BUU44531 Financial Reporting and Analysis I
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Topic 1: Regulatory framework
Overview
The need for regulation
Principles-based and rules-based framework
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The standard-setting process
Purpose of accounting standards
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The need for regulation
Companies are owned by shareholders but managed by directors (unlike sole traders)
Most shareholders of larger companies have no day-to-day involvement with the company
Shareholders rely upon financial reports for information to help them make important decisions
Similarly, creditors and other user groups may rely heavily on financial reports for information
Regulations try to ensure that financial reports provide a faithful representation of the financial position and performance

If there was no regulation for the form and content of financial statements, directors could provide users with false inform
Users would then make poor economic decisions.
Therefore it is crucial that financial reporting is subject to a body of rules and regulations.
These rules and regulations are collectively referred to as the "regulatory framework"

Principles-based and rules-based framework
A principles-based system works within a set of established principles.
E.g. IFRS is based on principles in the Conceptual Framework for Financial Reporting
These principles cover a wide range of scenarios without the need for a set of rules for each eventuality.

A rules-based system contains rules which apply to specific scenarios.
The US has historically used a rules-based system however many accounting scandals have arisen as a direct result of co

Advantages of a principles-based approach:
A principles-based approach on a single conceptual framework ensures that standards are consistent with each other.
Rules can be broken and 'loopholes' found whereas principles are more likely to offer a 'catch all' scenario.
Principles reduce the need for excessive detail in standards.

Disadvantages:
Principles can become out of date and can be overly flexible and therefore subject to manipulation.

Users of accounting information
Sources of regulation
Legislation
Accounting standards
Stock exchange regulations
1. Legislation

Broad rules; vary from country to country
Companies Acts in Ireland:
The accounting records that companies must keep
The requirement to prepare financial statements
Requirement that accounts give a “true and fair view”
Requirement that accounts be prepared in accordance with national/international standards
Circumstances in which group accounts must be prepared
Circumstances in which an audit is required
Duty to circulate its accounts to shareholders and to make them available for public inspection

2. Accounting standards
Detailed rules
National standards:
UK and Ireland, these are created by the Financial Reporting Council (FRC).
In the US, Financial Accounting Standards Board (FASB).
International standards: These are developed by the International Accounting Standards Board (IASB).

3. Stock exchange regulations
Apply to companies quoted on a stock exchange.
E.g. requirement to publish quarterly figures
Provide a more detailed analysis of some of the items in its financial statements than is required by law or the

Generally Accepted Accounting Practices (GAAP)
The complete set of accounting regulations (from all sources) that apply in a certain jurisdictions e.g. UK GAA
“Big GAAP”: the accounting regulations for large companies (generally listed companies). Many international s
“Little GAAP”: the accounting regulations for smaller companies. IASB issued an International Standard for Sm
Basically a simplified version of the full international standards, mainly used by unlisted companies.

International Accounting Standards Board (IASB)
Formed in 2001, as a replacement for the IASC.
Develop and amend International Financial Reporting Standards (IFRS). Standards produced by IASC were k
Structure:
14 members, chaired by Andreas Barckow
Responsible to the IFRS Foundation, which aims to develop global standards and promote their use.
The IFRS Advisory Council advises the IASB on its agenda and priorities.
The IFRS Interpretation Committee interprets international standards and provides guidance on matters not co

It has three formal objectives:
To develop, in the public interest, a single set of high quality, understandable and enforceable global accounti
To promote the use and vigorous application of those standards
To work actively with national accounting standard setters to bring about convergence of national accounting s

The standard-setting process
IASB develops standards by means of a “due process” involving preparers, users, the business community, st
Steps:
Identification of the topic area
Consideration of how the Conceptual Framework applies to this area
Consultation with the national standard-setters, the IFRS Foundation and IFRS Advisory Council

Publication of discussion document and consideration of comments
Publication of exposure draft and consideration of comments
Publication of standard
Publication of an international standard requires the approval of at least nine of the IASB’s members

IFRS 16 – Leases (iasplus.com)
Structure of an international standard
Introduction
Objectives and scope
Definitions of terms used in the standard
Body of the standard
Effective date and transitional provisions
Formal approval by IASB and any dissenting opinions

The following points are not part of the actual standard, but are often included:
Basis for conclusions
Application/implementation guidance and/or illustrative examples

Dissenting opinion – IAS 1
DO6 The Board members also believe that the amendments are flawed by offering entities a choice of presen

Purpose of accounting standards
Standards reduce variation in accounting practice and introduce a degree of uniformity into financial reporting.
Standards make it more likely that financial statements will provide a faithful representation of an entity’s finan
Meaningful comparisons may be drawn over time and between entities.
IASB Conceptual Framework stresses the importance of faithful representation and comparability.

