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IFRS Foundation: Framework-based IFRS Teaching Material

Introduction to a Framework-based approach to teaching the IAS 8 hierarchy



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A Framework-based approach to teaching the IAS 8 hierarchy

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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 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 teaching Chartered Accountant (CA)/Certified Public Accountant (CPA)-stream (or equivalent) students and illustrate this by reference to the general requirements that apply in the absence of an IFRS that specifically applies to a transaction, other event or condition. In this material particular focus is given to developing students' ability to *use their judgement* in developing and applying an accounting policy that results in information that is, among other things, relevant to the economic decision-making needs of primary users—existing and potential investors, lenders and other creditors who cannot require the reporting entity to provide information directly to them¹—and that is reliable (see paragraph 10 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*).²

The second part presents teaching material that could be used by educators to teach the IAS 8 hierarchy. The aim of the second part is to provide a case study that is relevant for students being taught using a Framework-based teaching approach. Applying the IAS 8 hierarchy requires knowledge of other IFRSs and the application of judgement. Consequently, the IAS 8 hierarchy is likely to be taught only towards the end of a course of study that leads to qualifying as a CA, CPA or equivalent. The teaching material is an integrated case study.

¹ See, for example, paragraphs OB2 and OB5 of the *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*).

² Paragraph 10.4 of the *IFRS for SMEs* specifies similar general requirements for entities that use that Standard.

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 in the *Conceptual Framework*. However, application of the cost constraint³ 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.⁴ 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 before 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

³ 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*).

⁴ 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* as well as 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 phenomenon⁵—the reporting entity’s economic resources, claims against the reporting entity and the effects of transactions and other events and conditions that change those resources and claims—to the objective of financial reporting).

In this material, the following steps are covered:

- (a) First, the economics of the economic phenomenon—such as transaction, other event or condition—is discussed.
- (b) Secondly, the elements in the transactions presented (ie asset, liability, equity, income, expense) are identified.
- (c) Thirdly, students explore what information about the economic phenomenon would be relevant to the economic decision-making needs of primary users—existing and potential investors, lenders and other creditors who cannot require the reporting entity to provide information directly to them—and that is reliable (information that can be faithfully represented etc).
- (d) Fourthly, students identify the IFRS requirements that explicitly specify accounting for the identified economic phenomenon. If no explicit IFRS requirement is found, then students identify the general requirements that apply in the absence of an IFRS that specifically applies to a transaction, other event or condition (ie paragraphs 10–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*—‘the IAS 8 hierarchy’).
- (e) Finally, students explore making the judgements that are necessary to account for and disclose the phenomenon. 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 resulting accounting policy is consistent with the objective and concepts set out in the *Conceptual Framework*. Similarly, in jurisdictions in which IFRS coexists 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 to the concepts that underlie IFRS as well as inform its development.

⁵ see paragraph QC2 of the *Conceptual Framework*

Furthermore, 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, when applying the IAS 8 hierarchy 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 reliable—including 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). The second level of the hierarchy⁶ 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).⁷

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 lifelong learning.

Classes at 3 stages

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 (or equivalent) students at three stages:

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

Not all topics are taught at all stages. For example, because applying the IAS 8 hierarchy requires knowledge of all IFRSs, and its application requires much judgement, the IAS 8 hierarchy is likely to be taught only at Stage 3. The Stage 3 material is an integrated case study.

⁶ 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.

⁷ 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 (for example, see http://www.ifrs.org/Use-around-the-world/Education/Pages/Framework-based-teaching-material.aspx); and tutorials (for example, see http://www.ifrs.org/Use-around-the-world/Education/Pages/Framework-based-teaching-material.aspx). 	<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 (available free from company websites or from university databases or EDGAR online etc); relevant published regulatory decisions (for example, ESMA⁸ decisions—available free from ESMA website); relevant press articles; notes (for example, see http://www.ifrs.org/Use-around-the-world/Education/Pages/Framework-based-teaching-material.aspx); and tutorials (for example, see http://www.ifrs.org/Use-around-the-world/Education/Pages/Framework-based-teaching-material.aspx). 	<ul style="list-style-type: none"> <i>A Guide through IFRS</i> (use in class and open-book examinations); IASB DPs and EDs (available free from www.ifrs.org); local GAAP; IFRS financial statements (available free from company websites or from university databases or EDGAR online etc); relevant published regulatory decisions (for example, ESMA decisions—available free from ESMA website); relevant press articles; advanced tutorials; and integrated case studies (for example, see http://www.ifrs.org/Use-around-the-world/Education/Pages/Framework-based-teaching-material.aspx).
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; selected regulatory decisions; and selected 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; selected regulatory decisions; and selected 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.

⁸ ESMA is the European Securities and Markets Authority. See <http://www.esma.europa.eu/>

Teaching the IAS 8 hierarchy

As jurisdictions implement IFRS, many find that applying IFRS principles is a special challenge. The previous accounting in many jurisdictions was often more rule-based—governed by tax or central government planning, rather than by 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. 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 judgements that are necessary to apply the IAS 8 hierarchy.

The table below sets out the reference material, judgements and the level of integration that is relevant to CA-/CPA-stream (or equivalent) students who are learning how to apply the IAS 8 hierarchy using a Framework-based teaching approach:

	Stage 3
Reference material: Standards and other pronouncements, projects and materials	<ul style="list-style-type: none"> • <i>Preface to International Financial Reporting Standards</i>; • <i>The Conceptual Framework for Financial Reporting</i>; • all IFRSs with particular focus on applying paragraphs 10–12 of IAS 8; • The material that accompanies, but does not form part of, IFRS (for example, the Basis for Conclusions, Illustrative Examples and Implementation Guidance); • Agenda Decisions of the IFRS Interpretations Committee; • the <i>IFRS for SMEs</i> (including the Basis for Conclusions on the <i>IFRS for SMEs</i>); • local GAAP, if any; • relevant requirements of other GAAPs that have a similar conceptual framework to the IASB's <i>Conceptual Framework</i>; • relevant IASB projects and related materials developed by others. For example, the IASB's research project on accounting for business combinations under common control see http://www.ifrs.org/Current-Projects/IASB-Projects/Business-Combinations/Pages/Business-Combinations-under-Common-Control.aspx and examples of related material prepared by others including: (i) the April 2013 Korea Accounting Standards Board Research Report No.33 Critical Perspectives in Accounting for BCUCC; and (ii) the October 2013 European Financial Reporting Advisory Group (EFRAG) and Organismo Italiano di Contabilità Discussion Paper Accounting for Business Combinations Under Common Control; and • relevant published regulatory decisions.
IFRS judgements	Facilitate the development of competence in making IFRS judgements to apply the IAS 8 hierarchy by, for example, using case studies that require such judgement, published financial statements that show application of the IAS 8 hierarchy, published regulatory decisions and press reports that deal with the application of the IAS 8 hierarchy, if any.
Integration of IFRS topics	The <i>Conceptual Framework</i> and all IFRSs
Integration with other accounting related disciplines	Integration with auditing, finance and taxation.