Incorporating International Financial Reporting Standards (IFRS) into Intermediate Accounting

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Preface

The purpose of these materials is to allow the intermediate accounting student and their faculty members to get started incorporating the International Financial Reporting Standards in their course sooner rather than later. The materials are NOT exhaustive; rather the materials cover the basic differences between U.S. GAAP and IFRS for those topics normally discussed in the Intermediate Accounting Course.

As of July 2008, there is no timetable for conversion from U.S. GAAP to IFRS for public companies operating in the United States. However, most of the rest of the developed world has adopted IFRS, so it is important that today’s accounting students have a basic understanding of these standards even if they do not become U.S. GAAP. We hope these materials help with that process.

We do not plan to update these materials. They will be available on the American Accounting Association’s web site, at http://aaahq.org/commons. If you have comments, have suggestions for improvements or corrections, please contact John Brozovsky [at jbrozovs@vt.edu] or Sam A. Hicks [at shicks@vt.edu]. If you prefer surface mail, contact either at Department of Accounting and Information Systems, Virginia Tech Mail Code 0101, Blacksburg, VA 24061. We will make corrections and add comments until December 31, 2008.
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</tbody>
</table>

## Resources

**US GAAP Codification**
http://asc.fasb.org/home

**IFRS Summaries**
Why learn IFRS?

International Financial Reporting Standards, commonly referred to as IFRS, are gaining momentum as the global norm in financial reporting. Issued by the London-based International Accounting Standards Board (IASB), IFRS is currently accepted in approximately 100 countries, including the members of the European Union, Israel and Australia. Many other countries, such as Canada, Mexico, India and Japan have committed to adopt or converge with IFRS by dates ranging from 2009 to 2011.

For years, the Financial Accounting Standards Board (FASB) has been working with the IASB as part of a long-term plan toward convergence of IFRS and U.S. generally accepted accounting principles (U.S. GAAP). With the 2007 decision of the U.S. Securities and Exchange Commission (SEC) to accept IFRS financial statements for foreign filers (without requiring reconciliation to U.S. GAAP), the timeline for U.S. adoption of IFRS is expected to accelerate at a rapid pace. In response to the SEC’s decision, accountants, managers and analysts began to question when the SEC would allow, or require, U.S. companies to use IFRS for their annual filings. While the answer to this question is still unknown, other ripple effects of the SEC’s decision can already be seen. In May 2008, the AICPA expressed its intent to incorporate IFRS into the CPA exam. In the same month, the AICPA also amended Rules 202 and 203 of the Code of Professional Conduct to recognize the IASB as an international accounting standard, allowing accountants of private US companies to prepare financial statements in accordance with IFRS.

Introduction to IFRS

Historically, multinational and global companies were required to prepare separate financial statements for each country in which they did business, in accordance with each country’s generally accepted accounting principles. In 1973, the International Accounting Standards Committee (IASC) was formed in response to the growing need to develop a set of common financial standards to address the global nature of corporate financing. In 2000, the IASC received support from the International Organization of Securities Commissioners (IOSCO), the primary forum for international cooperation among securities regulator. The IOSCO recommended its members (currently 181 organizations including the U.S. Securities & Exchange Commission and the Committee of European Securities Regulators) permit multinational companies to use IASC standards along with a reconciliation to national GAAP. In 2001, the IASC reorganized as the International Accounting Standards Board to incorporate representatives from national standard-setting organizations.

