



International Federation of Accountants

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Agenda Item

B.4

Committee: IAASB Consultative Advisory Group

Meeting Location: London

Meeting Date: September 20-21, 2007

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

Financial Reporting Standards Described by Reference to IFRSs

BACKGROUND

1. The Representatives will recall that this matter was discussed in the closed session of the September 11-12, 2006 meeting and in the public session of the April 2-3, 2007 meeting (see Appendix 1 to this paper, which shows Representatives' comments and related actions). 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 a 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

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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.

IASB PROPOSAL

7. This matter has been of concern to the International Accounting Standards Board (IASB), for the reasons set out above. In December 2006, the IASB agreed to issue an Exposure Draft of a proposed amendment to International Accounting Standard (IAS) 1, “Presentation of Financial Statements” adding disclosure requirements for entities that refer to IFRSs in describing the basis on which their financial statements are prepared, but that 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. If, following consideration of comments received on the Exposure Draft, the IASB agrees to proceed with the proposed amendment to IAS 1, it would form part of the annual improvements process of the IASB. The Exposure Draft of the IASB’s annual improvements will be published in October 2007. (The proposed amendment to IAS 1 is already posted on the IASB website as an Invitation to Comment. **See Appendix 2 to this paper.**)

IAASB PROPOSAL

8. The IAASB is of the view that, where it is an option, a preferred solution is to avoid references to IFRSs in circumstances when a financial reporting framework is such that compliance with it will not result in an explicit and unreserved statement of compliance with IFRSs, and instead refer to or describe such framework 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.
9. 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 auditor’s concern is to ensure that the references are not misleading.
10. The IAASB agreed that proposed ISA 700 (Redrafted), “The Independent Auditor’s Report on General Purpose Financial Statements” is the place to address this matter as it requires the auditor to evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.
11. An Exposure Draft of proposed ISA 700 (Redrafted) was approved at the July 2007 IAASB meeting. To enable respondents to consider how the issue of financial reporting frameworks described by reference to IFRSs might be addressed in ISA 700 (Redrafted), proposed guidance has been incorporated in paragraphs A9-A11 (addressing the auditor’s evaluation of the description of the financial reporting framework in the financial statements) and paragraphs A33-A34 (addressing the effect that such description may have

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on the auditor's opinion). These paragraphs are shaded in the Exposure Draft (**see Agenda Item B.4.1**).

12. The IAASB recognizes that the proposed guidance is based on the IASB's proposed amendment to IAS 1, which has not yet been finally approved by the IASB for inclusion in the annual improvements Exposure Draft and which is dependent on the IASB's due process. However, should the IASB proceed with its amendment, the IAASB would propose to incorporate the highlighted guidance in ISA 700 (Redrafted), and, therefore, considered it appropriate to use the opportunity to obtain respondents' comment on the proposed guidance. In the event that the IASB does not proceed with its current proposal, or amends the proposal in a material respect, the IAASB would have to decide how, if at all, to deal with the matter in those changed circumstances.
13. Respondents' comments to the Exposure Draft of proposed ISA 700 (Redrafted), and any changes that the IASB may agree based on comments received on its Invitation to Comment and annual improvements Exposure Draft, will be taken into account in finalizing ISA 700 (Redrafted). At that time, the IAASB will evaluate whether it is necessary to re-expose the proposed guidance.

International Auditing Practice Statement (IAPS) 1014

14. In considering the proposal regarding financial reporting frameworks described by reference to IFRSs, and in response to questions that have arisen about whether the auditor may express more than one opinion when financial statements represent that they comply with the applicable financial reporting framework and IFRSs, the IAASB was of the view that it may be helpful to incorporate the guidance in IAPS 1014, "Reporting by Auditors on Compliance with International Financial Reporting Standards" in proposed ISA 700 (Redrafted).
15. To enable respondents to the Exposure Draft of proposed ISA 700 (Redrafted) to consider this proposal, the guidance in IAPS 1014, appropriately amended, has been incorporated in proposed ISA 700 (Redrafted). See paragraphs A4-A8, which deals with the auditor's evaluation of the description of the financial reporting framework in the financial statements, and paragraphs A31-A32, which deals with the effect that such description may have on the auditor's opinion.
16. Should respondents to the Exposure Draft of proposed ISA 700 (Redrafted) agree with the proposal to incorporate the guidance in IAPS 1014 in proposed ISA 700 (Redrafted), the IAASB proposes that IAPS 1014 be withdrawn.

Exposure Draft of Proposed ISA 700 (Redrafted)

17. **IAASB CAG Member Organizations are encouraged to submit a comment letter on the Exposure Draft. The comment date is November 30, 2007.**

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Material Presented – FOR IAASB CAG REFERENCE PURPOSES ONLY

Agenda Item B.4.1 Exposure Draft of Proposed ISA 700 (Redrafted), “The Independent Auditor’s Report on General Purpose Financial Statements”

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Appendix 1

April 2-3, 2007 CAG Proposals

Below is an extract from the minutes of the April 2-3, 2007 meeting minutes and an indication of how the IAASB / IAASB Staff has responded to the Representatives' comments.

