Tutorial 01: Worldwide accounting diversity and convergence
1. INTRODUCTION TO INTERNATIONAL ACCOUNTING

What is International Accounting?

Accounting
The word *accounting* in International accounting encompasses:
- Functional areas of financial accounting, management accounting, auditing, taxation and accounting information systems

International
The word *international* in International accounting can be defined at three levels:

1. **Supranational accounting** – standards, guidelines and rules of accounting, auditing and taxation issued by supranational organisations [e.g. United Nations, Organisation for Economic Corporation and Development (OECD)].
2. **Company level** – standards, guidelines and practices that a company follows related to its international business and foreign investments (e.g. conversion of the results of foreign operations denominated in foreign currency).
3. **Country level and cross-country level** – study of standards, guidelines and rules of accounting, auditing and taxation that exist within each country and as well as comparison of those items across countries.

2. WORLDWIDE ACCOUNTING DIVERSITY

- Considerable differences exist across countries in the accounting treatment of many items.
- The lesser important differences relate to presentation of financial statements or terminology, whereas there are also more important difference that relate to recognition and measurement of assets / liabilities, income/expenses.

Examples:

1. In Maldives the Banks are required to account for its loan loss provision at the higher of; a time based (days in arrears of loans) provision calculated according to the rules laid down by the central bank, and the provision calculated purely based on IFRS principals.

   Therefore, the above provision could be different the provision a Bank in Sri Lanka may record in its financial statements calculated purely based on IFRS principals.

2. Its common for US companies to only include consolidated financial statements in its annual report, whereas companies in Europe commonly include the separate financial statements of the parent company along with the consolidated financial statements in its annual reports.

3. IAS 41 (para. 34) requires that an unconditional government grant related to a biological asset be recognised as income when the grant becomes ‘receivable’. The Norwegian version translates this as *mottas*, which means ‘received’. A grant could be receivable many years before it is received.

4. Investment properties are required to be measured at fair value in certain countries (e.g. UK, Sri Lanka), whereas certain other countries require investment property to be measured at cost (e.g. Germany, France)
2.1 Reasons for accounting diversity

2.1.1 Legal system

There are two major types of legal systems in the world: Common law and codified Roman law. To a certain extent the accounting practices of a country could be seen as being affected by the legal system it adopts.

**Common law:** [adopted mostly by English speaking countries; rely on a limited number of statutes, which is then interpreted by courts]

- A Corporate law that lays out the basic framework for Accounting exist.
- Specific accounting rules are determined by the profession (e.g. a professional accounting body such as CA-Sri Lanka), or a non-government body comprising various constituencies.
- Generally more detailed rules are developed [e.g. Financial Accounting Standard Board (FASB) in the US publishes a substantial amount of implementation guidance in its accounting standards.]

**Code law/Roman law:** [adopted mostly by non-English speaking countries; have relatively more statutes governing a wide range of activity]

- Corporate law establishes basic legal parameters governing business enterprises.
- Corporate law often stipulates which financial statements must be published in accordance with a prescribed format. Additional accounting measurement and disclosure rules are included in accounting law.
- Accounting law debated and passed by the national legislature.
- Accounting profession has less influence over the development of accounting standards.
- Accounting law tends to be more general and with less detail [e.g. German accounting law is silent about leases, the only related guidance is found in para 285, which simply states all liabilities must be recorded]

2.1.2 Taxation

a. In some countries published financial statements form the basis for taxation (e.g. Germany), where as in other countries financial statements presented to shareholders are adjusted based on tax laws/principals for tax calculation purposes.

b. The differences in treating income and expenses for accounting and tax purposes give rise the ‘Deferred taxes’.

2.1.3 Providers of financing

- Countries where financing dominated by families, Banks or the State – Less pressure for public accountability and information disclosure.