The term IFRS has both a narrow and broad definition. Narrowly, it refers to the specific set of numbered publications issued by the IASB. Broadly it refers to all publications approved by the IASB, including standards and interpretations issued by its predecessor, the IASC. Unlike U.S. GAAP, there is no hierarchy to IFRS guidance. All standards and interpretations have equal levels of authoritativeness.
Issued by the IASB:
- International Financial Reporting Standards (IFRS)
- Interpretations originated from the International Financial Reporting Interpretations Committee (IFRIC)

Issued by its predecessor, the IASC, prior to 2001:
- International Accounting Standards (IAS)
- Standing Interpretations Committee (SIC)

In practice, there is still much variance in how corporations apply IFRS. While the following descriptions of standards used by companies may sound similar, the financial statements prepared under the different methods may vary considerably:
- IFRS as national standards, with explanatory material added
- IFRS used as national standards, plus national standards for topics not covered by IFRS
- IFRS modified for national conditions
- National standards “similar to”, “based on”, or “converged with” IFRS

The IASB has no authority to enforce IFRS, and must rely on regulatory bodies of individual countries or regions. One possible method of enforcement lies in the IOSCO.

**Development of IFRS**

The IASB consists of 14 Board members, each with one vote. The Board members currently come from nine countries and have a variety of functional backgrounds. IASB board members are selected by the trustees of the International Accounting Standards Committee Foundation (IASCF), an independent organization. There are 22 trustees of the IASCF. To ensure adequate geographic representation, North America, Europe and the Asia/Oceania region each have 6 trustees. The remaining 4 trustees are appointed from any geographic area, in such a way that maintains balance both geographically and by professional background. Each trustee serves for a term of three years, renewable once. Vacancies are filled by vote of the existing trustees.

The IASB board members develop accounting standards in the following process designed to be transparent and accessible to all interested parties:
- Potential agenda items are discussed in IASB meetings. IASB meetings are open to the public, as well as broadcast and archived on the IASB website.
- Discussion papers and Exposure Drafts are published and posted on the IASB website for public comment. Public comments are also available on the IASB website.
- The IASB solicits comments from numerous standard-setting organizations and regulatory bodies. It also holds numerous meetings to obtain feedback from preparers, users, academics and other affected parties.
Status in the U.S.

The continuing globalization of business means many U.S. companies (operating or obtaining capital in foreign countries), including 40% of Global Fortune 500, are already affected by IFRS. In response to this trend, efforts have been under way to converge IFRS and U.S. GAAP since 2002. The IASB and FASB have worked together closely and developed a plan for convergence of the two sets of standards. Main areas of differences with U.S. GAAP are summarized below:

- Areas where IFRS and U.S. GAAP are not converged:
  - Consolidation policy, impairment, liabilities, intangibles
- Areas where there are differences in the “details”:
  - Revenues, income taxes, leases, pensions, business combinations, share-based payments

Despite the progress toward convergence, the financial information reported by a company may differ significantly under the two sets of standards. Historically, the SEC has allowed foreign companies trading stock on U.S. exchanges to prepare Form 20-F, their annual financial statements, in accordance with a foreign GAAP as long as reconciliation to U.S. GAAP was included. A review of 2006 reconciliations determined that approximately 2/3 of companies have higher income under IFRS, with a median increase of 12.9%. For the 1/3 of firms with lower income under IFRS, the median difference was 9.1%.

As previously mentioned, the SEC eliminated the reconciliation requirement for foreign private issuers using IFRS in November 2007. The SEC is currently considering allowing U.S. companies the option of using IFRS in the near future.

Pros and Cons

While many now believe the adoption of IFRS in the U.S. is inevitable, including AICPA President Barry Melancon, SEC chairman Christopher Cox, and the Big Four accounting firms, not everyone agrees this is in the best interest of the American public. Advocates for the U.S. adoption of IFRS believe one global set of standards will streamline costs for U.S. companies operating globally and increase comparability of financial statements between companies, resulting in lower costs of capital.

