

CREATION OF THE IASB

The IASC faced problems of legitimacy with regard to constituent support, independence, and technical expertise. For example, some interested parties perceived the fact that IASC board members worked at international standard setting only part-time and were not necessarily selected because of their technical expertise as an indication of the lack of commitment on the part of the IASC to develop the highest quality standards possible. Responding to these concerns, the IASC appointed a Strategy Working Party in 1996, which issued a discussion document in December 1998 entitled "Shaping IASC for the Future." This document proposed a vastly different structure and process for the development of international accounting standards. The final recommendations of the IASC Strategy Working Party were approved at its Venice meeting in November 1999. These recommendations, designed to deal with the issue of legitimacy, attempted to balance calls for a structure based on geographic representativeness and those based on technical competence and independence. Accordingly, it was decided that representativeness would be provided by the geographic distribution of the trustees, who would be essential to ensuring the effectiveness and independence of the board, but that board members would be selected based on their expertise. On April 1, 2001, the newly created International Accounting Standards Board (IASB) took over from the IASC as the creator of international accounting standards, which were to be called International Financial Reporting Standards (IFRS). The process of restructuring the IASC into the IASB took over five years and is summarized. The formation of the IASB in 2001, with a change in focus from harmonization to convergence or global standard setting, marked the beginning of a new era in international financial reporting.

THE STRUCTURE OF THE IASB

The IASB is organized under an independent foundation called the IFRS Foundation. Components of the structure are as follows:

1. Monitoring Board.
2. IFRS Foundation (IFRSF).
3. International Accounting Standards Board (IASB).
4. IFRS Interpretations Committee (IFRSIC).
5. IFRS Advisory Council (IFRSAC).
6. Working Groups (expert task forces for individual agenda projects).

MONITORING BOARD

The IASC Foundation Constitution was amended in February 2009 to create a Monitoring Board of public authorities. The Monitoring Board comprises the relevant leaders of the European Commission, the Japanese Financial Services Agency, the U.S. Securities and Exchange Commission, the Emerging Markets Committee of IOSCO, and the Technical Committee of IOSCO. The chairman of the Basel Committee on Banking Supervision is a nonvoting observer. The Monitoring Board oversees the IFRS Foundation Trustees, participates in the Trustee nomination process, and approves appointments to the Trustees.

The specific functions of the Monitoring Board include the following:

- i. To enhance public accountability of the IASC Foundation.
- ii. To participate in the Trustee nomination process and approval of appointments to the Trustees.

- iii. To carry out oversight responsibilities in relation to the Trustees and their oversight of the IASB's activities, in particular the agenda-setting process and the IASB's efforts to improve the accuracy and effectiveness of financial reporting and to protect investors.

TRUSTEES OF THE IFRS FOUNDATION

The IFRS Foundation consists of 22 Trustees (the number of trustees was increased from 19 to 22 as a result of revisions to the IFRS Foundation in June 2005). These 22 Trustees represent different geographical areas (six from North America; six from Europe; six from the Asia/Oceania region; four from any area, subject to establishing overall geographical balance). With regard to the composition of the Trustees, the constitution requires an appropriate balance of professional backgrounds, including auditors, preparers, users, academics, and other officials serving the public interest. Two Trustees will normally be senior partners of prominent international accounting firms. The Trustees of the IFRS Foundation have responsibility, among other things, to:

- i. Appoint the members of the IASB and establish their contracts of service and performance criteria.
- ii. Appoint the members of the International Financial Reporting Interpretations Committee and the IFRS Advisory Council.
- iii. Review annually the strategy of the IASC Foundation and the IASB and its effectiveness, including consideration, but not determination, of the IASB's agenda.
- iv. Approve annually the budget of the IFRS Foundation and determine the basis for funding.
- v. Review broad strategic issues affecting accounting standards, promote the IASC Foundation and its work, and promote the objective of rigorous application of International Accounting Standards and International Financial Reporting Standards—provided that the Trustees shall be excluded from involvement in technical matters relating to accounting standards.
- vi. Establish and amend operating procedures, consultative arrangements, and due process for the IASB, the International Financial Reporting Interpretations Committee, and the Standards Advisory Council.
- vii. Review compliance with the operating procedures, consultative arrangements, and due process procedures.
- viii. Approve amendments to the constitution after following a due process, including consultation with the IFRS Advisory Council and publication of an Exposure Draft for public comment and subject to the voting requirements.
- ix. Exercise all powers of the IFRS Foundation, except for those expressly reserved to the IASB, the IFRS Interpretations Committee, and the IFRS Advisory Council.
- x. Foster and review the development of educational program and materials that are consistent with the IFRS Foundation's objectives.