- Countries where funding is dominated by general public – public accountability, more disclosures are required (e.g. public listed entities)

- When funding is dominated by owners /shareholders – focus of the financial statements is more on profitability (income statement)

- When funding is dominated by Banks – the focus is more on solvency (balance sheet)
2.1.4 Inflation

a. Countries experiencing hyperinflation have found it necessary to adopt accounting rules that require inflation adjustment of historical costs.
b. Such chronic high rates of inflation were seen in some Latin American countries during 1980/90, and more recently in Zimbabwe.
c. Writing up fixed asset costs to reflect current prices, adjusting purchase cost by inflation in determining disposal gains are examples for inflation adjustments.

2.1.5 Political and economic ties

Through political and economic ties accounting rules have been conveyed from one country to another.

For example, countries colonies by British tend to follow British style of accounting while countries colonized by French tend to follow French type of accounting systems.

2.2 Problems caused by accounting diversity

I. Preparation of consolidated financial statements

Inconsistent accounting practices adopted by countries create difficulties to multinationals in preparing consolidated financial statements.

Such entities will have to either make significant adjustments / reconciliations between local GAAPs of the foreign subsidiaries and the parent entities accounting framework (e.g. IFRS or US GAAP); or require the foreign subsidiaries to maintain a separate set of financial statements following the accounting framework of the parent entity for group reporting / consolidation purposes.

II. Access to foreign capital markets

To gain access to a foreign capital market a company may have to present its financial in accordance with the accounting standards of the country in which the capital market is located.

For example, a European corporate that produces financial statements under IFRS, will have to re-produce its financial statements under US GAAP, if it wishes to list itself in the New York stock exchange.

III. Comparability of financial statements

Diversity in accounting will make financial statements less comparable across counties. It will also significantly affect the analysis of foreign financial statements for making investment and lending decisions.

IV. Lack of high-quality accounting information

Another problem associated with accounting diversity is the lack of high quality accounting standards in some parts of the world.
Harmonization and convergence

Because of the problems caused by worldwide accounting diversity, attempts to reduce such differences have been ongoing for decades. This process in known as harmonization.

Initial efforts focused on harmonization—reducing differences among the accounting principles used in major capital markets around the world. By the 1990s, the notion of harmonization was replaced by the concept of convergence—the development of a unified set of high-quality, international accounting standards that would be used in at least all major capital markets.

2.3 Accounting clusters

Along with the world wide accounting diversity, there are clusters of countries that share common accounting orientation and practices.

Example:

The Anglo-Saxon / Anglo-American model: the approach taken in the UK and US, where accounting is oriented towards the decision needs of a large number of investors and creditor. Most of these countries follow a common law legal system.

Continental European model: this is used by most of Europe, Japan and other code law /Roman law countries. Companies in this group are closely tied to banks as the primary source of financing.

Inflation adjusted model: This model was found primarily in South America. It resembles the Continental European model but extensively use adjustments for inflation.
Nobes’s Judgmental classification of financial reporting systems.

The importance of this hierarchical model is that it should comparability of financial statements across countries.

For example, financial statements of New Zealand are highly comparable to UK, while financial statements of US are less comparable to UK (compared to NZ). However, US financial statements are more comparable to UK, compared to Japan.
2.4 The influence of culture on financial reporting

2.4.1 Hofstede’s Cultural dimensions

Hofstede identified four cultural dimensions that can be used to describe general similarities and differences in cultures around the world.

1. **Individualism** – preference for a loosely knit society, compared to a closely knit society (collectivism).

2. **Power distance** – extent to which hierarchy an unequal power distribution in institutions are accepted.

3. **Uncertainty avoidance** – degree to which individuals feel uncomfortable with uncertainty and ambiguity.

4. **Masculinity** – emphasis on masculine values of performance and achievement, rather than feminine values of relationships, caring and nurturing.

5. **Long-term orientation** – fostering virtues oriented towards future rewards, in particular perseverance and thrift.

2.4.2 Gary’s accounting values

Gary identified four widely recognized accounting values.

1. **Professionalism Vs Statutory control** – preference for exercise of individual professional judgement and maintenance of professional self-regulation as oppose to compliance with prescriptive legal requirements and statutory control.

2. **Uniformity versus flexibility** – preference for enforcement of uniform accounting practices between companies and for the consistent use of such practices over time as opposed to flexibility in accordance with the perceived circumstances of individual companies.