On the other hand, many people are concerned that IFRS is not as robust as U.S. GAAP, that the cost of transition will be high, and that the U.S. market is not prepared for the transition. Based on the similar transition in Europe, experts estimate the implementation of IFRS will take companies two to three years. This includes time to gather the necessary information, modify accounting and control systems, and possibly renegotiate debt and other agreements linked to financial performance. An additional concern is the lack of accounting professionals familiar with IFRS. Knowledge of IFRS will be a valuable asset as you enter the workplace during this time of dynamic change in the accounting environment.
Resources

IFRS - [http://www.iasb.org/About+Us/About+IASB/About++the+IASB.htm](http://www.iasb.org/About+Us/About+IASB/About++the+IASB.htm)

[http://www.iasb.org/About+Us/About+the+Foundation/Constitution.htm](http://www.iasb.org/About+Us/About+the+Foundation/Constitution.htm)


1 Analysis of US GAAP Reconciliations from Forms 20-F -

Exercises

1. International Financial Reporting Standards is comprised of which of the following?
   a. International Financial Reporting Standards
   b. International Accounting Standards
   c. Interpretations from the International Financial Reporting Interpretations Committee
   d. All of the above
   e. a and b

2. How can national standard-setting bodies be involved in setting International Financial Reporting Standards?
   a. Recommending topics for the International Accounting Standards Board agenda
   b. Participate in joint research projects
   c. Provide feedback on discussion papers and exposure drafts
   d. All of the above
   e. a and b

3. How are International Financial Reporting Standards enforced?
   a. Enforcement Committee of the International Accounting Standards Board
   b. Regulatory bodies of individual countries
   c. International Securities and Exchange Commission
   d. All of the above
   e. None of the above

4. Explain to a friend how accounting rules are established in the international arena.
The conceptual framework for IFRS is documented in the *IASB Framework for the Preparation and Presentation of Financial Statements* (Framework). Originally issued by the IASC in 1989, the Framework was adopted by the IASB in 1991 and serves as a guide for accounting issues not specifically addressed in the standards or interpretations. This reliance on the Framework is established in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, which states that management should use its judgment in developing accounting policies for areas in which the standards do not provide guidance. IAS 8 further requires that management consider the definitions, recognition criteria and measurement concepts for assets, liabilities, income, and expenses presented in the Framework before exercising its judgment.

The framework specifically addresses:
- Objectives of financial statements
- Qualitative characteristics
- Concepts of capital and capital maintenance
- Elements of financial statements

While there are many similarities (e.g. objectives of financial statements) between the Framework and the conceptual framework established by FASB in the six Statements of Financial Accounting Concepts, there are differences as well. The greatest difference lies in the concepts of capital and capital maintenance, which include measurement methods to be used in recognizing elements of the financial statements. While US GAAP relies primarily on historical cost (with the exception of certain financial instruments which are carried at fair value), IFRS lists several options – historical cost, current cost, realizable value, and present value – without providing guidance on which method to implement.

An additional difference is found in the elements of financial statements. While the definitions are similar for the two organizations, there are differences in the details – e.g. the line between liabilities and equity as applied to convertible debt. A minor difference is also found in the qualitative characteristics identified in each framework. The IASB Framework focuses on understandability, relevance, reliability, and comparability. US GAAP also includes these characteristics, but adds a focus on consistency – the ability to compare the financial statements of an entity at two different points in time.

As part of the long-term convergence project, IASB and FASB are jointly working on developing a conceptual framework to be adopted by both organizations. Early stages of the project include agreement on the objects, qualitative characteristics, and elements of financial statements. Later stages focus on measurement issues, reporting entities, and presentation and disclosure.
Resources
IASB Framework for the Preparation and Presentation of Financial Statements
http://www.iasb.org/NR/rdonlyres/E366C162-17E4-4FBE-80EB-7A506A615138/0/Framework.pdf

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors
http://www.iasb.org/NR/rdonlyres/F9A4C4D6-4C87-43C3-BF61-4DC8CA8BC1A1/0/IAS8.pdf

Exercises

1. The conceptual framework for IFRS addresses:
   a. Objectives of financial statements
   b. Qualitative characteristics
   c. Concepts of capital and capital maintenance
   d. All of the above
   e. None of the above

