

2002

M I L L E R

INTERNATIONAL
ACCOUNTING
STANDARDS

G U I D E

David Alexander
Simon Archer



ASPEN LAW & BUSINESS

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Foreword

A lot has changed since the printing of the first edition of the *Miller International Accounting Standards Guide*, just a year ago. The Trustees under Chairman Paul Volcker have had an impressive funding run to secure the financial support for the next several years. The reorganization of the IASC has been completed and the new 14-member board, renamed the International Accounting Standards Board (IASB), has held several meetings to address the most urgent issues and draft a plan to lay out a blueprint for convergence in financial reporting. The 49-member—geographically spread—Standards Advisory Council (SAC) met for the first time in July 2001. The new IASB standards will be called International Financial Reporting Standards (IFRS) and the body that provides timely guidance on financial reporting issues is now the International Financial Reporting Issues Committee (IFRIC). A preface has been approved which will create a different look and layout of the standards.

Probably one of the most important events will be the mandatory application of the standards in Europe. The experience gained from this effort will have a significant effect on the rest of the financial reporting world.

Finally, continue to look at our redesigned Web site, iasb.org.uk.

August 2001

Kurt P. Ramin
Commercial Director, IASB

Preface

The new 2002 *Miller International Accounting Standards Guide (Miller IAS Guide)*, part of **The Complete Miller GAAP Library for Business**, explains and analyzes International Accounting Standards (IASs) promulgated by the International Accounting Standards Committee (IASC).

International accounting standards are playing an increasing role in the context of the globalization of capital markets. In particular, they provide a basis for the consolidated financial statements of multinational corporations based in countries where national GAAP are not considered to provide a basis that satisfies internationally accepted qualitative criteria for financial reporting. Some multinational corporations use U.S. GAAP for a similar reason. At the present time, IASs are not accepted as a substitute for U.S. GAAP as a basis for financial statements of foreign registrants with the U.S. Securities and Exchange Commission (SEC); but they are accepted by the London Stock Exchange and elsewhere in Europe. Consequently, they are used by an increasing number of multinational corporations based in Continental Europe and Asia as a basis for their consolidated financial statements. Such countries include Austria, France, Germany, Italy, and Switzerland. An understanding of IASs is therefore necessary for an understanding of the consolidated financial statements of such corporations.

Chapter 1, "The International Accounting Standards Committee—Past, Present, Future," explains in more detail the role and usage of IASs. It also examines their current status in terms of international acceptance as a basis for financial reporting in the context of cross-border securities listings (including that of foreign registrants in the United States). Their central role in the next phase of accounting harmonization within the European Union is explained. The recent major restructuring of the IASC, in the light of its intended role as a global accounting standard-setter for listed corporations, is described.

How to Use the 2002 *Miller IAS Guide*

Following an introductory section that covers the International Accounting Standards Committee, its Framework for the preparation and presentation of financial statements, and the key IAS 1, "Presentation of Financial Statements," the 2002 *Miller IAS Guide* organizes IASC accounting pronouncements into three parts (Overview, General Standards, and Industry-Specific Standards), then, alphabetically by topic. So that the authoritative information is immediately accessible, each chapter deals comprehensively with

one, or in a few cases two, IASs and the related pronouncements of the IASC's Standing Interpretations Committee (SIC). Each chapter also indicates the main differences between IAS and U.S. GAAP on the matters dealt with in the chapter. However, the *Miller IAS Guide* is not written with the assumption that the reader is familiar with U.S. GAAP.

This edition is current through IAS 41, "Agriculture."

A few topics covered by IAS GAAP are not covered by U.S. GAAP, and vice versa. In a number of cases, the topic coverage in FASB pronouncements is narrower and more focused than it is in IASC pronouncements. (This is the main reason why the number of U.S. GAAP pronouncements is substantially greater than the number of IAS GAAP pronouncements.) Another reason is that current IASs include only two specialized accounting standards, IAS 30, "Disclosures in the Financial Statements of Banks and Similar Financial Institutions," and IAS 41, "Agriculture."

Chapters in the *Miller IAS Guide* also contain illustrations and examples to demonstrate and clarify specific accounting principles. They also contain **Practice Pointers**, which clarify issues of application, as well as **Observations**, which discuss issues of interpretation and bring apparent inconsistencies to your attention.

Material in the *Miller IAS Guide* can be located several ways: In addition to the Guide's **Table of Contents**, the **Cross-Reference** shows the chapter in which a particular pronouncement is discussed. The **Index** provides quick, accurate reference to needed information. In addition, an **Appendix** describes individual countries' usage and application of IASs.