Representatives' comments	IAASB / IAASB Staff response
<p>Mr. Upton provided an update on the IASB activities in this regard. He noted that companies that comply with the full set of current IFRSs are very upset with companies that do not because users are not able to distinguish the two cases from the notes in the financial statements. He was of the view that only a small number of listed companies in Europe are making use of the EC carve out, and that therefore most are in full compliance, although the reference to the accounting framework is to "IFRS as adopted ..."</p> <p>It would be helpful if auditors could give a second opinion that refers only to IFRS, where full compliance is achieved. As regards the IASB's proposed disclosures, affected groups do not seem comfortable with it. Part of the discomfort is because the proposal is read as requiring reconciliation between the national financial reporting framework (modified IFRSs) and the full set of current IFRSs, which is not the intention. He agreed that it is important that the IASB clarify the proposal before the exposure draft is issued.</p> <p>Mr. Kellas noted that Mr. Upton highlighted a further dimension to the issue than dealt with in the IAASB proposal. That is, the possibility of two separate audit opinions in the case where a jurisdiction has adopted modified IFRSs, but companies are able to comply with both the national financial reporting framework and the full set of current IFRSs.</p>	<p>Proposed ISA 700 (Redrafted) now includes application material that deals with financial statements that are prepared and presented in accordance with more than one financial reporting framework and the effect this has on the auditor's opinion. See paragraphs A6-A8 and A31 of ED-ISA 700 (Redrafted).</p>
<p>Ms. Todd McEnally noted her disappointment with the lack of progress in dealing with the matter. She was of the view that the global bodies do not seem anxious to deal with the matter, and that the IASB cannot do it alone. She supported the IASB proposal,</p>	<p>Noted.</p>

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Representatives' comments	IAASB / IAASB Staff response
noting that it provides a short-term solution. She supported quantitative disclosures of the differences between the national financial reporting framework (modified IFRSs) and the full set of current IFRSs. She encouraged the affected groups also to find a long-term solution.	
Ms. Singh noted that the Institute of International Finance has discussed the matter in the context of the reconciliation required by the US SEC reconciliation. She noted that the US SEC has indicated that it will not eliminate the reconciliation until there is full compliance with IFRSs. The Institute's member firms support disclosure of all material differences; however, it did not discuss whether those disclosures should be qualitative or quantitative. Ms. Singh supported quantitative disclosures.	Noted.
Ms. De Beer noted that the credibility of financial reporting is important in developing economies and many developing economies therefore have adopted the international standards. However, there are examples of fairly large developing economies where compliance with IFRSs is claimed while certain IFRSs have not been adopted. She supported the IASB proposal, but suggested that it be clarified. She was also concerned that the proposed requirement may be carved out by the national standard setter. The matter therefore also needs to be addressed from another perspective. She was of the view that the IAASB proposal will assist in this regard.	Noted. Paragraph A9 of ED-ISA 700 (Redrafted) contains the following text to address circumstances where the proposed IAS 1 requirement is carved out by a national standard setter: "If the framework is described by reference to International Financial Reporting Standards, but the framework does not require the entity to disclose the information in (a) and (b) above and the financial statements do not in fact disclose such information, the description is likely to be misleading if the effect on financial statements of the difference between the framework and International Financial Reporting Standards may be significant."
Mr. Lamoureux was of the view that a reconciliation between the national financial reporting framework (modified IFRSs) and the full set of current IFRSs should be mandatory.	Noted.
Mr. Morris was concerned that preparers should receive equal treatment. He considered that an emphasis of matter paragraph should be required	Paragraph A33(b) of ED-ISA 700 (Redrafted) is linked to the requirement in ED-ISA 706 (Revised and Redrafted), which requires the auditor to include

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<p>in all cases rather than left to the auditor's judgment. He also noted that the requirement proposed by the IASB could be carved out by the national standard setter, thereby leading to jurisdictional inconsistencies.</p>	<p>an Emphasis of Matter paragraph in the auditor's report when the auditor considers it appropriate to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to the users' understanding of the financial statements, provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements.</p> <p>Since the requirement is established in ED-ISA 706 (Revised and Redrafted) the IAASB did not consider it necessary to include a requirement in ED-ISA 700 (Redrafted).</p>
<p>Ms. Sucher noted that within IOSCO there is a range of opinions about the IASB proposal. Members expressed various concerns, which include the fact that the proposed requirement may be carved out and, more importantly, that the IASB proposal may condone an incomplete approach to IFRSs. She indicated that IOSCO is still considering the matter.</p>	<p>Noted.</p>
<p>Mr. Rabine noted that the relevant committee of the EC is considering the matter, and that it will be important to understand the exact meaning of the IASB proposal. He was not sure that it was appropriate to make the auditor alone responsible. Ms. Blomme also indicated that the proposal may create issues for auditors in Europe if there is no requirement for companies to make the relevant disclosures.</p>	<p>Noted.</p>
<p>Mr. Damant suggested that, due to the importance of the matter, it be referred to the Financial Stability Forum.</p>	<p>This comment has been drawn to the attention of the IASB for action as appropriate.</p>

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Appendix 2

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.