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IFRS Foundation: Framework-based IFRS Teaching Material

Introduction to a Framework-based teaching approach to accounting for property, plant and equipment and other non-financial assets



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A Framework-based teaching approach to accounting for property, plant and equipment

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This material has benefited greatly from the feedback and comments from people attending a series of workshops on the Framework-based approach to teaching International Financial Reporting Standards (IFRS) organised by the IFRS Foundation and others and from peer reviews by a number of a number of anonymous reviewers.

Introduction

This material has two parts. The aim of the first part is to explain what is meant by Framework-based teaching and why it is important and useful for educators. We demonstrate how a Framework-based approach could be used in each of the three stages of the learning continuum typically followed by Chartered Accountant (CA)/Certified Public Accountant (CPA) stream students and illustrate this by reference to the IFRS requirements for property, plant and equipment (IAS 16 *Property, Plant and Equipment* and Section 17 *Property, Plant and Equipment* of the *IFRS for Small and Medium-sized Entities (SMEs)*).

The second part presents teaching material that could be used by educators of Stages 1, 2 and 3 classes. The aim of the second part is to provide reference material and examples that are relevant for students being taught using a Framework-based teaching approach. The Stage 1 material comprises summary notes for students from relevant sections of the *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*), IAS 16 and Section 17. It also contains examples and discussion questions relating to the identification, recognition, measurement, derecognition and judgements and estimates in accounting for property, plant and equipment (PPE). The final section of the Stage 1 material presents an example of a tutorial question and a suggested answer.

The Stage 2 material includes reference material (a reading list for review before class) and other class material to assist educators with teaching PPE with other non-financial assets. It also includes notes for students based on extracts from the *Conceptual Framework* and the main principles in IAS 16 and Section 17 of the *IFRS for SMEs*. The notes include examples and discussion questions relating to the identification, recognition, measurement, derecognition and presentation and disclosure of PPE and a discussion of significant judgements and estimates in accounting for PPE. A set of assignment questions is then presented followed by a tutorial question and a suggested answer.

The Stage 3 material is an integrated case study.

Part 1: Framework-based teaching

The Conceptual Framework

The objective of the *Conceptual Framework* is to “facilitate the consistent and logical formulation of IFRSs” (paragraph 8 of the Preface to IFRS). In other words, the *Conceptual Framework* sets out the agreed concepts on which the IASB bases Standards. Consequently, most IFRS requirements are consistent with the concepts set out therein. However, application of the cost constraint¹ continues to result in some IFRS requirements that do not maximise the qualitative characteristics or other main concepts in the *Conceptual Framework*.

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.² Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit (see paragraph OB2 of the *Conceptual Framework*). In order to assess an entity’s prospects for future net cash inflows, existing and potential investors, lenders and other creditors need information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity’s management and governing board have discharged their responsibilities to use the entity’s resources (see paragraph OB4 of the *Conceptual Framework*).

The main concepts in the *Conceptual Framework* that flow from the objective of general purpose financial reporting include the qualitative characteristics of useful financial information, the definitions of the elements of financial statements and the accrual basis of accounting. Because these and other aspects of the *Conceptual Framework* flow logically from the objective of general purpose financial reporting, a good understanding of the objective is fundamental to Framework-based teaching. It is vital to focus on the principles of accounting that underpin the topic under discussion and why particular accounting techniques are used to process the related information prior to illustrating the mechanics involved in the process itself—such principle-based understanding enables students to cope with previously unseen situations, whereas process-driven learning allows students only to cope with situations with which they are familiar.

Framework-based teaching

Framework-based teaching relates the concepts in the *Conceptual Framework* to the particular IFRS requirements being taught. In other words, Framework-based teaching relates the accounting and reporting of the entity’s economic resources, claims against the entity, and

¹ When setting Standards, the IASB assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information (paragraph QC38 of the *Conceptual Framework*).

² Many of those users cannot require the reporting entity to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need (paragraph OB5 of the *Conceptual Framework*). Consequently, they are considered to be the primary users of financial statements.

changes in its resources and claims, and other transactions and events, to the objective of financial statements and the main concepts that flow from that objective.

To use Framework-based teaching, students must first be taught the objective of financial reporting and the other main concepts set out in the *Conceptual Framework* and the economics of the particular transaction or event to be accounted for. Then the class can reflect on what information about the resulting economic resources of the entity or the resulting claims against the entity (and changes in those resources and claims) would be useful to existing and potential investors, lenders and other creditors to help them to assess the prospects for future net cash inflows to the entity (ie students should relate the economic phenomenon to the objective of financial reporting).

In this material, the following steps are covered:

- (a) First, the identification of the element in the transactions presented (ie asset, liability or equity) is emphasised.
- (b) Secondly, classification of the identified element (ie an asset is classified as PPE) is discussed. This approach is clearly evident in the format of all journal entries presented in the material (ie Dr Asset—PPE).
- (c) Thirdly, students are introduced to the relevant IFRS requirements.
- (d) Finally students could also be exposed to the main principles in IASB Discussion Papers or proposed Standards (Exposure Drafts) that, if adopted, would replace the current IFRS requirements. Such material should be the focus of educator-led discussions.