3. **Conservatism versus Optimism** – preference for cautious approach to measurement so as to cope with the uncertainty of future events as opposed to more optimistic, risk taking approach.

4. **Secrecy versus transparency** – preference for confidentiality, and restriction of information disclosure to those who are closely involved with management / financing, as oppose to more transparent, open and publicly accountable approach.

2.4.3 Relationship between accounting values and cultural dimensions

Gary argues that national cultural values affect the accounting values, as shown in the below table.

<table>
<thead>
<tr>
<th>Cultural dimensions</th>
<th>Accounting values</th>
</tr>
</thead>
<tbody>
<tr>
<td>Professionalism</td>
<td>Neg</td>
</tr>
<tr>
<td>Uniformity</td>
<td>Pos</td>
</tr>
<tr>
<td>Conservation</td>
<td>n/a</td>
</tr>
<tr>
<td>Secrecy</td>
<td>Pos</td>
</tr>
<tr>
<td>Power distance</td>
<td>Neg</td>
</tr>
<tr>
<td>Uncertainty avoidance</td>
<td>Neg</td>
</tr>
<tr>
<td>Individualism</td>
<td>Pos</td>
</tr>
<tr>
<td>Masculinity</td>
<td>Pos</td>
</tr>
<tr>
<td>Long term orientation</td>
<td>Neg</td>
</tr>
</tbody>
</table>
Accounting values of **Conservatism** and **Secrecy** have the greatest relevance to information in financial statements.

Examples:

- Companies that has a longer-term orientation and wants to avoid future uncertainty tend to be more conservative in providing for impairments / loan losses.
- When there is strong focus on performance measurements and achievement of targets; individualistic decision making (i.e. less participative), such entities tend to be more aggressive (thus, less conservative) in its accounting values.
- High power distant societies are likely to be characterized by restriction of information to preserve power inequalities.
- Societies where there is more emphasis on performance and achievements (masculinity), there will be greater tendency for publicize such achievements and material success (i.e. less secrecy)

A study done by Gary has also revealed that there is **strong positive relationship** between **conservatism** and **secrecy**.

### 2.5 Religion and accounting

Religion plays an important role in defining national culture in many parts of the world, which can also have an impact on business practices.

E.g. Islamic banking that operated under the rules of Shariah law. Malaysian Accounting Standard Board has developed an accounting standard relating to *Presentation of Financial Statements of Islamic Financial Institutions*. 
2.6 A simplified model – International accounting diversity

Nobes developed a simplified model limiting the reasoning for international accounting diversity to, culture and nature of financing system.

- Culture of a country, including its institutional structure determine the nature of its financing system.
- Financing system is seen as the most relevant factor in determining the purpose of financial reporting.

Most countries in the developed world have a self-sufficient culture. For these countries, Nobes applies his model as follows:

**Self sufficient : Type 1 culture**
- Strong equity - outsider financing (large number of outside shareholders)
- Class A accounting for outside shareholders
- * Measurement practices are less conservative
- * Disclosure is extensive
- * Accounting practice differs from tax rules
- * Similar to Anglo-saxon type accounting

**Self sufficient : Type 2 culture**
- Weak equity - outsider financing
- Class B accounting for tax and creditors
- * Measurement practices are more conservative
- * Disclosure is not extensive
- * Accounting practice more closely follows tax rules
- * Similar to Continental European accounting.

**Recent changes in Europe**

- Because of the desire of companies to attract international equity investments, several European countries with class B accounting systems developed a two tiered financial reporting system in 1990’s. Austria, France, Germany, Italy and Switzerland gave listed companies the option to use IFRSs (a class A accounting system), in preparing their consolidated financial statements. Separate parent entity financial statements and other entities remained to report under the local GAAPs.
- In 2005, European Commission mandated all publicly traded companies within the EU to use IFRS in preparing consolidated financial statements.
2.7 Further evidence on accounting diversity

Following are some of the further differences in accounting that exist across countries.