INTERNATIONAL ACCOUNTING STANDARDS BOARD

The IASB has sole responsibility for establishing International Financial Reporting Standards (IFRS). The principal responsibilities of the IASB are to:

- i. Develop and issue International Financial Reporting Standards and Exposure Drafts.
- ii. Approve Interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC).

The Board consists of 16 members (effective February 1, 2009), of whom at least 13 serve full-time and not more than 3 part-time. The Board members are selected on the basis of professional competence and practical experience. They are expected to represent a geographical mix (effective February 2009), and to ensure a broad international diversity, by July 2012 there will normally be:

- i. Four members from the Asia/Oceania region.
- ii. Four members from Europe.
- iii. Four members from North America.
- iv. One member from Africa.
- v. One member from South America.
- vi. Two members appointed from any area, subject to maintaining overall geographical balance.

Due process procedures followed by the IASB include the following (the steps that are required by the IASC Foundation constitution are indicated by an asterisk*):

- i. Ask the staff to identify and review the issues associated with the topic and to consider the application of the Framework to the issues.
- ii. Study national accounting requirements and practice and exchange views about the issues with national standard-setters.
- iii. Consult the Standards Advisory Council about the advisability of adding the topic to the IASB's agenda. *
- iv. Form an advisory group (generally called a "working group") to advise the IASB and its staff on the project.
- v. Publish for public comment a discussion document.
- vi. Publish for public comment an exposure draft approved by vote of at least nine IASB members, including any dissenting opinions held by IASB members (in Exposure Drafts, dissenting opinions are referred to as "alternative views"). *
- vii. Publish within an Exposure Draft a basis for conclusions.
- viii. Consider all comments received within the comment period on discussion documents and exposure drafts. *
- ix. Consider the desirability of holding a public hearing and the desirability of conducting field tests and, if considered desirable, holding such hearings and conducting such tests.
- x. Approve a standard by the votes of at least nine IASB members and include in the published standard any dissenting opinions. *
- xi. Publish within a standard a basis for conclusions, explaining, among other things, the steps in the IASB's due process and how the IASB dealt with public comments on the exposure draft.

In March 2006, the Trustees of the IFRS Foundation published a new Due Process Handbook for the IASB. The Handbook describes the IASB's consultative procedures.

IFRS ADVISORY COUNCIL

The IFRS Advisory Council provides a forum for participation by organizations and individuals, with an interest in international financial reporting, having diverse geographical and functional backgrounds, with the objective of:

- i. Advising the IASB on agenda decisions and priorities in the IASB's work.
- ii. Informing the IASB of the views of the organizations and individuals on the Council on major standard-setting projects.
- iii. Giving other advice to the IASB or the Trustees.

The Advisory Council currently has about 40 members. The requirement is to have at least 30 members. Members are appointed by the Trustees for a renewable term of three years. They have diverse geographic and functional backgrounds.

IFRS INTERPRETATIONS COMMITTEE

The IFRS Interpretations Committee (initially this committee was known as the Standing Interpretations Committee, and later changed to the International Financial Reporting Interpretations Committee) has 14 members appointed by the Trustees for terms of three years (in November 2007, the membership was increased from 12 to 14). The Committee's Responsibilities include the following:

- i. To interpret the application of International Financial Reporting Standards (IFRSs) and provide timely guidance on financial reporting issues not specifically addressed in IFRSs or IASs, in the context of the IASB's framework, and undertake other tasks at the request of the Board.
 - To publish Draft Interpretations for public comment and consider comments made within a reasonable period before finalizing an Interpretation.
- ii. To report to the Board and obtain Board approval for final Interpretations.

THE IASB FRAMEWORK

The Need for a Framework

With no conceptual framework, accounting standards would be developed unsystematically. As a result, accounting standards may be inconsistent and, according to Gresham's law bad accounting practices will triumph over good practices. In this situation a principle or practice would be declared to be "right" because it was generally accepted, but it would not be generally accepted because it was "right." Further, it is unwise to develop standards unless there is agreement on the scope and objective of financial reporting, the type of entities that should produce financial reports, recognition, and measurement rules, and qualitative characteristics of financial information. Furthermore, by adding rigor and discipline, a conceptual framework enhances public confidence in financial reports, and preparers and auditors can use the conceptual framework as a point of reference to resolve an accounting issue in the absence of a standard that specifically deals with that issue. The Framework for the Preparation and Presentation of Financial Statements was first approved by the IASC board in 1989 and was reaffirmed by the newly formed IASB in 2001. The objective of the Framework is to establish the concepts underlying the preparation and presentation of IFRS-based financial statements. It deals with the following:

1. Objective of financial statements and underlying assumptions.
2. Qualitative characteristics that affect the usefulness of financial statements.
3. Definition, recognition, and measurement of the financial statements elements.
4. Concepts of capital and capital maintenance.

