A2-BF28-2A18F392C8C7/7866/07_120.pdf)

ALSO AT

[http://www.cysec.gov.cy/publiccompanies\\_newsletters\\_3\\_en.aspx](http://www.cysec.gov.cy/publiccompanies_newsletters_3_en.aspx)

## Business Combinations

- **Concept**

Statement of financial position should reflect entity's assets and liabilities, i.e., economic resources controlled by the entity and claims to those resources

**Principle**

Acquirer is entity that obtains control of acquiree

**Rule**

Assess control based on **indicators**

**Judgment**

**Does acquirer control acquiree?**

## CESR Database assessing 'control'

- Decision ref.EECS/1209-15: Identification of the acquirer in a business combination
- Decision ref.EECS/1209-16: Identifying the acquirer in a business combination
- Decision ref.EECS/0209-04 Control
- Decision ref.EECS/0209-05: Business Combinations, reverse acquisitions

## Example: Classification judgments Debt equity classification CESR Database

- Decision ref.EECS/1208-08: Classification of financial instruments
- Description of the issuer's accounting treatment
  - Issuer is a finance conglomerate that, as a bond issuer, prepared its first IFRS financial statements for the year ended 31 December 2007. The issuer has an operating subsidiary B which has a series of A-shares which have voting rights. The issuer owns 70% of A-shares and the rest are held by external shareholders. Under a shareholders' agreement, entity **B is obliged to pay an annual dividend of 5%. The dividend payment is cumulative even if entity B does not have sufficient distributable funds at the time the payment is due.** In the issuer's consolidated opening IFRS balance sheet as of 1 January 2006, and in the interim financial statement for 2007, the A-shares of entity B were **classified as equity instruments**. As the issuer consolidates entity B in its financial statements as a subsidiary and the 30% of A-shares owned by external parties were reported as a minority interest.
- Enforcer found that the classification of the A-shares as equity instruments in the issuer's consolidated opening IFRS balance sheet and interim financial statement of 2007 did **not comply with IAS 32**.

## Teach how to make IFRS judgments

- Most requirements in IFRSs require judgment to apply
  - => Students need to learn to make judgments
- Students need to **understand IFRSs**, not simply memorize their requirements, to understand the intent of the principle
- **Basis for Conclusions can be instructive**
  - **Explains IASB's reasoning for selecting principles and rules**
  - **Describes rejected alternatives and explains why they were rejected**
  - CESR agrees!

## Segment reporting judgment CESR Database

- Decision ref.EECS/1209-07: Segmental reporting
- Description of accounting treatment
  - Issuer, whose shares are listed and traded on an unregulated market, early applied IFRS 8 'Operating Segments' in its December 2007 financial statements as part of its transition to IFRS. **The accounts did not disclose certain information required by IFRS 8, on the grounds of commercial sensitivity.** The omitted information included the segmental analysis of revenues from external customers; the operating segments responsible for revenue from major customers, and the measure of profit or loss reported to the chief operating decision maker.

## Auditor's & CESR's position

- Auditors' opinion **qualified** on basis of disagreement in relation to non-compliance with IFRS 8

## Enforcement decision

- Enforcer found that accounts did not comply in all respects with requirements of IFRS 8.

## Rationale for enforcement decision

- When challenged, issuer argued making **specific disclosures required by IFRS 8 might affect its competitive position**. Enforcer noted IFRS 8 does not provide a 'competitive harm' exemption. ... **Basis for Conclusions** explains IASB concluded such an exemption would be inappropriate because it would provide a means for broad non-compliance
- Remember eIFRS!
  - Free versions of IFRS do not include basis for conclusions & dissenting opinions

## Judgment and principles based standards

- A shift to less rules-based principles will increase the need for judgment: “A principle-based standard relies on judgments. Disclosure of the choices made and the rationale for these choices would be essential. If in doubt about how to deal with a particular issue, preparers and auditors should relate back to the core principles. The basis for conclusions (the rationale underlying a particular standard and published with it) should also include, in particular, the question of whether there is only a single view to tackle the economics of the situation. Often there are competing views—is one regarded as more relevant? If so, the reasons for choosing that particular view should be explained in the basis for conclusions and the reasons for rejecting the others clearly outlined.”\*

\*Sir David Tweedie, Speech before the Subcommittee on Securities, Insurance and Investment of the United States Senate, Washington, D.C., October 24, 2007, p. 10.