2. What is the status of the IFRS/US GAAP convergence project related to conceptual frameworks?
   a. No convergence is considered necessary, since the framework is not an accounting standard
   b. It is part of the short-term convergence project
   c. It is part of the long-term convergence project
   d. Convergence has been completed
   e. None of the above

3. What are differences between the conceptual framework for IFRS and US GAAP?
   a. Measurement methods
   b. Focus on reliability
   c. Focus on understandability
   d. a and b
   e. b and c

4. Your company is considering switching from US GAAP to IFRS. Your CEO, Julie Jones, has asked you to identify the major differences in the conceptual frameworks of US GAAP and IFRS so that she can understand the different foundations of the accounting rules.
Unit 3 – Income Statement and Other Comprehensive Income

**Income statement**

For IFRS, there is no set format for the income statement, but there are six required elements:

- Revenue
- Finance costs
- Profit or loss from associates and joint ventures accounted for using the equity method
- Tax expense
- Discontinued operations
- Profit or loss (bottom line)

The expenses may be presented by nature (e.g., depreciation, purchases, employee benefits, advertising) or by function (expenses are allocated to cost of sales, administrative expenses, distribution expenses, etc). If expenses are presented by function, additional disclosure is required for the amount of depreciation, amortization and employee benefit expense.

This differs from US GAAP, which uses a single-step (expenses are presented by function and total expenses are deducted from total income) or multi-step (calculates gross profit before other income and expenses are presented) format. The SEC requires public companies to present expenses by function.

An additional difference between the two accounting methods is that IFRS prohibits items from being presented as Extraordinary (defined for US GAAP as material transactions both unusual in nature and infrequent in occurrence) either on the face of the income statement or in the accompanying notes.

**Other Comprehensive Income**

Through 2008, IFRS does not use the term “other comprehensive income”, but reports these items in a statement entitled “Statement of Recognised Income and Expenses” (SoRIE) which includes all changes to owner’s equity that are not transactions with owners. The SoRIE is a required primary financial statement if the company elects certain accounting treatment for pension reporting. Otherwise, the company is allowed to choose whether to present the SoRIE or include comprehensive income as a component of the statement of changes in shareholder’s equity; the company is not allowed to present both statements. If the company uses the SoRIE, information regarding transactions with shareholders (dividends, shares issued, etc.) must be included in the notes to the financial statements.

IASB has issued a revised IAS 1 *Presentation of Financial Statements*, effective in 2009. The revised standard introduces the term comprehensive income, and requires a company to present either one combined statement of comprehensive income (that includes current profit and loss followed by components of other comprehensive income), or two separate statements – an income statement and a statement of comprehensive income (that begins with
net profit and loss and is followed by components of other comprehensive income). Similar to US GAAP, components of other comprehensive income may be reported net of tax, or before tax with a single line reporting tax on other comprehensive income. The footnotes should disclose the tax impact for each component of comprehensive income.

The revision to IAS 1 was a result of Phase A of the IASB’s project on financial statement presentation and brings the IFRS presentation of other comprehensive income very close to that of US GAAP. However, the revised IAS 1 prohibits the presentation of non-owner transactions (other comprehensive income) in the statement of changes in shareholders’ equity. US GAAP allows the firm to select from three alternative presentations of other comprehensive income – a separate statement, inclusion in the income statement, or inclusion in the statement of changes in stockholders’ equity. Phase B, a joint project with FASB, will focus on more detailed aspects of the financial statements – e.g. required subtotals and totals.

The appendices include sample presentations of other comprehensive income as presented by IFRS through 2008, as well as under the revised IAS 1 effective for years beginning on or after January 1, 2009.