I. Financial statements
   – US companies are required to include a Balance sheet, Income statement, Cash flow statement and a statement that shows changes in equity.

   Companies worldwide provides a Balance sheet and an Income statement. However, there is less uniformity with regard to the need to provide a cash flow statement.

   – A statement of changes in non-current assets is often found in the financial statements prepared by German companies.

II. Format of the financial statements
   – US, Mexican, Canadian, Japanese companies list assets and liabilities in the balance sheet from most liquid (cash) to lease liquid (fixed assets / intangibles).

   Companies in most other countries list assets and liabilities in the reverse order.

   – US companies mostly present expenses by nature on the face of its Income statements [e.g. cost of materials, personnel costs, depreciation], whereas European companies mostly present expenses by function [e.g. cost of goods sold, Sales and marketing expenses, Administration expenses].

III. Level of detail

   US companies – relatively few line items on the face of the financial statements, and supplement these with additional details in notes. Whereas in some other countries more detailed line items are provided in the financial statements.

IV. Terminology

   The terms used to describe similar items could differ between countries.

   Example:
   
   New Zealand – Cash and liquid deposits, Current tax assets, Debtors, Stocks

   USA – Cash and cash equivalents, Taxes receivable, Accounts receivable, Inventories

V. Disclosure

   Numerous differences exist across countries in the amount and type of information disclosed in a set of financial statements.

   The disclosures required to be made by publicly traded companies in the US are generally considered to be the most extensive in the world.
VI. Recognition and measurement

Differences related to recognition and measurement of assets, liabilities, income and expenses are the most important international differences exist in financial reporting.

Recognition – relates to decision on whether or not an item should be recorded in the financial statements.

Measurement – relates to the amount to be reported in the financial statements.

Example:

US GAAP requires PPE to be carried on the balance sheet at historical cost less depreciation. If an asset is impaired, carrying value is written down to fair value.

In contrast under IFRS companies are free to choose between two different methods of valuation. PPE may be carried on the balance sheet at either historical cost or at revalued amounts. Revaluation is the amount of fair value at the date of the revaluation.
3. INTERNATIONAL CONVERGENCE OF FINANCIAL REPORTING

The accounting profession and standard setters have been under pressure from multinational companies, stock exchanges, securities regulators, international lending institutions (e.g. World Bank / IMF) and other international bodies’ such as G20 to reduce diversity and harmonize accounting standards and practices internationally.

3.1 International accounting standard setting

There was a rapid expansion of international trade, foreign direct investment and engagement in international transactions during 1950s and 1960s. This fueled the need to harmonize and standardize financial reporting so that it would make the financial statements across countries comparable for investment, lending, performance evaluation and other purposes.

*Harmonization*: reduction of alternatives while retaining a high degree of flexibility in accounting practices. This allows different countries to have different standards as long as the standards do not conflict.

*Standardization*: elimination of alternatives in accounting for economic transactions and events.

*International convergence of accounting standards*:

This can be interpreted in following different ways

- Enforcement of a single set of accepted standards by several regulatory bodies (e.g. IASB and FASB).
- Diminishing differences among accounting standards issued by several regulators.
- Two or more jurisdictions agree on a core set of common standards, varying interpretations on non-core issues.

3.2 Harmonization efforts

Accounting harmonization can be considered in two ways:

- *Harmonisation of accounting regulations or practices.* [e.g. Chinese government’s effort through legislation to harmonise Chinese GAAP and ISAC GAAPs]
- *Harmonisation of accounting practices* – this is the ultimate goal in international harmonisation, as harmonisation of standards may not necessarily lead to harmonisation of accounting practices.

Regionally and worldwide a several organisations were involved in the harmonization effort:

- International Accounting Standards Committee (IASC)
- European Union
- International Organisation of Securities Commissions
- International Federation of Accountants
- International Forum of Accountancy Development

3.2.1. International Organisation of Securities Commissions (IOSCO)

Established in 1974 to provide a framework in which securities regulatory agencies in Americas could exchange information, and provide assistance and advice to agencies supervising emerging markets.
1986 – Opened its membership to regulatory agencies in other parts of the world; and today IOSCO is the leading organization for securities regulators around the world.