## Key issues for auditing IFRS judgments

Examples from practicing auditors

- Fair value measurements and accounting estimates, particularly the reasonableness of the methods and assumptions used, including those used by specialist\*
- Adequacy of disclosures\*
- Consideration of a company's ability to continue as a **going concern, particularly in the current environment**
- Revenues, particularly multiple element revenue arrangements\*
- Definition of a component when auditing in accordance with ISA 600

## Key issues for auditing IFRS judgments

Examples from practicing auditors

- Definition of Cash Generating Unit. Some industries appear completely ‘disparate’ in terms of the level at which impairment will be measured.
  - Lease classification - although this will go away based on the direction of the IASB discussion paper.
  - Debt versus equity classification of some preference shares\*
  - Concept of control\*
  - Share-based payments and discretion clauses\*
- \*See CESR enforcement database

## IFRS for SMEs

- Free training material
  - <http://www.iasb.org/IFRS+for+SMEs/Training+material.htm>
- Each module includes:
- Introduction — overview of module, including:
  - Learning objectives — description of capabilities & competences that learner should attain by successfully completing module.
  - IFRS for SMEs & material that accompanies, but does not form part of, IFRS.
  - Overview of requirements of the section ie brief technical summary.
- Requirements — full text of the section of the IFRS for SMEs with added notes & worked examples. Notes & examples designed to clarify & illustrate requirements.
- **Significant estimates & other judgments — discussion of significant estimates & other judgments in accounting for transactions & events in accordance with that section of IFRS for SMEs**
- Comparison with full IFRSs — summary of main differences between this section of IFRS for SMEs & corresponding full IFRS.
- **Test your knowledge — collection of multiple-choice questions (with answers) designed to test learner’s knowledge of requirements of this section of IFRS for SMEs .**
- **Apply your knowledge — collection of case studies (with solutions) designed to develop learner’s ability to account for transactions & events in accordance with this section of IFRS for SMEs.**

## MC questions

- Inventories must be measured at:
  - (a) cost
  - (b) the lower of cost and estimated selling price less costs to complete and sell
  - (c) the lower of cost and fair value less costs to complete and sell
- On 25 March 20X4 the entity discovered that, as a result of a computational error, depreciation expense for the year ended 31 December 20X3 is overstated by CU29,000. The entity's 31 December 20X3 financial statements were authorized for issue on 1 April 20X4. The entity must:
  - (a) correct its 31 December 20X3 financial statements before issuing them.
  - (b) reduce depreciation for the year ended 31 December 20X4 by CU29,000 (ie prospective allocation—a change in accounting estimate).
  - (c) restate (correct) the depreciation expense reported for the year ended 31 December 20X3 in the comparative figures of its 20X4 financial statements (ie retrospective restatement of a prior period error).

## Illustrative 'examples' biological assets

- Biological assets are living animals & plants capable of biological transformation or harvest into either agricultural produce that is accounted for as inventory or other biological assets. Determining whether an asset is a biological asset or inventory sometimes depends on the purpose for which the asset is held.

## Illustrative ‘examples’ biological assets

- A vintner processes grapes harvested from its vineyards into wine in a 3-year maturation cycle. Each year entity sells approximately 20% of the grapes harvested to local retailers in the table grape market. Vintner grows only one variety of grapes.
- Vines are biological assets. Up to point of harvest the vintner’s grapes are not inventory—they are part of the biological assets (vines).
- Irrespective of intended use (ie wine or table grape), at point of harvest the grapes are inventory. On initial recognition as inventory (ie at point of harvest) grapes are recorded at fair value less estimated costs to sell. In this case, cost could be determined with reference to the table grape market in which the entity participates.

## Illustrative examples adjusting events

- An entity gives warranties at time of sale to purchasers of products. On 31 December 20X5 an entity assessed its warranty obligation to be CU100,000.
- Immediately before 31 December 20X5 financial statements were authorized for issue, entity discovered a latent defect in 1 of its lines of products (ie a defect not discoverable by reasonable or customary inspection). As a result of discovery, entity reassessed estimate of its warranty obligation at 31 December 20X5 at CU150,000.
- The event—discovery of latent defect—is an adjusting event after end of reporting period. The condition—latent defect—existed in products sold before 31 December 20X5.

## Illustrative examples adjusting events

- Facts same as previous example. However, latent defect discovered 31 March 20X6, after 31 December 20X5 statements authorized for issue.
- In April 20X6 entity paid CU150,000 to transfer obligation to an independent third party.
- Latent defect not an event after end of the reporting period because it was discovered after 20X5 financial statements authorized for issue. CU100,000 obligation for warranty provision was measured and reported in good faith in entity's 31 December 20X5 annual financial statements. Additional CU50,000 not provided for at 31 December 20X5 is a change in accounting estimate and recognized as an expense in determining P&L for 3-month period ended 31 March 20X6. Thus, it will be included in P&L in 20X6 financial statements.



**Joint IAAER-IFRS Foundation**

**IFRS Teaching  
Special Interest Session**

4 November 2010 – Singapore, Singapore

**Roundtable Q&A**

**Panellists:**

**Mary Barth**

*Professor of Accounting,  
Stanford University and  
Academic Advisor to the IASB*

**Holger Erchinger**

*Partner,  
KPMG LLP*

**Katherine Schipper**

*Professor of Accounting,  
Duke University and  
former Member,  
FASB*

**Donna Street**

*Professor of Accounting,  
University of Dayton and  
President,  
IAAER*

**Michael Wells**

*Director  
IFRS Education Initiative, IFRS Foundation*