**Minority interest**

Through 2008, net income differs between the two frameworks due to the presentation of minority interest. Minority interest refers to the ownership of a subsidiary with less than 50% interest. For US GAAP prior to 2009, a company acquiring over 50% interest in a firm reports 100% of the subsidiary’s income, but also records an expense equal to the portion of income attributed to minority shareholders of the subsidiary. Thus the parent company’s net income only includes the percentage of the subsidiary’s income attributed to the parent company. For IFRS, 100% of the subsidiary’s income is reported by the parent company and reflected in net income. A disclosure on the face of the financial statements indicates the amount of net income attributed to shareholders (of the parent company) and the amount attributed to minority interest (of the subsidiary). When foreign private issuers prepared the net income reconciliation on Form 20-F, they either included minority interest as a reconciling item or began the reconciliation with IFRS net income attributed to shareholders.

This difference will be minimized when FAS 160 *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51* becomes effective for years beginning on or after December 15, 2008. Under the new guidance, US GAAP will include 100% of the subsidiary’s income in net income. Earnings attributed to the minority interest will be subtracted on the face of the financial statements to present net income attributed to the parent.

**Resources**

IAS 1 *Presentation of Financial Statements*

Exercises

1. What items are currently required elements of the IFRS income statement?
   a. Revenue
   b. Cost of sales
   c. Comprehensive income
   d. a and b
   e. All of the above

2. Through 2008, other comprehensive income may be reported in which IFRS financial statement?
   a. Statement of comprehensive income
   b. Statement of changes in shareholders’ equity
   c. Statement of recognized income and expenses
   d. b or c
   e. All of the above

3. What change(s) is/are introduced in the revised IAS 1 *Presentation of Financial Statements* effective 2009?
   a. Allows statement of recognized income and expenses
   b. Allows statement of comprehensive income
   c. Prohibits comprehensive income from being presented in statement of changes in stockholders equity
   d. a and c
   e. b and c

4. Through 2008, how is net income attributed to minority interest presented in the IFRS income statement?
   a. Included in net income
   b. As a reduction to net income
   c. Disclosed on the face of the income statement
   d. a and c
   e. b and c
5. How must the following IFRS financial statement be changed to be in compliance for years beginning after January 1, 20X9? Assuming there are no differences in IFRS/US GAAP calculations, how must the IFRS statement be changed so the presentation is in accordance with US GAAP?

**Impressive Corp**  
**Statement of Recognised Income and Expense**  
**Year Ended December 31, 20X8**  
(dollar amounts are in millions)

<table>
<thead>
<tr>
<th></th>
<th>20X8</th>
<th>20X7</th>
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<tbody>
<tr>
<td>Unrealized gain, investments</td>
<td>$ (3)</td>
<td>$ 10</td>
</tr>
<tr>
<td>Loss on cash flow hedge</td>
<td>(5)</td>
<td>(5)</td>
</tr>
<tr>
<td>Tax on items taken directly to equity</td>
<td>3</td>
<td>(2)</td>
</tr>
<tr>
<td>Net income recognised directly in equity</td>
<td>(5)</td>
<td>3</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>130</td>
<td>100</td>
</tr>
<tr>
<td><strong>Total recognised income and expense for the year</strong></td>
<td><strong>$ 125</strong></td>
<td><strong>$ 103</strong></td>
</tr>
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</table>

6. Using the information provided in the following US GAAP financial statement, present the information in accordance with IFRS effective through 2008.

**Sanford Incorporated**  
**Statement of Operations and Comprehensive Income**  
**Year Ended December 31, 20X8**  
(dollar amounts are in millions)