Aims / objectives include:

i. Better regulation of domestic and international markets
ii. Ensure integrity of markets – application of standards and enforcement.
iii. Facilitate cross-border securities offerings / listings.
iv. Advocate adoption of high-quality accounting standards across-borders.

3.2.2 International federation of Accountants (IFAC)

Established in 1977 at the 11th World Congress of Accountants in Munich, with 63 founding members representing 51 countries. IFAC currently comprise of over 175 members and associates in more than 130 countries and jurisdictions, representing almost 3 million accountants.

Mission – serve public interest, and to strengthen the worldwide accounting profession, and contribute to the development of high quality professional standards on auditing, ethics, education and training.

3.2.3 International Forum of Accountancy Development (IFAD)

Following the East Asian crisis in late 1990, IFAD was created as a working group between the Basel Committee, the IFAC, IOSCO, large accounting firms, OECD, UNCTAD and the world bank.

Objective include:

- Promote understanding by governments of the value of transparent financial reporting;
- Help harness funds and expertise to build accounting and auditing capacity in developing countries
- Promote corporation among governments, professional bodies, financial institutions, regulators, standard setters, capital providers and issuers.

3.2.4 European Union

Founded in 1957 with the signing of the Treaty of Rome by six European nations; Belgium, France, Germany, Italy, Luxemburg and Netherlands. Currently EU consist of 28 members states (in 2016 UK through a referendum decided to exit from the EU – known as “Brexit”)

Aims / objectives include:

- Create a unified business environment
- Harmonization of company law and taxation
- Promote freedom of movement of goods/labour between member countries
- Creation of a community capital market

EU attempted to harmonize financial reporting practices within the community by issuing directives that possess the force of law and binding on member countries. There, were two main directives in this regard:

Fourth directive (1978):

- Dealt with valuation rules, disclosure requirements, and the format of financial statements.
- Provided considerable flexibility by allowing countries to choose from acceptable alternatives.
- This flexibility created room for non-comparability in financial statements.
- Introduced the “true and fair view” principal.
Seventh directive (1983)

- Dealt with consolidated financial statements.
- Had a significant impact as consolidations were not previously common in continental Europe.

Although EU directives did not lead to complete comparability across member nations, it helped reduce differences in financial statements.

As a result of these directives some eastern European nations (e.g. Hungary, Poland, Czech Republic) had to abandon their previous soviet style accounting and adopt more western, market oriented systems.

1990 – EU indicated that there will not be any further directives relating to accounting.

1995 – EU indicated it would associate efforts taken by IASC towards accounting harmonization.

2002 – Passed a proposal requiring EU companies to prepare consolidated financial statements in accordance with International Accounting Standards (IAS). Requirement was effective from 2005 onwards.

3.2.5 International Accounting Standards Committee (IASC)

Established in 1973 by an agreement of the leading professional accounting bodies in 10 countries (UK, USA, Germany, Australia, Canada, France, Ireland, Japan, Mexico and Netherlands)

Broader objective as to formulate “International Accounting Standards” (IAS).

Harmonization effort of IASC happened over phases during the period 1973 to 2001, and ended with the creation of IASB in 2001.

1973 to 1988 (15 years)

IASC issued 26 generic IASs. Many of which allowed multiple options.

“Lowest common denominator” approach – standards reflected an effort to accommodate existing accounting practices of different countries. E.g. **IAS 11 – Construction contracts**, as originally written in 1979 allowed percentage-of-completion method and Completed contract method to account for long-term construction contracts.

1989 to 1993 (5 years)

1989 – Published the “Framework for the preparation and presentation of financial statements”; this sets out, objectives of financial statements, qualitative characteristics of financial information, elements of financial statements, recognition criteria etc.

1993 – 10 accounting standards were revised as part of a ‘Comparability project’. E.g. IAS 11 was revised to require the use of percentage-of-completion method, thereby removing the previous options available.

