

2014

IFRS Foundation: Framework-based IFRS Teaching Material

# Stage 3– the IAS 8 hierarchy



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## Part 2: teaching material

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### Stage 3: teaching material

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Material on the IAS 8 hierarchy—the general requirements that apply in the absence of an IFRS that specifically applies to a transaction, other event or condition—<sup>1</sup>is not presented for Stage 1 and 2 students. Applying the IAS 8 hierarchy requires knowledge of all IFRSs and the application of judgement. Consequently, the IAS 8 hierarchy is likely to be taught only toward the end of a course of study that leads to qualifying as a CA, CPA or equivalent.

The teaching material at Stage 3 on the IAS 8 hierarchy is an integrated case study. In this material particular focus is given to developing students' ability to *use their judgement* in developing and applying accounting policies 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 them.<sup>2</sup> (see paragraph 10 of IAS 8).

Teaching at Stage 3 should focus on enhancing the ability of students to make the estimates and other judgements that are necessary to account for economic phenomena (transactions, conditions and events) in accordance with IFRS. To do so effectively, a teacher could explore, in class discussions, the judgements about the accounting and reporting of economic phenomena that are unfamiliar to the students. The *Amalgam case study* presented below is an example of the type of material that could be used to support the Framework-based teaching of the IAS 8 hierarchy in Stage 3 classes.

We recommend that the teacher provides a meaningful Framework-based learning experience that contributes to a cohesive understanding of IFRS by:

- (a) initiating the class discussion on the case study with a simple question: what information about particular economic phenomena (transaction, condition or event) in the case study would existing and potential investors, lenders and other creditors find most relevant in making decisions about providing resources to the entity?
- (b) extending that discussion to consider whether the most relevant information is available and can be faithfully represented. If it is not available or cannot be faithfully represented, then consider what information that can be faithfully represented, in a manner whose benefits exceed the cost of obtaining it, would best meet the objective of financial reporting;
- (c) identifying the elements (ie assets, liabilities, equity, income and expenses) of the entity using the definition of an elements in the *Conceptual Framework*;
- (d) facilitating, for each identified economic phenomenon, a discussion of which IFRS (or IFRSs) applies to the accounting for each of the identified economic phenomena. If no explicit IFRS requirement is found, then the teacher can introduce the IAS 8 hierarchy;

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<sup>1</sup> See paragraphs 10–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

<sup>2</sup> See, for example, paragraphs OB2 and OB5 of the *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*).

- (e) facilitating a discussion about how to apply paragraphs 10–12 of IAS 8 to develop and apply an accounting policy for such an economic phenomenon; and
- (f) focusing discussions mostly on those issues that involve significant judgements and estimates, thereby honing the students’ ability to make the judgements and estimates that are necessary to apply IFRS.

### How to get the most out of the case study

Completing the *Amalgam case study* will necessarily require students to consider a diverse range of economic phenomena for which there are no explicit IFRS requirements. Discussion of the judgements in this case study necessarily includes key aspects of the *Conceptual Framework* and any IFRSs dealing with issues that are similar and related to those presented in the case study. Discussion may also include the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, as well as other accounting literature and accepted industry practices.

The case study could easily be extended to include aspects of corporate governance, managerial accounting and finance by, for example, asking the students to perform financial modelling for the entity separately for each of the possible accounting treatments identified for each economic phenomenon presented in the case study to which the IAS 8 hierarchy applies—because IFRS does not explicitly specify accounting and reporting for that transaction. That discussion could also explore what might be a motivation for the choice of one method compared to another and whether that motivation is consistent with the objective of financial reporting.

The case study can also be extended to the accounting for income tax, by assuming that the tax laws of a jurisdiction that the students are familiar with apply to the entity. Furthermore, the case could be extended to the multidisciplinary accounting subject of taxation by, for example, asking students to discuss possible tax planning strategies for the entity.