For more information about international accounting and auditing standards, visit the Miller International Accounting Library at www.millerseries.com.

Acknowledgments

The authors and publisher wish to thank both Susan Harding, formerly Research Manager of the International Accounting Standards Committee, for reviewing the technical content of the *Miller IAS Guide*, and Kurt Ramin, Commercial Director of the IASC, for making this important addition to professional accounting literature possible. They would also like to thank Robert Sack, CPA, for his review of U.S. GAAP. Finally, they also would like to thank Anita Rosepka, Managing Editor, and Bernard Johnston, Senior Manuscript Editor, of Aspen Law & Business for their indispensable contributions in bringing this second edition of the *Miller IAS Guide* to press.

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Contents

Foreword by Kurt Ramin	vii
Preface	ix
About the Authors	xi

Part I: Overview

The International Accounting Standards Committee— Past, Present, and Future	1.01
Framework for the Preparation and Presentation of Financial Statements	2.01
Presentation of Financial Statements	3.01

Part II: General Standards

Accounting for Investments	4.01
Borrowing Costs	5.01
Business Combinations	6.01
Cash Flow Statements	7.01
Changing Prices and Hyperinflationary Economies	8.01
Consolidated Financial Statements	9.01
Construction Contracts	10.01
Discontinuing Operations	11.01
Earnings per Share	12.01
Employee Benefits	13.01
The Equity Method	14.01
Events after the Balance Sheet Date	15.01
Financial Instruments	16.01
Foreign Currency Translation	17.01
Government Grants and Government Assistance	18.01
Impairment of Assets	19.01
Income Taxes	20.01
Intangible Assets	21.01
Interim Financial Reporting	22.01
Inventory Pricing and Methods	23.01
Investment Property	24.01
Leases	25.01
Net Profit or Loss for the Period, Fundamental Errors, and Changes in Accounting Policies	26.01

Property, Plant, and Equipment	27.01
Provisions, Contingent Liabilities, and Contingent Assets	28.01
Related Party Disclosures	29.01
Revenue	30.01
Segment Reporting	31.01
Part III: Industry-Specific Standards	
Agriculture	32.01
Disclosures in the Financial Statements of Banks and Similar Financial Institutions	33.01
Appendix: Use of IAS in Countries Around the World	34.01
Cross-Reference—Original Pronouncements to 2002 <i>Miller International Accounting Standards Guide</i>	35.01
Index	36.01

CHAPTER 1

THE INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE— PAST, PRESENT, AND FUTURE

CONTENTS

Introduction	1.01
History of IASC	1.02
Causes of Differences	1.04
The New Structure	1.07
The Future	1.09

INTRODUCTION

The International Accounting Standards Committee (IASC) was comprehensively restructured in 2001 and re-named the International Accounting Standards Board (hereinafter IASB). It describes itself on its Web site as

an independent, private sector body, formed in 1973 with the objective of harmonising the accounting principles which are used by businesses and other organisations for financial reporting around the world.

IASB's formal objectives, as stated in its revised Constitution approved by members on May 24, 2000, are:

- (a) to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions;
- (b) to promote the use and rigorous application of those standards; and
- (c) to bring about convergence of national accounting standards and International Accounting Standards to high quality solutions.

As stated in the Home Page of IASB's Web site,

The objective of the [IASB] is to achieve convergence in the accounting principles that are used by businesses and other organisations for financial reporting around the world. This, in turn, improves the ability of investors, creditors, governments, and others to make informed resource allocation and policy decisions.

Thus, the original objective of "harmonising accounting principles" has evolved into the objectives of "develop[ing]...a single set of *high quality...global accounting standards...to help participants in the world's capital markets and others make informed decisions,*" "promot[ing] the...*rigorous application of those standards*" and "bring[ing] about convergence...[toward] *high quality solutions.*"

This evolution of its objectives is associated with its collaboration with the International Organization of Securities Commissions since 1995, which led in 2000 to a comprehensive restructuring of IASC to take effect in 2001. This introductory chapter aims to provide an overview of IASC's history, its recent re-structuring as IASB, and the challenges facing it.

HISTORY OF IASC

IASC was created in 1973. Its creation was related to that of the International Federation of Accountants (IFAC). IFAC is the worldwide umbrella organization of accountancy bodies. It is independent of government or pseudo-government control. Its stated purpose is to develop and enhance a coordinated worldwide accountancy profession with harmonized standards. All members of the IFAC are automatically members of the IASC.