1993 to 2001 (8 years)

1993 – Entered in to an agreement with IOSCO to develop a core set of international standards that could be endorsed by IOSCO for cross-listing purposes. 30 standards were developed as part of this project, which got completed with the publication of IAS 39 – Financial Instruments in 1998.

2000 – The Technical committee of IOSCO recommended these standards to the securities regulators, as an alternative to the use of local standards.

USA and Canada did not allow IASs without reconciliation to local GAAPs for listing purposes.
Challenges to IASC

- UN and OECD raised concerns over legitimacy of IASC since it was created by the accounting profession with self-interest.
- Challenges with regard to support, commitment and expertise of IASC board members.
- During 1980 IFAC unsuccessfully tried twice to gain control over IASC.

Creation of International Accounting Standard Board (IASB)

In response to challenges of IASC, IASB was created in 2001, which then became the creator of International Accounting Standards, which were to be called as “International Financial Reporting Standards” (IFRSs).

IASB’s structure is based on geographical representativeness, technical competence and independence. Trustees are selected based on geographical representations and the board members are selected based on technical expertise.

The structure of IASB

The principal responsibilities of IASB are to:

- Develop and issue IFRSs and Exposure drafts.
- Approve interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC)
3.3 Arguments for and against international convergence of financial reporting standards

3.3.1 Arguments for convergence

a) To increase comparability of financial statements worldwide for the globalization of capital markets.
b) Makes it easier for investors to evaluate potential foreign investments, thereby take advantage by risk reduction through international diversification.
c) Simplify the evaluation of multinationals of possible foreign takeover targets.
d) Reduce financial reporting costs of companies that seek to list on foreign stock exchanges.
e) Facilitate cross listing of securities that would allow companies to gain access to less expensive capital in other countries.
f) National differences in corporate reporting cause loss of investor confidence.
g) Investors often build a premium to the required return on their investments if there is uncertainty or lack of comparability in figures. Such premiums can be as high as 40%.
h) One set of universal accounting standards would reduce the cost of preparing worldwide financial statements and also would make auditing simplified.
i) Would increase the mobility of accounting and auditing staff across countries.
j) Raises the quality of accounting practices internationally. Developing countries would be able to adopt a ready-made set of high quality standards with minimum cost and effort.

3.3.2 Arguments against convergence

a) Magnitude of differences that exist between countries and the political cost of eliminating those differences would be enormous.
b) Resistance of nationalist forces to bow down to international bodies.
c) Difficulties in arriving at principals that satisfies all parties involved throughout the world.
d) Opponents of convergence argue that well developed capital markets did exist even without uniform accounting practices.
e) “Standard overload”, as a result of requiring some entities to comply to set of standards that are not required to them.
f) Capital markets could require the few companies that benefit from cross-border financing to provide the required information/reconciliations, without needing all the companies to converge.
g) Because of different environmental influences, differences in accounting across countries might be appropriate and necessary. (e.g. different stages in economic development, different sources of financing)

In 2002, the six largest public accounting firms worldwide conducted a survey of national efforts in 54 countries to promote convergence with IFRS. Almost all the countries surveyed intend to converge with IFRS. The survey also identified three different convergence strategies:

1. Replace national GAAP with IFRS.
2. Adopt IFRS as national GAAP on a standard-by-standard basis.
3. Eliminate differences between National GAAP and IFRS.

It should also be noted that Harmonisation or Convergence of accounting standards might not necessarily result in comparable financial statements internationally due to nation specific factors such as Culture and other factors that leads to different interpretations of standards, and differing levels of compliance.
### 3.4 The IASB – “Framework”

In order to develop accounting standards in a systematic manner, IASB introduced a conceptual framework.

