



Committee: IAASB Consultative Advisory Group

Meeting Location: New York

Meeting Date: April 2-3, 2007

Financial Reporting Frameworks Described by Reference to International Financial Reporting Standards (IFRSs)

Background

1. The CAG will recall that this matter was discussed in the closed session of the September 11-12, 2006 meeting. This section provides a reminder of the background.
2. A number of jurisdictions are adopting IFRSs. In some cases, the jurisdictions may adopt less than the complete set of current IFRSs. This may be because of the time it takes a jurisdiction to introduce new standards locally, such that the issue is merely one of timing. It may be because a jurisdiction regards a certain IFRSs as unsuitable for the jurisdiction. Or it may be because a regulator wishes to impose its own rules in respect of certain aspects of financial reporting. In each case, national standard setters, legislators or regulators may mandate how the financial reporting framework is to be described in financial statements or the auditor's report, or both.
3. Descriptions of financial reporting frameworks that are required in certain jurisdictions include "IFRSs as adopted for use in [country X]" and "IFRSs as modified by banking regulators for the use of banks in [country X]." Such descriptions are required in the general purpose financial statements of the relevant entities.
4. A financial reporting framework which is described in terms such as those set out above is not IFRSs; the user may not know what the differences between the framework and IFRSs are, or where to find them. The user, however, is entitled to expect that there is close relationship between the framework used and IFRSs.
5. In the case of some financial reporting frameworks, the differences between adopted or modified IFRSs and the complete set of current IFRSs may be of no significance to some or many entities, such that the effect of using the framework is in fact identical to IFRSs in the vast majority of cases.
6. In the case of other financial reporting frameworks, however, an apparently insignificant difference between adopted or modified IFRSs and the complete set of current IFRSs may have a significant effect on the reported financial position or performance of some or many entities. As a result of such effects, there is the possibility that a user may be misled if he or she were to think that the financial statements comply, or comply in all but immaterial respects, with IFRSs. Accordingly, preparers and auditors should be concerned to avoid such a possibility.

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7. The IAASB discussed this matter in the executive session of the September 2006 and February 2007 IAASB meetings.
8. In September 2006, some IAASB members stressed the importance of involving regulators, such as IOSCO and the Basel Committee on Banking Supervision, as well as other bodies, such as the Financial Stability Forum and the World Bank, in resolving this matter.
9. Other IAASB members were of the view that amendments to the IFRSs and ISAs to address this matter could serve to expedite the involvement of regulators and other organizations in this matter. It could also lead to more countries adopting the complete set of current IFRSs without modification. Furthermore, disclosures in the financial statements of differences between the applicable financial reporting framework (referred to as “IFRSs as adopted in [country X],” for example) and the complete set of current IFRSs would provide users of those financial statements with helpful information.
10. The proposal below, which may be refined before being presented to the IAASB in July, incorporates the IAASB’s comments on the proposal that was presented at the February 2007 meeting but has not otherwise been discussed or agreed by IAASB.

International Accounting Standards Board (IASB)

11. The Trustees of the IASC Foundation and the IASB have discussed this matter in various meetings and with regulators, the firms, and users groups.
12. The IASB agreed in December 2006 to propose to insert in IAS 1, “Presentation of Financial Statements” disclosure requirements for entities that refer to IFRSs in describing the basis on which their financial statements are prepared but are not able to make an explicit and unreserved statement of compliance with IFRSs. Such an entity would be required to make disclosures about how its financial statements would have been different if prepared in full compliance with IFRSs. (The proposed amendments to IAS 1 and a Basis for Conclusions are included in the Appendix.)
13. The IASB’s proposal will form part of its annual improvements process. The Exposure Draft will be published on October 1, 2007 with a 90-day comment period. It is expected that the amendments to the Standards will be published on April 1, 2008 and, allowing the minimum 9-month period for translation and endorsement mechanisms, take effect January 1, 2009.

Regulators

14. Messrs. Kellas and Sylph discussed the matter with representatives from IOSCO and the Basel Committee on Banking Supervision.
15. Various IOSCO representatives took differing views and indicated a desire to consider the matter further and, in particular, to consider the proposals of the IASB and IAASB.

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16. The Basel Committee indicated that it would be helpful to obtain concrete examples, as specific cases may be easier to handle through dialogue. It also suggested that the matter be discussed with the European Commission, the International Monetary Fund, the Monitoring Group and the World Bank. It encouraged the IASB and IAASB to develop clear proposals. The matter has not been separately discussed with the European Commission and the World Bank, other than through the IAASB Consultative Advisory Group. The matter was raised at a meeting of the Monitoring Group in February 2007.
17. Based on the comment of the Basel Committee, Mr. Kellas wrote to members of the Transnational Auditors Committee (TAC), asking for more specific information about the circumstances under which modified IFRSs is arising. Only a few responses were received, together with a summary outlining different situations encountered.

