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Visual Representation of Accounting Standards

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The new normal in the regulatory environment of financial reporting is rapid changes in accounting standards with large philosophical and conceptual shifts in underlying principles. For example, in the realm of the International Financial Reporting Standards (IFRS), newly issued IFRS 9 *Financial Instruments*, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 13 *Fair Value Measurement* have significant impacts on the future of financial reporting. Further, the exposure drafts on lease accounting and revenue recognition are likely to be released in the year 2014 that would change well-established accounting approaches. An accounting professor faces the tremendous challenge of equipping students to deal with the rapid change in accounting standards. This paper offers a project assignment that accounting professors teaching the Advanced Financial Accounting (AFA) course can use to instill in students the skills of analyzing and deconstructing the logical flow of an accounting standard. This project assignment has been rated on “quality and usefulness” by students as “most useful” at a very high score of 6.54 out of a perfect score of 7, which is 95th percentile in the university-wide ranking.

Learning Outcomes

This project aims to achieve the following learning goals:

- Instil in students an independent and pro-active learning spirit to deal with dynamic changes in financial reporting.
- Students to acquire skills of analyzing, deconstructing and identifying the conceptual underpinnings in International Financial Reporting Standards (IFRS) and better understand the standards.
- Students to be able to visually represent the flows and connectivity within the new accounting standard on determination of control in special situations. The new standard will have a major impact on determining the boundaries of economic unit reporting in the future.
- The ability of students to critically evaluate the standard and implementation issues.

Assignment Idea

A new accounting standard or exposure draft is chosen. Examples are IFRS 9 *Financial Instruments*, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 13 *Fair Value Measurement* and exposure drafts on leases and revenue recognition. We used IFRS 10 in our assignment.

Resources were provided to students to facilitate their independent learning. Guest speakers were invited to speak on the new standards. Students are required to read the basis of conclusions for the new standard to understand the rationale for its requirements. Students form teams to read, analyze and draw the flow of the selected standard’s requirements.

Students are given a free hand to use their creativity to present the flows in an interesting and visually appealing manner. For example, they may use decision flowcharts, mental mapping techniques, concept flows or any suitable form to visually represent the contents of a standard. The students need to apply their decision flowcharts to a real-life case and interpret the effects the new standard has on existing practices.

Background on IFRS 10

On 12 May 2011, the International Accounting Standards Board (IASB) issued IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*.

Sir David Tweedie, Chairman of the IASB made the following comments:

These improvements tighten up the reporting requirements for the consolidation of subsidiaries and special purpose vehicles, and require the substance of joint arrangements to be revealed. The comprehensive disclosure requirements will help investors to understand better risks associated with the creation or management of special purpose vehicles. As a package, these changes will provide a check on off balance sheet activities and give investors a much clearer picture of the nature and extent of a company's involvement with other entities.

IFRS 10 seeks to resolve divergent practices arising from the differences in the concept of control in the incumbent standards IAS 27 (source of Singapore's FRS 27) *Consolidated and Separate Financial Statements* and SIC-12 (source of Singapore's INT FRS 112) *Consolidation – Special Purpose Entities* and the inconsistent application of this concept among entities and across situations. For example, entities had different applications of the control concepts in circumstances where the investor controls the investee but with less than the majority of the voting rights, special purpose entities, agency relationships or protective rights.

IAS 27 defines control as the power to govern financial and operating activities of an entity to obtain benefits from these activities. SIC-12 places greater emphasis on risks and rewards in the context of special purpose entities. This conflict between the two standards leads to inconsistent application of the standards. IFRS 10 replaces SIC-12 and the consolidated financial statement requirements in IAS 27.

The financial crisis of 2008 also highlighted an urgent need to clarify the concept of control to ensure that special purpose entities do not remain as off-balance sheet vehicles when these vehicles are a source of significant risks to investors. Towards this end, IFRS 10 provides an overarching conceptual framework that governs the determination of control for all arrangements, including those arising from non-voting rights. The International Accounting Standards Board (IASB) issued IFRS 10 in May 2011 and requires the standard to be effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted (IASB, 2011).