By adding rigor and discipline, a conceptual framework will increase public confidence in financial reports. It also provides a platform for auditors 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, as first approved by the board of IASC in 1989 and reaffirmed by the newly formed IASB in 2001, deals with the following:

i. **Objectives** of the financial statement and underlying **assumptions**
   - Primary objective – provide information useful for decision making.
   - Underlying assumptions used in the preparation of financial statements:
     - **Accrual basis** - an accounting method, which reports income when earned and expenses when incurred, as opposed to cash basis accounting, which reports income when received and expenses when paid.
     - **Going concern** – assumption about the entities ability to continue its operations into the foreseeable future.

ii. **Qualitative characteristic of financial statements**

There are four qualitative characteristics that make the financial information useful:
   - Understandability
   - Relevance
   - Reliability
   - Comparability

iii. **Elements of financial statements – Definition, recognition and measurement**

<table>
<thead>
<tr>
<th>Element</th>
<th>Definition</th>
<th>Recognition</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Asset</strong></td>
<td>Resources controlled by the entity, from which future economic benefits are expected to flow to the entity.</td>
<td>Assets should only be recognized when it is probable that the future economic benefits will flow to the entity, and the cost can be measured reliably.</td>
<td>Measurement bases include: Historical cost, realizable value, fair value</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td>Present obligations arising from past events that are expected to be settle through an outflow of resources.</td>
<td>When it is probable that an outflow of resources is will be required to settle the liability and the amount can be measured reliably.</td>
<td>Measurement bases include: present value of expected future cash outflows to settle the obligation; amount that is required to settle the obligation, undiscounted settlement value in the normal course of business.</td>
</tr>
<tr>
<td><strong>Income</strong></td>
<td>Encompasses both revenue and gains. Defined as increase in equity other than from transactions with owners.</td>
<td>Income should be recognized when the increase in asset or the decrease in liability can be measured reliably.</td>
<td>NA</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td>A decrease in equity other than through distributions to owners.</td>
<td>Expenses should be recognized when the related decrease in asset or the increase in liability can be measured reliably.</td>
<td>NA</td>
</tr>
</tbody>
</table>
iv. Concept of capital and capital maintenance

Capital maintenance is how an entity defined the capital that it seek to maintain.

**Financial capital maintenance:** Profit is earned only if the financial amount of net assets at the end of the period exceeds the financial amount of net assets at the beginning of the period, after excluding contributions from and distributions to owners during the period.

**Physical capital maintenance:** profit is earned only if the physical productive capacity of the entity at the end of the period exceeds the physical productive capacity at the beginning of the period.

### 3.5 International Financial reporting Standards (IFRSs)

IFRS constitutes a comprehensive systems of financial reporting addressing a full range of accounting concerns. Since IASB is a private body, it does not have the ability to enforce its standards. Instead IASB develop IFRSs as a public good, making it available to any country or company that might choose to adopt it.

Following is a list of IASs and IFRSs currently in issue:

<table>
<thead>
<tr>
<th>IAS</th>
<th>Title</th>
<th>Originally issued</th>
<th>Fully withdrawn</th>
<th>Superseded by</th>
</tr>
</thead>
<tbody>
<tr>
<td>01</td>
<td>Presentation of Financial Statements (1997)</td>
<td>1975</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Events after the Reporting Period (2007)</td>
<td>1978</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Construction Contracts (1993)</td>
<td>1979</td>
<td>1-Jan-18</td>
<td>IFRS 15</td>
</tr>
<tr>
<td>17</td>
<td>Leases (1997)</td>
<td>1982</td>
<td>1-Jan-19</td>
<td>IFRS 16</td>
</tr>
<tr>
<td>18</td>
<td>Revenue (1993)</td>
<td>1982</td>
<td>1-Jan-18</td>
<td>IFRS 15</td>
</tr>
<tr>
<td>20</td>
<td>Accounting for Government Grants and Disclosure of Government Assistance</td>
<td>1983</td>
<td></td>
<td></td>
</tr>
<tr>
<td>21</td>
<td>The Effects of Changes in Foreign Exchange Rates (1993)</td>
<td>1983</td>
<td></td>
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<tr>
<td>23</td>
<td>Borrowing Costs (1993)</td>
<td>1984</td>
<td></td>
<td></td>
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<tr>
<td>24</td>
<td>Related Party Disclosures</td>
<td>1984</td>
<td></td>
<td></td>
</tr>
<tr>
<td>26</td>
<td>Accounting and Reporting by Retirement Benefit Plans</td>
<td>1987</td>
<td></td>
<td></td>
</tr>
<tr>
<td>28</td>
<td>Investments in Associates and Joint Ventures (2011)</td>
<td>1989</td>
<td></td>
<td></td>
</tr>
<tr>
<td>29</td>
<td>Financial Reporting in Hyperinflationary Economies</td>
<td>1989</td>
<td></td>
<td></td>
</tr>
<tr>
<td>33</td>
<td>Earnings per Share</td>
<td>1997</td>
<td></td>
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<td>34</td>
<td>Interim Financial Reporting</td>
<td>1998</td>
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<tr>
<td>36</td>
<td>Impairment of Assets</td>
<td>1998</td>
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<td>37</td>
<td>Provisions, Contingent Liabilities and Contingent Assets</td>
<td>1998</td>
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<td>38</td>
<td>Intangible Assets</td>
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<td>Investment Property</td>
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<td>41</td>
<td>Agriculture</td>
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IAS 1 is a single standard providing guidelines for the presentation of financial statements. The standard stipulates that a set of IFRS based financial statements must include a balance sheet, income statements, a statement of cash-flows, a statement of changes in equity, accounting policies and explanatory notes. IAS 1 establishes the overriding principal of fair presentation and permits an override of a requirement of an IASB standard in the extremely rare situation where management concludes that compliance with a requirement of a standard would be misleading.