IASC's recent description of itself as an "independent private sector body" is accurate and revealing. It is, in essence, a private club, with no formal authority. This is in contrast to national regulatory or standard-setting bodies, which operate within a national jurisdiction and some form of legal and governmental framework that delineates, defines, and provides a level of authority. The IASC, however, has operated throughout its existence in the knowledge that in the last resort, it and its standards have no formal authority. It therefore has all along had to rely on persuasion and the quality of its analysis and argument. This can be seen to have had two major effects. First, the quality of logic and discussion in its publications has generally been high, and its conclusions—if sometimes debatable—have been feasible and clearly articulated. Second, however, the conclusions and recommendations of many of the earlier published IAS documents often had to accommodate two or more alternative acceptable

treatments, simply because both or all were already being practiced in countries that were members of IASC and were too significant to be ignored.

The disadvantages of this state of affairs are obvious and were well recognized by the IASC itself. Toward the end of the 1980s, the IASC decided it would attempt a more proactive approach, and early in 1989 it published an Exposure Draft (E32) on the comparability of financial statements. This proposed the elimination of certain treatments permitted by particular IASs and the expression of a clear preference for one particular treatment, even where two alternatives were still to be regarded as acceptable.

This "comparability project" led to a whole raft of revised standards operative from the mid-1990s, which did indeed considerably narrow the degree of optionality compared with the earlier versions of the standards issued in the 1970s and 1980s. The comparability project, therefore, can be said to have made the set of IASs more meaningful and significant. Of course, it did nothing to increase the formal authority of the IASC.

In 1995, as the next stage in its development, IASC entered into an agreement with the International Organization of Securities Commissions (IOSCO) to complete a "core set" of IASs by 1999. With regard to the agreement, IOSCO's Technical Committee stated that completion of "comprehensive core standards acceptable to the Technical Committee" would allow it to "recommend endorsement" of those standards for "cross-border capital raising in all global markets." The potential significance of this agreement is great. If it all goes through successfully, it will mean that one set of financial statements, properly prepared in accordance with IAS GAAP, would automatically be acceptable for listing purposes without amendment and without any reconciliation to national (i.e., local) GAAP on each and all of the world's important stock exchanges. This would save huge resources at the international and multinational level, both for preparers and for users and analysts. The role of national standard-setters, except arguably for small and medium-sized enterprises, would simply disappear, if enforcement were left to other bodies.

From the IASC viewpoint, successful implementation of this process would provide the *de facto* authority that it needs and craves. Any enterprise failing to accept the authority of IASC would know that its shares would be likely to be de-listed.

This, of course, raises the issue of effective enforcement, for which IASB is dependent on securities regulators and other bodies with the power to impose de-listing and other sanctions, and on a mechanism for bringing breaches of IASs to the attention of such bodies.

In December 1998, the then IASC completed its "core standards" program with the approval of IAS 39, "Financial Instruments: Recognition and Measurement" (see Chapter 18). Following the publication of the report of IASC's Strategic Working Party, "Recommendations

on Shaping IASC for the Future," in November 1999, the Board of IASC approved proposals in December 1999 to make significant changes to IASC's structure, in order to prepare it for an enhanced role as a global accounting standard-setter.

Following these preparations, the year 2000 was a momentous one for IASC. In May 2000 the proposed structural changes were approved by IASC's membership. (The results of these changes are outlined in "The New Structure," below.) Also in May 2000, IOSCO formally accepted the IASC's "core standards" as a basis for cross-border securities listing purposes worldwide (although for certain countries, notably the United States, reconciliations of items such as earnings and stockholders' equity to national GAAP are still required). In June 2000, the European Commission issued a Communication proposing that all listed companies in the European Union would be required to prepare their consolidated financial statements using IASs, a proposal that has since been adopted.

It is apparent, however, that acceptance of IASs by the SEC, for the financial reporting of foreign registrants for U.S. listings, is a crucial element in the new IASB's acceptance as the global accounting standard-setter. This is discussed further under "The Future," below.

CAUSES OF DIFFERENCES

Before we speculate about possible outcomes, it is helpful to think about the context in which this game is being played out. Moving back only twenty years, to the end of the 1970s, financial reporting practices, traditions, and philosophies differed enormously among key countries in the so-called developed world (to say nothing of the situation in developing and third-world countries). Ignorance of these differences was, and indeed in many respects still is, both widespread and deep-seated. The roots of these differences can, to a significant extent, be explained by considering four general factors, as follows.