Among other things, the purpose of the Framework is to assist the IASB in developing future standards and revising existing standards. It also is intended to assist preparers of financial statements in applying IFRS and in dealing with topics that have not yet been addressed in IFRS. The Framework identifies

investors, creditors, employees, suppliers, customers, government agencies, and the general public as potential users of financial statements but concludes that financial statements that are designed to meet the needs of investors will also meet most of the information needs of other users. This is an important conclusion because it sets the tone for the nature of individual IFRS, that is, that their application will result in a set of financial statements that is useful for making investment decisions.

Objective of Financial Statements and Underlying Assumptions

The Framework establishes that the primary objective of IFRS-based financial statements is to provide information useful for decision making. Financial statements also show the results of management's stewardship of enterprise resources, but that is not their primary objective.

To meet the objective of decision usefulness, financial statements must be prepared on an **accrual basis**. The other underlying assumption is that the enterprise for which financial statements are being prepared is a **going concern**.

Qualitative Characteristics of Financial Statements

The four characteristics that make financial statement information useful are:

- i. understandability,
- ii. relevance,
- iii. reliability, and
- iv. comparability.

Information is relevant if it can be used to make predictions of the future or if it can be used to confirm expectations from the past. The Framework indicates that the relevance of information is affected by its nature and its materiality. An item of information is material if its misstatement or omission could influence the decision of a user of financial statements. Information is reliable when it is neutral (i.e., free of bias) and represents faithfully what it purports to.

The *Framework* specifically states that reflecting items in the financial statements based on their economic substance rather than their legal form is necessary for faithful representation. The *Framework* also states that while the exercise of prudence (conservatism) in measuring accounting elements is necessary, it does not allow the creation of hidden reserves or excessive provisions to deliberately understate income, as this would be biased and therefore would not have the quality of reliability.

Elements of Financial Statements: Definition, Recognition, and Measurement

1. **Assets** are defined as resources controlled by the enterprise from which future economic benefits are expected to flow to the enterprise. Note that a resource need not be owned to be an asset of an enterprise. This allows, for example, for leased resources to be treated as assets. An asset should be recognized only when it is probable that future economic benefits will flow to the enterprise and the asset has a cost or value that can be measured reliably. The *Framework* acknowledges that several different measurement bases may be used to measure assets including historical cost, current cost, realizable value, and present value.
2. **Liabilities** are present obligations arising from past events that are expected to be settled through an outflow of resources. Obligations need not be contractual to be treated as a liability. Similar to assets, liabilities should be recognized when it is probable that an outflow of resources will be required to settle them and the amount can be measured reliably. Also as with assets, several

different bases exist for measuring liabilities including the amount of proceeds received in exchange for the obligation, the amount that would be required to settle the obligation currently, undiscounted settlement value in the normal course of business, and the present value of future cash outflows expected to settle the liabilities.

3. **Income:** encompasses both revenues and gains, it is defined as increases in equity, other than from transactions with owners.
4. **Expenses:** including losses, are decreases in equity, other than through distributions to owners. The *Framework* identifies **income and expenses** as the two elements that constitute profit.
5. **Equity** is defined as assets minus liabilities.

Income should be recognized when the increase in an asset or decrease in a liability can be measured reliably. The *Framework* does not provide more specific guidance with respect to income recognition. (This topic is covered in IAS 18, Revenue.) Expenses are recognized when the related decrease in assets or increase in liabilities can be measured reliably. The *Framework* acknowledges the use of the matching principle in recognizing liabilities, but specifically precludes use of the matching principle to recognize expenses and a related liability when it does not meet the definition of a liability. For example, it is inappropriate to recognize an expense if a present obligation arising from a past event does not exist.

Concepts of Capital Maintenance

The *Framework* describes different concepts of capital maintenance (financial capital maintenance versus physical capital maintenance) and acknowledges that each leads to a different basis for measuring assets (historical cost versus current cost). The *Framework* does not prescribe one measurement basis (and related model of accounting) over another, but indicates that it (the Framework) is applicable to a range of accounting models.