If the IASB is considering changing an IFRS requirement (for example, by publishing a Discussion Paper or Exposure Draft) relevant to the information in the case study, or the IFRS Interpretations Committee (the ‘Interpretations Committee’) is considering developing an Interpretation (or has stated why it is not developing an Interpretation) on an issue that is relevant to the case study, the teacher could lead a discussion about the extent to which the principles under development would result in information that better serves the objective of financial reporting.

Similarly, if the students are also studying another reporting framework (for example, the *IFRS for SMEs*<sup>3</sup> or a local GAAP), discussing which reporting framework provides more useful information to potential and existing investors, lenders and other creditors for making decisions about providing resources to the entity strengthens the cohesiveness of the students’ understanding of financial reporting.

Finally, by modifying the fact pattern presented in the case study the teacher can further enhance the class discussion. For example, the teacher could extend the discussion on business combinations under common control by asking the class to consider how, if at all, their answer to the case would change if Amalgam was wholly owned by Mrs C.

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<sup>3</sup> In particular, see paragraphs 10.4–10.6 of the *IFRS for SMEs*.

The case study is also an example of the type of material that could be adapted to test whether students have developed the capability to make the judgements that are necessary to apply the IAS 8 hierarchy.

When class time is limited, discussion can easily be segregated into a number of parts for discussion in separate sessions.

### **Stage 3: reference material**

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The following materials may be useful as references:

- (a) *Preface to International Financial Reporting Standards*;
- (b) *The Conceptual Framework for Financial Reporting (Conceptual Framework)*;
- (c) International Financial Reporting Standards (Standards), issued by the International Accounting Standards Board (IASB), comprising:
  - (i) International Financial Reporting Standards;
  - (ii) International Accounting Standards;
  - (iii) IFRIC Interpretations; and
  - (iv) SIC Interpretations;
- (d) the material that accompanies, but does not form part of, the Standards (for example, the Basis for Conclusions, Illustrative Examples and Implementation Guidance);
- (e) Agenda Decisions of the IFRS Interpretations Committee;
- (f) the *IFRS for SMEs* (including the Basis for Conclusions on the *IFRS for SMEs*);
- (g) if different from IFRS, local GAAP;
- (h) the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards to IFRS (for example, US GAAP);
- (i) relevant IASB projects and related materials developed by others;
- (j) Discussion Papers and Exposure Drafts issued by the IASB; and
- (k) relevant published regulatory decisions.

### **Stage 3: class material**

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- (a) *A Guide through IFRS* (including reference material (a)–(e) above);
- (b) the IFRS Foundation *IFRS for SMEs* training modules;
- (c) relevant extracts from the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards to IFRS;
- (d) selected extracts from relevant other accounting literature;
- (e) selected annual financial statements and other documents that provide evidence of relevant accepted industry practices;

- (f) relevant issues being considered by the IASB<sup>4</sup> 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 for examples of related material prepared by others see: (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](#);
- (g) issues being considered by the Interpretations Committee;<sup>5</sup>
- (h) relevant published IFRS regulatory decisions;
- (i) relevant IFRS press coverage; and
- (j) case studies (for example, the case study provided below).

### Stage 3: case study

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#### Learning objectives

By completing the *Amalgam case study*, students should enhance their ability to:

- (a) identify information about economic phenomena that, within the context of the objective of financial reporting as set out in the IASB's *Conceptual Framework* would be relevant to the economic decision-making needs of users and that is reliable (for example, can be faithfully represented);
- (b) understand the judgements that must be exercised when accounting for, and reporting, economic phenomena in accordance with IFRS when applying the IAS 8 hierarchy; and
- (c) develop the ability to make the judgements necessary to apply the IAS 8 hierarchy for a variety of economic phenomena.

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<sup>4</sup> The following links should be provided to students: <http://www.ifrs.org/Current-Projects/IASB-Projects/IASB-agenda-consultation/Pages/IASB-agenda-consultation.aspx> and <http://www.ifrs.org/Current-Projects/IASB-Projects/Pages/IASB-Work-Plan.aspx>.

<sup>5</sup> The following link should be provided to students: <http://www.ifrs.org/Current-Projects/IFRIC-Projects/Pages/IFRIC-Projects.aspx>.