<table>
<thead>
<tr>
<th></th>
<th>20X8</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$ 433</td>
<td>$ 400</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>245</td>
<td>230</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>188</td>
<td>170</td>
</tr>
<tr>
<td>Selling and administrative expenses</td>
<td>39</td>
<td>43</td>
</tr>
<tr>
<td>Income from operations</td>
<td>149</td>
<td>127</td>
</tr>
<tr>
<td>Other income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td>10</td>
<td>12</td>
</tr>
<tr>
<td>Income on continuing operations before tax</td>
<td>159</td>
<td>139</td>
</tr>
<tr>
<td>Income tax</td>
<td>60</td>
<td>53</td>
</tr>
<tr>
<td>Income before extraordinary item</td>
<td>99</td>
<td>86</td>
</tr>
<tr>
<td>Extraordinary item - loss from earthquake, net of $23 tax</td>
<td>(45)</td>
<td>-</td>
</tr>
<tr>
<td>Net income</td>
<td>54</td>
<td>86</td>
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<tr>
<td>Other comprehensive income</td>
<td></td>
<td></td>
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<tr>
<td>Available for sale investments</td>
<td>(3)</td>
<td>10</td>
</tr>
<tr>
<td>Cash flow hedge</td>
<td>(5)</td>
<td>(5)</td>
</tr>
<tr>
<td>Income tax related to other comprehensive income</td>
<td>3</td>
<td>(2)</td>
</tr>
<tr>
<td>Other comprehensive income (loss) for the year, net of tax</td>
<td>(5)</td>
<td>3</td>
</tr>
<tr>
<td><strong>Comprehensive income</strong></td>
<td><strong>$ 49</strong></td>
<td><strong>$ 89</strong></td>
</tr>
</tbody>
</table>
**Example 1 - presented with changes in equity**

**Impressive Corp**  
**Statement of Changes in Equity**  
**Year Ended December 31, 20X8**  
(dollar amounts are in millions)

<table>
<thead>
<tr>
<th></th>
<th>Equity Attributable to Shareholders</th>
<th>Minority Interest</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Share Capital</td>
<td>Other Reserves</td>
<td>Retained Earnings</td>
</tr>
<tr>
<td><strong>Balance at 12/31/20X6</strong></td>
<td>$50</td>
<td>$15</td>
<td>$25</td>
</tr>
<tr>
<td><strong>Changes in equity for 20X7</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrealized gain, investments</td>
<td>10</td>
<td>10</td>
<td>-</td>
</tr>
<tr>
<td>Loss on cash flow hedges</td>
<td>(5)</td>
<td>(5)</td>
<td>-</td>
</tr>
<tr>
<td>Tax on items taken directly</td>
<td>(2)</td>
<td>(2)</td>
<td>-</td>
</tr>
<tr>
<td>to equity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net income recognised directly in equity</td>
<td>3</td>
<td>3</td>
<td>-</td>
</tr>
<tr>
<td>Profit for 20X7</td>
<td>80</td>
<td>80</td>
<td>20</td>
</tr>
<tr>
<td><strong>Total recognised income and expense for 20X7</strong></td>
<td>3</td>
<td>80</td>
<td>83</td>
</tr>
<tr>
<td>Dividends</td>
<td>(20)</td>
<td>(20)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Balance at 12/31/20X7</strong></td>
<td>$50</td>
<td>$18</td>
<td>$85</td>
</tr>
<tr>
<td><strong>Changes in equity for 20X8</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrealized gain (loss), investments</td>
<td>(2)</td>
<td>(2)</td>
<td>1</td>
</tr>
<tr>
<td>Loss on cash flow hedge</td>
<td>(5)</td>
<td>(5)</td>
<td>-</td>
</tr>
<tr>
<td>Tax on items taken directly</td>
<td>(3)</td>
<td>(3)</td>
<td>-</td>
</tr>
<tr>
<td>to equity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net income recognised directly in equity</td>
<td>(4)</td>
<td>(4)</td>
<td>1</td>
</tr>
<tr>
<td>Profit for 20X8</td>
<td>104</td>
<td>104</td>
<td>26</td>
</tr>
<tr>
<td><strong>Total recognised income and expense for 20X8</strong></td>
<td>(4)</td>
<td>104</td>
<td>100</td>
</tr>
<tr>
<td>Dividends</td>
<td>(25)</td>
<td>(25)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Balance at 12/31/20X8</strong></td>
<td>$50</td>
<td>$14</td>
<td>$164</td>
</tr>
</tbody>
</table>