Using a Framework-based approach, teaching is enriched by discussing the extent to which the requirements (or proposed requirements) are consistent with the objective and concepts set out in the *Conceptual Framework*. Similarly, in jurisdictions in which IFRS co-exists with local general purpose financial reporting standards (local GAAP) that are based on a similar conceptual framework, Framework-based teaching provides an effective and efficient basis for teaching both sets of standards simultaneously.

Because the objective of the *Conceptual Framework* is to facilitate the consistent and logical formulation of IFRS, adopting a Framework-based approach when teaching IFRS provides students with a cohesive understanding of IFRS by relating the IFRS requirements to the objective of IFRS financial information and the concepts that underlie IFRS and inform its development. Furthermore, IFRS teachers should explain why, for some IFRS requirements, the IASB concluded that it was not cost-beneficial to maximise the qualitative characteristics or other main concepts in the *Conceptual Framework*. The IASB's reasons are usually set out in the Basis for Conclusions that accompanies, but does not form part of, the particular Standard. In some instances, in order for a Standard to be finalised, a compromise must be reached. In such cases, certain IASB members who do not fully agree with the requirements of the Standard as they are written (or who disagree with certain requirements) provide their differing opinions in the form of a Dissenting Opinion to the Standard. It is useful to refer students to such Dissenting Opinions to illustrate further the judgements necessary in the application of the *Conceptual Framework* in the 'formulation' of Standards (for example, see the Dissenting Opinions to IAS 38 *Intangible Assets*).

A Framework-based approach to teaching IFRS also allows for similar topics to be taught more effectively and efficiently—similar economic characteristics can be focussed on and differences highlighted.

To a large extent, financial statements that conform to IFRS are based on estimates, judgements and models rather than exact depictions. Because the *Conceptual Framework* establishes the concepts that underlie those estimates, judgements and models, it provides a basis for the use of judgement in resolving accounting issues. For example, if there is no explicit IFRS requirement that applies to a transaction, other event or condition, management uses its judgement to develop and apply an accounting policy that results in information that is relevant to the economic decision-making needs of users and is faithfully represented (ie resulting in a neutral, complete and faithful representation of the financial position, financial performance and cash flows of the entity, which reflects the economic substance of the economic phenomenon) (see paragraph 10 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*). The second level of the hierarchy³ for applying that judgement requires that management refer to and consider the definitions, recognition criteria and measurement concepts in the *Conceptual Framework* (see paragraph 11 of IAS 8).⁴

Classes in Stages 1, 2 and 3

For the reasons set out above, Framework-based teaching should also better prepare students to update their IFRS knowledge and competencies continuously in the context of life-long learning.

Framework-based teaching can be used at all levels at which IFRS is taught. However, the number of IFRS requirements covered and the extent of integration with other IFRS topics and related disciplines (for example, finance, tax, economics and statistics) would vary depending upon the objectives of the course and the level at which the Standards are taught. Similarly, the teaching objectives regarding IFRS estimates and other judgements would progress from awareness through understanding to competence depending upon the objectives of the course and the level at which the Standards are taught. The table below maps the progression of Framework-based teaching of CA/CPA stream students at three stages:

- (a) Stage 1: a student's first financial reporting course;
- (b) Stage 2: a financial reporting course mid-way to qualifying as a CA or CPA; and
- (c) Stage 3: a course immediately before qualifying as a CA or CPA.

The stages are necessarily broadly defined to take into account the many different approaches to qualifying as CAs and CPAs worldwide. We do not suggest that PPE is taught as a separate topic on three occasions. Instead, we provide material that can be used at various stages when PPE is taught and when PPE examples are relevant to other topics (for example, impairment, fair value measurement, provisions).

³ The sources considered (in their descending order) in paragraph 11 of IAS 8 are often referred to as the 'hierarchy' used when applying the provisions of IAS 8.

⁴ For more information about Framework-based teaching see Wells, M. (2011) Framework-based teaching of principle-based standards, *Accounting Education: An international journal* Vol. 20 No. 4: 373:385.