Proposal

18. ***It is assumed for purposes of this proposal that the applicable financial reporting framework is acceptable.*** There may be cases where a framework (or its description) is not acceptable, such as where so much of IFRSs is excluded as to make any reference to IFRSs wholly and irredeemably misleading, or where the gaps are filled by unacceptable requirements. These questions need to be considered by individual auditors in the light of the specific circumstances, including the views of the local professional bodies.
19. ***It is assumed for purposes of this proposal that the description of the financial reporting framework by reference to IFRSs is mandated by law or regulation.*** The most obvious solution is to avoid references to IFRSs, and replace them with references such as the following: “the financial reporting framework applicable in [country X],” or “accounting principles applicable to banks in [country X].” The notes to the financial statements would include an appropriate description of the accounting policies. However, there will be cases where such a solution is not possible because the description of the framework is mandated by law or regulation. In such cases the concern is to ensure that the references are not misleading.
20. Because of the potential for misleading users, and based on the IASB’s proposal, it is proposed that the IAASB amend ISA 700, “The Independent Auditor’s Report on General Purpose Financial Statements”¹ to provide for the following:
 - (a) The auditor’s report should describe the applicable financial reporting framework by reference to IFRSs (i.e., using the wording that management is required to use).
 - (b) The auditor should consider whether the auditor’s report should include an Emphasis of Matter paragraph that draws attention to the relevant note in the financial statements (see proposed amendment to IAS 1 in the Appendix). Factors that may affect the auditor’s consideration include the possible materiality of the differences, which of course is likely to be unknown. A failure on the part of management to include the

¹ Amended as a result of ISA 800 (Revised), close off document approved October 2006.

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necessary disclosures, or to do so adequately, would be grounds for qualification of the opinion.

21. Approval of the exposure draft of proposed ISA 700 (Redrafted) is planned for July 2007.

Action Requested

22. Representatives are asked to discuss the proposal. In particular:
- (a) Do you foresee any particular difficulties in your jurisdictions, if affected by this proposal?
 - (b) Is the approach of permitting reference to amended IFRS only where such a reference is *required* by law or regulation appropriate? In some jurisdiction, such references may be used as a matter of custom or practice, or preference on the part of the regulator – this latter position may be the case, for example, in the EU.
 - (c) Is the suggestion of qualification sustainable?

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Appendix – Proposed Amendments to IAS 1

(Available from the website of the International Accounting Standards Board at <http://www.iasb.org/NR/rdonlyres/AB986651-373A-4249-847D-96C2C255FD06/0/IASB2006OmnibusEDsectionIAS1ReportingcompliancewithIFRSs.pdf>)

Introduction and

Invitation to Comment

In this Exposure Draft the International Accounting Standards Board proposes to insert in IAS 1 *Presentation of Financial Statements* disclosure requirements for entities that refer to International Financial Reporting Standards (IFRSs) in describing the basis on which their financial statements are prepared but are not able to make an explicit and unreserved statement of compliance with IFRSs. Such an entity would be required to make disclosures about how its financial statements would have been different if prepared in full compliance with IFRSs.

The Board invites comments on the proposed amendments to IAS 1. It would particularly welcome answers to the question set out below. Comments are most helpful if they indicate the specific paragraph, contain a clear rationale and, when applicable, provide a suggestion for alternative wording.

The Board is not requesting comments on matters in IAS 1 not addressed in the Exposure Draft.

Question

Do you agree with the proposal for new disclosure requirements? If not, why?

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Proposed amendments to IAS 1 *Presentation of Financial Statements*

In the Standard, paragraph 14A is added. Paragraph 105 is amended (new text is underlined). For ease of reference, paragraph 14 is included although no changes are proposed to it.

Overall considerations

Fair presentation and compliance with IFRSs

- 14 An entity whose financial statements comply with IFRSs shall make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with IFRSs unless they comply with all the requirements of IFRSs.**
- 14A When an entity refers to IFRSs in describing the basis on which its financial statements are prepared but is not able to make an explicit and unreserved statement of compliance with IFRSs, the entity shall:**
- (a) describe each difference between the basis on which its financial statements are prepared and IFRSs that are applicable to its financial statements; and**
 - (b) describe how its reported financial position and performance of the entity would have differed if it had complied with IFRSs.**
- 105 Notes are normally presented in the following order, which assists users in understanding the financial statements and comparing them with financial statements of other entities:**
- (a) a statement of compliance with IFRSs (see paragraph 14) or description of differences from IFRSs (see paragraph 14A);**
 - (b) a summary of significant accounting policies applied (see paragraph 108);**
 - (c) supporting information for items presented on the face of the balance sheet, income statement, statement of changes in equity and cash flow statement, in the order in which each statement and each line item is presented; and**
 - (d) other disclosures, including:**
 - (i) contingent liabilities (see IAS 37) and unrecognised contractual commitments; and**
 - (ii) non-financial disclosures, eg the entity's financial risk management objectives and policies (see IFRS 7).**

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Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the draft amendments.

- BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in proposing amendments to IAS 1 *Presentation of Financial Statements*.
- BC2 An entity might refer to IFRSs in describing the basis on which its financial statements are prepared without describing those statements as complying with IFRSs. For example, the accounting policies may be described as being 'in accordance with IFRSs as adopted/modified for use in [country X]'. In some situations, a financial reporting framework based on IFRSs and the complete set of current IFRSs may not be significantly different. In other cases, however, the differences may significantly affect the reported financial position or performance of an entity. Consequently, references to IFRSs in describing the basis on which the financial statements are prepared may mislead users. Some users might expect there to be a close relationship between financial statements based on IFRSs and those in compliance with IFRSs. Furthermore, users may be unable to identify the differences between a financial reporting framework based on IFRSs and the complete set of current IFRSs.
- BC3 The Board proposes that, when an entity refers to IFRSs as the basis of its financial reporting framework but does not make an unreserved statement of compliance with IFRSs, it should disclose each instance when IFRSs are not complied with, that is applicable to its financial statements. It should also describe (but need not quantify) the effect, on the statement of financial performance and statement of financial position, of the difference between complying with the accounting required by IFRSs and the accounting treatments applied by the entity. Such disclosures would enable users to judge the usefulness of the information presented and the significance of those differences for the financial statements. It would also help users to interpret those statements and assess their comparability with those of other entities.