Instructions to Students

The focus of this assignment is on the definition of control in IFRS 10 *Consolidated Financial Statements* and the application of this definition to special situations. IFRS 10 sets out the definition and principles relating to control to enable entities to determine the boundaries for consolidation of subsidiaries. The elaboration of the principle of control is spelt out in both the standard and its Application Guidance. Hence, your responses to the detailed assignment questions should incorporate the principles for determining control in IFRS 10, with appropriate definitions in Appendix A and the Application Guidance of IFRS 10 in

Appendix B. You need not consider the accounting requirements relating to the consolidation process and loss of control (paragraphs 19 to 26 of IFRS 10 and the related Application Guidance). To add richness to your understanding of the principles and requirements of IFRS 10, you are strongly encouraged to read the Basis of Conclusions to IFRS 10¹.

Detailed Assignment Questions

1. Visually represent the requirements of IFRS 10 relating to control in a flowchart or any other suitable mode. The objective of the visual representation is to show the conceptual, logical flow and connectivity of concepts, principles and requirements in IFRS 10 and the related Application Guidance.

Some points to note:

- Examples of visual representation include decision flowcharts, concept/mind maps or schematic diagrams. There is no one prescribed mode. The visual representation can take on any form and is limited only by your imagination.
- Credit will be given for logical flow, accuracy of representation, ease of understanding, creativity and visual impact.
- Your visual representation diagrams should be as original as you are (please note instructions concerning plagiarism).
- Hand-drawn maps are acceptable.
- Your diagrams should not exceed a total of **five** single-sided A4 pages.
- There is no specified font-size but the diagrams should be legible and readable.

(40%)

2. IFRS 10 was issued to deal with situations when assessing power over an investee may not be “straightforward”. These situations may arise, for example, when the power over an entity is not obtained directly and solely from the voting rights granted by equity instruments and where more than one factor may need to be considered such as, for example, one or more contractual arrangements (paragraph 11 from IFRS 10).

Choose any one real-life entity, arrangement or relationship which, in your opinion, has a voting right structure or arrangement(s) which do not permit a “straightforward” evaluation of control. To guide your choice, your candidate should be sufficiently complex so that it is not clearly a subsidiary or clearly not a subsidiary at first glance². Your case entity should also not be totally devoid of information such that you will not be able you to proceed reasonably in your project execution or be able to make reasonable assumptions or inferences.

¹ IFRS 10, without the Basis of Conclusions, is downloadable from www.iasb.org. The Basis of Conclusions is downloadable from PwC Comperio, a database subscribed by SMU Library.

² These entities may include what the FASB describes to as “variable interest entities”. You may refer to FASB Accounting Standards Codification, Subtopic 810 to the characteristics of these entities. However, your candidate need not be restricted to these entities.

The entity³ may originate from any country but you must provide the links/source of your information which should be in the English language. It is not important to establish whether the entity presently has a controlling interest and who the interest is. You may also select an entity for which there is no existing controlling interest. In your evaluation, you will disregard the existing control relationship, if any, and evaluate the control relationship, if any, afresh using the IFRS 10 framework.

- (a) Why is the determination of control not “straightforward” in your case entity? Explain the arrangements, voting rights structure or other factors that complicates the determination of control in your case entity.
- (b) Apply your flowchart in part (1) to guide your determination of control for your entity using the IFRS 10 framework. Where information is not available at various nodes in your flowchart, you should propose “what if” scenarios and the possible paths in your flowchart for each scenario. You may also make reasonable assumptions in place of “what if” scenarios. (However, please note the condition with respect to availability of information in the selection criteria).
- (c) From your analysis, conclude whether control exists, and if so, indicate the most likely source of “control”. If you conclude that control does not exist or is ambiguous, explain your basis of conclusion.