	Stage 1	Stage 2	Stage 3
Reference material: Standards and other pronouncements	Extracts from the <i>Conceptual Framework</i> and basic IFRS principles.	The <i>Conceptual Framework</i> , IFRS principles and the <i>full text of IFRS requirements</i> on the topics being taught.	The <i>Conceptual Framework</i> , the <i>full text of IFRS requirements</i> , local GAAP requirements (if any) and core principles in IASB Discussion Papers (DPs) and Exposure Drafts (EDs).
Suggested class material	<ul style="list-style-type: none"> reference material (above); notes (see Part 2 for example of notes for property, plant and equipment (PPE)); and tutorials (see Part 2 for an example of a tutorial for property, plant and equipment (PPE)). 	<ul style="list-style-type: none"> reference material as set out in <i>A Guide through IFRS</i> (use in class and open-book examinations); IFRS Foundation <i>IFRS for SMEs</i> training modules (free from www.ifrs.org); IFRS financial statements (free from company websites or from university databases or EDGAR online etc); relevant published regulatory decisions (for example, ESMA⁵ decisions—free from ESMA website); relevant press articles; notes (see below for example of notes for PPE); and tutorials. 	<ul style="list-style-type: none"> <i>A Guide through IFRS</i> (use in class and open-book examinations); IASB DPs and EDs (free from www.ifrs.org); local GAAP; IFRS financial statements (free from company websites or from university databases or EDGAR online etc); relevant published regulatory decisions (for example, ESMA decisions—free from ESMA website); relevant press articles; advanced tutorials; and integrated case studies.
IFRS judgements and estimates	Create <i>awareness</i> of IFRS judgements and estimates. Some ideas: <ul style="list-style-type: none"> video/web clips; class discussions; and basic tutorials. 	Develop <i>understanding</i> of selected IFRS judgements and estimates. Some ideas: <ul style="list-style-type: none"> video/web clips; class discussions; advanced tutorials; group competitions; extracts from published financial statements; select regulatory decisions; and select press reports. 	Develop <i>competence</i> in making IFRS judgements and estimates. Some ideas: <ul style="list-style-type: none"> video/web clips; class discussions; advanced tutorials; case studies; group competitions; extracts from published financial statements; select regulatory decisions; and select press reports.
Integration of IFRS topics	Very little, if any.	Moderate.	Significant.
Integration with other accounting related disciplines (for example, auditing, finance, tax)	Very little, if any.	Moderate.	Significant.

⁵ ESMA is the *European Securities and Markets Authority*. See <http://www.esma.europa.eu/>

IFRS and accounting for property, plant and equipment

As jurisdictions implement IFRS, many find that the accounting for fixed assets is a special challenge (Upton, 2010).⁶ The previous accounting in such jurisdictions was often influenced or governed by tax or central government planning, rather than financial reporting principles designed to inform capital allocation decisions. Some other jurisdictions, where accounting was based on concepts similar to those that underlie IFRS, had developed prescriptive rules and industry-specific guidance that replaced the use of judgement in accounting for PPE. Because IFRS is made up of principle-based Standards designed for use globally and across all industries it does not include such prescriptive rules and industry-specific guidance. Consequently, applying IFRS requires the use of estimates and other judgements. This material shows how Framework-based teaching can be used to better prepare students studying IFRS to make the estimates and other judgements that are necessary to apply IAS 16 and Section 17 of the *IFRS for SMEs*.

The table below maps the progression of CA/CPA stream students learning how to account and report PPE in accordance with IFRS using a Framework-based teaching approach:

	Stage 1	Stage 2	Stage 3
Reference material: Standards and other pronouncements	<ul style="list-style-type: none"> • Extracts from the <i>Conceptual Framework</i>: objective, qualitative characteristics, element definitions, recognition criteria; and • main principles in IAS 16: definition of PPE, cost, revaluation, depreciation, impairment and derecognition. 	<ul style="list-style-type: none"> • <i>Conceptual Framework</i>; • IAS 16 and/or Section 17 of the <i>IFRS for SMEs</i>; and • Basis for Conclusions on IAS 16. 	<ul style="list-style-type: none"> • <i>Conceptual Framework</i>; IASs 16, 23 and 36, IFRS 5 and IFRIC 1; • Basis for Conclusions on relevant Standards; • main principles in IASB EDs and DPs; and • local GAAP.
IFRS judgements and estimates	Create awareness of the basic estimates required for depreciation (for example, depreciation method, useful life and residual value).	Facilitate the development of an understanding of the judgements and estimates (see those described in pages 25–27 of Module 17 of the IFRS Foundation training material on the <i>IFRS for SMEs</i>) by using: examples, published financial statements, published regulatory decisions and press reports.	Facilitate the development of competence in making IFRS estimates and other judgements by, for example, using case studies that require judgement in making estimates and other judgements, published financial statements, published regulatory decisions and press reports.
Integration of IFRS topics	Very little, if any.	Introduction to IFRSs 3, 5, 10 & 11, IASs 1, 8, 10, 12, 17, 20, 21, 23, 27, 34, 36, 37 & 38, IFRICs 1 & 18 and SIC 25	Significant integration, commonly including IFRSs 3, 5, 10 & 11, IASs 1, 8, 10, 12, 17, 20, 21, 23, 27, 31, 34, 36, 37 & 38, IFRICs 1 & 18 and SIC 25.
Integration with other accounting related disciplines	Very little, if any.	Some integration with auditing, finance and taxation.	Increased integration with auditing, finance and taxation.

⁶ Upton, W. Depreciation and IFRS, 2010. Available at <http://www.ifrs.org/Use-around-the-world/Education/Pages/Occasional-Education-Notes.aspx>