IFRS 1 provides guidance to companies that are adopting IFRS for the first time. IFRS 1 requires an entity to comply with each IFRS effective at the reporting date of its first IFRS financial statements. However, IFRS 1 provides exceptions to this rule where the cost of complying with this requirement would likely to exceed the benefits to users.

### 3.6 Adoption of IFRS Vs convergence to IFRS

**Adoption** of IFRS, in simple terms mean the country applying IFRS would implement IFRS in the same manner as issued by the IASB. Once adopted the country’s accounting standards will be fully compliant with the guidelines issued by IASB.

However, **convergence** with IFRS mean that the Accounting standard Board of the country applying IFRS would work towards with IASB to develop high quality comparable accounting standards over time. His countries converging to IFRS may deviate to a certain extent from IFRS’s as issued by the IASB.

**There are a number of different ways in which a country might adopt IFRSs:**

1. *All companies* – in effect IFRS replaces national GAAP.
2. *Parent companies in preparing consolidated financial statements* – separate / individual financial statements continue to be prepared under local GAAP.
3. *Stock exchange listed companies* – Non-listed entities use national GAAP.
4. *Foreign companies listed on domestic stock exchange.*
5. *Domestic companies that are listed in foreign stock exchanges.*
3.7 IFRS in the United States

Historically US GAAPs have been ‘Rule based”, whereas, IFRSs have been “Principal based”. There had been increasing support in the US for a principal based system in recent times.

In 2002, at a meeting in Norwalk, Connecticut, FASB and IASB pledged to use their best efforts to make their existing financial reporting standards compatible, and to coordinate their work programs to achieve compatibility. This is known as the “Norwalk Agreement”.

2006-2008 financial crisis brought intense political pressure to both FASB and IASB to accommodate the interests of the Banking regulators in the standard setting process. IFRS 9 – financial instruments can be seen as a response to it.

In 2007 SEC decided to remove the requirement that foreign private issuers (foreign companies with less than 50% US ownership) using IFRS reconcile their financial statements to US GAAP. This reflects recognition of IFRS as a high quality set of accounting standards.

In 2009, FASB and IASB issued a joint statement detailing the status of the convergence process, and identified two particularly controversial topics: (1) Accounting for financial instruments and (2) De-recognition of assets and liabilities. The Issue of IFRS 9 – Financial Instruments by IASB was a response to this.

In 2011, IASB and FASB competed the Fair Value Measurement project, and issued IFRS 13 and SFAS 257 respectively.

In 2014, IASB chairman suggested that IASB would no longer seek full convergence with US GAAP. However, this may not mean that the convergence project is completely abandoned; it merely has been reduced to a low priority level.