Possible problems with international standards
A lack of flexibility, and the worry that a single accounting treatment might not be appropriate in all cases.
The IASB overcomes this disadvantage by allowing entities to override a standard if compliance with that stan
This event should be extremely rare.

Worldwide use of IFRS
Required for listed companies in over 140 countries (including all EU countries).
India’s national standards largely converged with IFRS.
Japan permits most listed companies to use IFRS.
China substantially converged with IFRS.
Hong Kong fully converged with IFRS.
USA: Foreign companies listed on US stock exchanges are permitted to use IFRS. However, it’s not clear yet,

Advantages of harmonisation
Businesses operate globally, and investors make investment decisions on a global basis. Financial informatio

Advantages for MNCs:
Access to international finance is easier if financial information is more understandable and consistent
Accounting for international subsidiaries is easier as it would all be prepared on the same basis
Greater efficiency in accounting departments

Advantages for investors:
Financial information would be consistent between different entities from different regions, therefore more infor

Advantages for tax authorities:
Tax liabilities of investors should be easier to calculate.

Advantages for international accounting firms:
Accounting and auditing is easier if similar accounting practices exist on a global basis.

Disadvantages of harmonisation
Difficult to introduce, apply and enforce in different countries, with a range of social, political, economic and bu
Different legal systems may prevent the application of certain accounting practices
Countries may be unwilling to accept anther country's standards
Costly to develop a fully detailed set of accounting standards.

IFRS 1 First-time Adoption of IFRS
Objective: to ensure that an entity's first financial statements under IFRS contain high-quality information
"First IFRS reporting period": the reporting period covered by the first IFRS financial statements.
"Date of transition to IFRS": the date at the start of the earliest period for which comparatives are provided in it
Most financial statements cover a period for a year and give comparative information for the previous year. So

Example
Tom Ltd first adopts IFRS in 2023

The first IFRS reporting period is year ended 31 December 2023

The date of transition to IFRS is 1 January 2022.

Need to prepare an "opening IFRS statement of financial position as at the date of transition". This statement r

1. Recognise all assets and liabilities whose recognition is required by international accounting standards, eve

E.g. IAS 19 Employee Benefits requires an employer to recognise its liabilities under defined benefit pension p

2. Don't recognise items as assets or liabilities if this is not permitted by the international standards.

E.g. IAS 38 Intangible Assets does not permit recognising expenditure on any of the following as an intangible

3. Reclassify items which were recognised as one type of asset or liability under previous GAAP, but which are

E.g. IFRS 7 Financial Instruments Presentation has principles for classifying items as financial liabilities or equ

4. Apply international standards in measuring all recognised assets and liabilities.

Must use the same accounting policies in the opening IFRS statement of financial position and in all periods pr

These policies must comply with all international standards in force at the end of the first IFRS reporting perioc

Certain reconciliations are required:

A reconciliation of equity (capital and reserves) as reported under previous GAAP with equity recalculated und

A reconciliation of total comprehensive income for the last period in which the entity reported under previous G

Example
Tom Ltd adopts IFRS in 2022
Its last financial statements under previous GAAP were to the year ended 31 December 2021
The company must prepare:
A reconciliation of equity at two dates: 1 January 2021 and 31 December 2021
A reconciliation of total comprehensive income for year to 31 December 2021
See Ryanair example on Blackboard

Example
A company which has always prepared financial statements to 31 December, prepares its first IFRS financial s

Requirement:
Identify the first IFRS reporting period and state the date of transition to IFRS
Explain the procedure which must be followed in order to prepare the financial statements for the year to 31/12
Identify the reconciliations which the company must include in its financial statements for the year to 31/12/21.

Solution
(a) First IFRS reporting period = year to 31/12/21
Date of transition to IFRS = beginning of business on 1/1/20 (close of business on 31/12/19)

(b) The procedure is as follows:
An opening IFRS statement of financial position as at 31/12/19 (or 1/1/20) must be prepared in accordance wit
The company must then prepare a revised version of the financial statements for the year to 31/12/20, again fo
The financial statements for the year to 31/12/21 are then prepared.

(c) Required reconciliations:

A reconciliation of the company’s equity as reported under previous GAAP, with equity as calculated under the
A reconciliation of the company’s total comprehensive income as reported under previous GAAP for the year t

Required readings
Chapter 1 (Melville)
Kirwan and Pierce (2017). The role and current status of IFRS in the completion of national accounting rules –
Podcast: https://www.charteredaccountants.ie/Accountancy-Ireland/Podcasts
(June 2017 – Regulation)