Some points to note:

- Credit will be given for the following:
 - The choice of an interesting candidate reflecting your diligent and creative search process and understanding of the principles of IFRS 10.
 - The relevant application of control principles and factors in IFRS 10 and the logical application of your flowchart.
 - Appropriate identification of relevant information and assumptions.
 - Ability to explain the complexities of the control evaluation and application of the process.
 - Good communication skills – clear, concise and grammatically-correct expressions.
 - Sound reasoning and conclusions.
- Part (b) of Question 2 may be presented in any suitable form, e.g. a mixture of text and diagram. However, you need to be clear and relevant in all your responses, regardless of the mode of presentation.
- The page limit for parts 2 and 3 of this assignment is 12 pages, 11 pt. font size with one inch margins. The page limit includes appendices but excludes attachment of materials relating to your case entity.

³ For brevity, the term entity in this assignment refers to an arrangement, relationship, structure and any other unit that is clearly identifiable and separate from the investor or its stakeholders.

(40%)

3. From insights gained in (1) and (2), identify any five⁴ requirements in IFRS 10 and the Application Guidance that pose the greatest challenge in interpretation and application and suggest any further steps, if any, that the IASB may take to ensure greater comparability among reporting entities. If you think that no further steps need to be taken, explain your conclusion.

(20%)

Implementation

This assignment was given in term one of the 2011-2012 academic year, with submission timeline the week before the last lesson of the term. This was a group project (comprising 5 to 6 students in each group) with an assessment weighting of 20% in the AFA course. The assessment considered completeness, logical flow, ease of understanding and visual appeal of the submitted projects. An example of the rubric is attached in Appendix C.

The AFA course is a core senior level accounting course, covering advanced accounting topics relating to business combinations, inter-corporate investments, consolidation, foreign currency translation and accounting for financial instruments. This assignment was given as a research project to students at the start of the course, which tested their ability to exploit the massive knowledge resources and address the assignment questions. Students were expected to commence the project prior to the topics being taught, to acquire independent learning ability.

The soft copy of their reports was compared with other reports (past and present) and other data sources using an anti-plagiarism software. A visual comparison was made of known internet sources (e.g. the Big 4 literature) to check for plagiarism. None was detected.

As this was a group project, students could submit a peer review form in case they felt there was an unequal distribution of work within their groups. The peer review form would indicate the contributions of individual members. The professor would review the peer review forms and make a final decision. No students submitted peer review forms for this assignment.

Samples of Visual Representations

Conclusion

We present a novel approach to learning accounting standards via visual representation using decision flowcharts, mental mapping or concept charts. Students learn to visualize the requirements of a standard better. In doing so, they remember the standard in more than one way – besides cognitively processing the requirements - they visually see the connections and flow in the standard. In addition, students find the project more interesting

⁴ This assumes a group of 5 members. For equitable reasons, the number of requirements will vary according to the group size.

when they can use their creativity to express their understanding of the standard. To many, it is definitely more fun than writing an essay!

References

International Accounting Standards Board (IASB), 2011. *Basis of Conclusions on IFRS 10 Consolidated Financial Statements and Amendments to Guidance*. IASB, London, UK.

Appendix C

Group members:

| | Below expectations Below 70% | Meets expectations 70% to 79% | Moderately exceeds expectations 80% to 85% | Far exceeds expectations 86% to 100% |
|---|---------------------------------|----------------------------------|---|---|
| Q1. Visual representation (40%) | | | | |
| <ul style="list-style-type: none"> Logical flow | | | | |
| <ul style="list-style-type: none"> Accuracy of representation | | | | |
| <ul style="list-style-type: none"> Ease of understanding | | | | |
| <ul style="list-style-type: none"> Creativity and visual impact | | | | |
| Overall assessment for Q1 | | | | |
| Q2. Case analysis (40%) | | | | |
| Part (a) <ul style="list-style-type: none"> Ability to identify and explain salient control issues and complexities Choice of an interesting candidate | | | | |
| Part (b) <ul style="list-style-type: none"> Logical and systematic application of control principles and flowchart Appropriate identification of relevant information and assumptions | | | | |
| Part (c) <ul style="list-style-type: none"> Sound reasoning and conclusions | | | | |
| Overall assessment for Q2 | | | | |
| Q3. Critical analysis (20%) | | | | |
| <ul style="list-style-type: none"> Ability to explain interpretation and application challenges Overall assessment for Q3 | | | | |
| Strengths: | | | | |
| Areas for improvement: | | | | |

Overall Grade: