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International Accounting Standards Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.
These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting:	**16 November 2006, London**
Project:	**Annual improvement process**
Topic:	**Reporting compliance with IFRSs (Agenda Paper 2A)**

1. The staff have identified that the following issue would be most appropriately resolved via the annual improvements process (as agreed by the Board in July 2006).

   Issue: Should IAS 1 *Presentation of Financial Statements* be amended to provide guidance on situations where the financial statements of an entity are based on, but not in full compliance with, IFRSs?

2. The purpose of this paper is to propose that the above issue be added to the Board's annual improvements project, to provide analysis on that issue and to propose a solution.

Staff recommendation

3. The staff recommends that:

- the Board should add the issue described in paragraph 1 to the annual improvements project; and

- IAS 1 should be amended in accordance with the proposed drafting in paragraph 22 of this paper.

Structure of the paper

4. The background to this issue, staff analysis and proposed drafting of amendments have been presented in the main body of this paper.

Background

5. Concerns have been expressed by the International Auditing and Assurance Standards Board (IAASB) about the way in which IFRS is referred to in financial statements and audit reports, particularly in those countries/regions where IFRSs are not adopted in full.

6. In many countries, the basic financial reporting framework for general purpose financial statements is IFRSs. However, in addition to those countries that require full compliance with IFRSs, the following situations exist:

a) Some countries are moving towards adoption of IFRSs, and have adopted some but not all of the complete set of current IFRSs for use in their jurisdiction.

b) Some countries/regions have adopted IFRSs but have altered the standards in some way.[1]

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[1] For example, by removing certain provisions, or by removing options in certain IFRSs, or by adding requirements, which may restrict the availability of certain accounting policies or may require additional disclosures. These jurisdictions often require compliance with 'IFRSs as adopted in [X]'. Nevertheless, some entities reporting in those jurisdictions may be able to report in compliance with IFRSs.

c) In some countries regulators require practices for certain classes of entity (such as banks), the result of which may be that the general purpose financial statements of those entities do not conform to IFRSs.

d) Some countries have adopted the IFRSs at a particular date as their own local standards but have not kept up-to-date for subsequent changes in IFRSs; other countries have adopted IFRSs but find it difficult to implement changes as they occur.[2]

7. The staff's concern with the situations illustrated in paragraph 6 is the potential for misunderstanding by the users of the financial reports described as being based on IFRS that are not in compliance with IFRS; and harm to the IFRS brand.

8. In circumstances where a reporting framework is stated as being based on, but not fully compliant with IFRS, the user may be unaware of the differences between the financial reporting framework and full IFRS. Further, the user may expect that, given the reference to IFRS, that there is a close relationship between the framework used and IFRS.

9. In some cases, the differences between the reporting framework and IFRS may be insignificant. However, in other cases, an apparently insignificant difference between the financial reporting framework based on IFRS and the complete set of current IFRS may have a significant effect on the reported financial position or performance of some or many entities.

10. As such, there is the possibility that a user may be misled into thinking that the financial statements comply, or comply in all but immaterial respects, with IFRS and make decisions based on this assumption. Accordingly, preparers and auditors should be concerned to avoid such a possibility.

11. The issue, particularly in circumstances (a)-(c) of paragraph 6 above, is how should the financial reporting framework being applied in these situations be referred to in the financial report of the entity?

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[2] Recent announcements by the IASB of an increased lead time between publication of an IFRS and its effective date are designed to alleviate these situations. They are not further considered in this paper.

Staff analysis

12. Paragraph 14 of IAS 1 *Presentation of Financial Statements* requires a statement of 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.**

13. There is no explanatory material in IAS 1 elaborating on paragraph 14. In particular, there is no guidance on references to frameworks based on IFRSs which do not claim to comply with all IFRS requirements.

14. The staff notes that often the government or regulator wishes to retain reference to IFRSs, and expects entities and their auditors to report in terms such as “fair presentation in accordance with IFRSs as adopted in [country/region X]” or “fair presentation in accordance with IFRSs, as modified for banks in [country X]”.

15. The terms ‘International Financial Reporting Standards’, ‘IFRS’ and ‘IFRSs’ are trademarks of the IASC Foundation. However, the staff does not consider that the IASB is in a position to restrict countries/regions, from including in their laws or regulations, references such as ‘IFRSs as adopted in [X]’. Neither is it feasible for the IASB to demand removal of such references as already exist. That is to say, just as the IASB has no authority to require anyone to use IFRSs, it has no authority to specify that IFRSs be adopted as a complete set without alteration. However, that is not to say, that the IASB should do nothing.

16. The IASB and the Trustees have been liaising with groups such as the IAASB, regulators (including IOSCO), the firms, and user groups such as the CFA Institute. The staff believe it would assist the IASB's dialogue with these groups if the IASB was to add some material to IFRSs noting that references to IFRSs 'as adopted' or 'as modified' may be misleading to users. Such material could comment that such references could undermine the objective of financial statements and/or the fair presentation of the financial position, financial performance and cash flows of an entity.

17. In its consideration of this issue, the IAASB is considering mandating that an unqualified opinion is possible only when:

    (a) the notes to the financial statements include an appropriate explanation of the differences between the applicable financial reporting framework and IFRSs, including an indication of the significance in the case of the reporting entity; and

    (b) the auditor's report draws attention to this note and the fact that the applicable financial reporting framework differs from IFRSs.

18. The staff believe it would provide considerable support to the IAASB's requirements if the IASB were to modify IAS 1 to add:

    a) an explanation that references such as IFRSs 'as adopted' or 'as modified' may be misleading to users; and

    b) a requirement to disclose the nature (and effects) of any differences between the modified IFRSs followed in the financial statements and those set by the Board.

19. The staff have considered whether by providing guidance to address situations where financial statements are based on a framework that is not fully compliant with IFRSs, the Board may be seen as accepting this practice. Whilst the staff believe this would be an unfortunate interpretation, the benefits of actively managing this issue will provide greater benefits to users.

Staff recommendation

20. The staff recommend that IAS 1 should be amended in accordance with the proposed drafting in paragraph 22 of this paper.

21. **Does the Board agree?**

Drafting

22. The following additions are proposed to IAS 1 *Presentation of Financial Statements* should the Board agree with the staff recommendations:

Overall considerations

Fair presentation and compliance with IFRSs

14A Where the entity's financial statements are described as being based on IFRSs but are not fully compliant with IFRSs, the entity shall disclose:

(a) all instances where IFRSs are not complied with; and

(b) indicate the significance of those differences to its financial statements.

Basis for Conclusions on Proposed Amendments to IAS 1 *Presentation of Financial Statements*

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

Reporting compliance with IFRSs

BC1 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, such differences may have a significant effect on the reported financial position or performance of some or many entities. Consequently, such references may be misleading to users. Some users may expect that statements based on IFRSs are representative of statements in compliance with IFRSs. Further, users may not be able to identify the differences between a financial reporting framework based on IFRSs and the complete set of current IFRSs.

BC2 The Board decided that, in circumstances where an entity refers to, but is not in compliance with, IFRSs as the basis of its financial reporting framework, it shall disclose the instances where IFRSs are not complied with and the significance of the differences between IFRSs and the accounting basis applied by the entity. This will enable users to make judgments about the usefulness of the information presented and the effect of differences on the financial statements.