1. *The relative importance of law.* The point at issue here is the extent to which the "law of the land" determines the details of accounting and financial reporting. Tradition in the Anglo-Saxon countries is that the law specifies general principle only, while in countries heavily influenced by Roman law tradition, the law tends to include more detail. Most of mainland Europe exemplifies the latter approach.
2. *Prescription or flexibility.* If regulation is not specified in full detail in legislation, then there are still two alternatives available. First, regulation might be created in detail by professional accounting bodies. Second, the broad regulation, whether created by legislation or by professional accounting bodies, may

be explicitly designed on the assumption that the individual expert, in each unique situation, can and should choose the appropriate course of action, within the broad parameters laid down. This was very much the approach in the Anglo-Saxon world before the creation of national standards bodies some thirty years ago.

3. *The providers of finance.* The national accounting systems developed before the 1970s predate the arguments of recent years that accounting statements must satisfy the needs of a wide variety of users. Generally, the suppliers of finance to business were the only users seriously considered until late in the last century (sometimes quite late). Different countries have very different financial institution structures and finance-raising traditions. It follows that accounting practice will have been adapted to suit the local dominant sources of finance. In some countries, tradition tends to focus on the shareholders and, therefore, on profit and on the reporting of expenses and revenues. Some other countries have more active banking sectors and fewer shareholder investors. Accounting in those countries will tend to focus on creditors, and therefore on the balance sheet and on the convention of prudence. Also, bankers tend to have access to "inside information" in those circumstances and are less reliant on annual reports.

A more obvious, but less often quoted, example of the influence of finance provision on financial reporting can be seen by considering the systems of eastern Europe as they begin to emerge from a half-century during which all finance was provided by the state.

4. *The influence of taxation.* The general point here is that the scope and extent of the influence of taxation law on financial statements vary considerably. Perceptions of this are often simplistic. In reality, no country can justly claim that tax considerations do not influence published results, and no country can be accused of simply taking tax-based results and publishing them just as they are. Within these nonexistent extremes, however, lies a variety of tradition and practice. It is common in many countries, for instance, for some tax allowances to be claimable only if the identical figure from the tax computation is also used in the published financial statements.

The most powerful of these causal factors creating and explaining historical differences is almost certainly the sources of finance. It is arguably this same factor that is now driving the move toward internationalism in financial reporting and its regulation. The market for the *supply* of finance for larger enterprises is now a single global market. If our analysis is correct, this means that the *demand* for finance is inevitably forced to operate in a single global market

scenario. The demand for globally understood financial reports is therefore logically unstoppable.

As we have already hinted, the above arguments, while in our view fully justified at the “listed enterprise” level, do not necessarily imply any need to alter national financial reporting as it applies to small businesses. They certainly do not logically apply to the economies of many third-world countries. The implications for possible “two-tier” systems within countries and between economic regions raise significant issues, which both IASC and national regulatory systems have hardly begun to tackle, though discussion of such problems is outside the scope of this book. Unlike U.S. GAAP, at least as promulgated, which are intended to apply only to enterprises whose shares are tradeable, IAS GAAP seek applicability, in general, to all enterprises, in all types of economy. This intention is now beginning to be questioned within IASC. In its Statement in the IASC Annual Review 2000, the outgoing Board of IASC commented as follows (pars. 29–30):

During the last few years, the [outgoing] Board has detected various indications that strong demand exists for more work on the application of accounting standards to reporting by small enterprises. The demand has been noted first in developing countries and countries in transition to market economies.... The Board...wishes IASC to continue to meet the needs of constituents in developing countries and the needs of small businesses in general. It recognises that a case may exist for having different accounting standards for small businesses and large businesses...[but] inclines to the view that a case can be made rarely, if at all, for differences in standards for recognition and measurement...; a stronger case may exist with regard to disclosure standards and it may be possible to do more to help small businesses....

Given the position and role of IASC, and the widely differing practices and attitudes of its constituents, is it really valid to talk of Generally Accepted Accounting Principles in the IASC context? Is IAS GAAP the same species of animal as, say, U.S. GAAP, distinguished only by minor genetic individualities? Or is it of a different species or even genus?

One difference is clear, at least at the time of writing and at the time of the issuance of the International Accounting Standards described and discussed in this volume. IAS GAAP (we continue to use the term, if only for convenience) is, inevitably, designed to be “generally accepted” in a variety of different legal and cultural contexts. U.S. GAAP, U.K. GAAP, German regulation, and other national systems have no need for this consideration. This may sound like a weakness of IAS GAAP. From a national standpoint, perhaps it is, but national standpoints are no longer entirely valid. The very reason for the existence of the IASC is that financial reports must be