**Example 2 - presented in separate statement**

**Impressive Corp**  
**Statement of Recognised Income and Expense**  
**Year Ended December 31, 20X8**  
(dollar amounts are in millions)

<table>
<thead>
<tr>
<th></th>
<th>20X8</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unrealized gain, investments</td>
<td>$ (3)</td>
<td>$10</td>
</tr>
<tr>
<td>Loss on cash flow hedge</td>
<td>(5)</td>
<td>(5)</td>
</tr>
<tr>
<td>Tax on items taken directly</td>
<td>3</td>
<td>(2)</td>
</tr>
<tr>
<td>to equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net income recognised directly in equity</td>
<td>(5)</td>
<td>3</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>130</td>
<td>100</td>
</tr>
<tr>
<td><strong>Total recognised income and expense for the year</strong></td>
<td>$125</td>
<td>$103</td>
</tr>
</tbody>
</table>

Attributable to:  
Owners of the parent $100 $83  
Minority interest $25 $20
Example 1 - Comprehensive income in one statement & expenses by function

Impressive Corp
Statement of Comprehensive Income
Year Ended December 31, 20X8
(dollar amounts are in millions)

<table>
<thead>
<tr>
<th></th>
<th>20X8</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$433</td>
<td>$400</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>(245)</td>
<td>(230)</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>188</td>
<td>170</td>
</tr>
<tr>
<td>Other income</td>
<td>21</td>
<td>13</td>
</tr>
<tr>
<td>Distribution costs</td>
<td>(9)</td>
<td>(9)</td>
</tr>
<tr>
<td>Administrative expenses</td>
<td>(20)</td>
<td>(18)</td>
</tr>
<tr>
<td>Other expenses</td>
<td>(2)</td>
<td>(5)</td>
</tr>
<tr>
<td>Finance costs</td>
<td>(8)</td>
<td>(11)</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>170</td>
<td>140</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>(40)</td>
<td>(40)</td>
</tr>
<tr>
<td>PROFIT FOR THE YEAR</td>
<td>130</td>
<td>100</td>
</tr>
<tr>
<td>Other comprehensive income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Available for sale investments</td>
<td>(3)</td>
<td>10</td>
</tr>
<tr>
<td>Cash flow hedge</td>
<td>(5)</td>
<td>(5)</td>
</tr>
<tr>
<td>Income tax related to other comprehensive income</td>
<td>3</td>
<td>(2)</td>
</tr>
<tr>
<td>Other comprehensive income for the year, net of tax</td>
<td>(5)</td>
<td>3</td>
</tr>
<tr>
<td>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</td>
<td>$125</td>
<td>$103</td>
</tr>
</tbody>
</table>

Profit attributable to:
Owners of the parent            $104  $80
Minority interest               $26    $20

Total comprehensive income attributable to:
Owners of the parent            $100  $83
Minority interest               $25    $20

Earnings per share, basic and diluted (in dollars) $0.46 $0.30
Example 2 - Comprehensive income in two statements & expenses by nature

Impressive Corp
Income Statement
Year Ended December 31, 20X8
(dollar amounts are in millions)

<table>
<thead>
<tr>
<th></th>
<th>20X8</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$433</td>
<td>$400</td>
</tr>
<tr>
<td>Other income</td>
<td>21</td>
<td>13</td>
</tr>
<tr>
<td>Changes in inventories of finished goods &amp; WIP</td>
<td>(99)</td>
<td>(95)</td>
</tr>
<tr>
<td>Raw material and consumables used</td>
<td>(79)</td>
<td>(92)</td>
</tr>
<tr>
<td>Employee benefits expense</td>
<td>(45)</td>
<td>(43)</td>
</tr>
<tr>
<td>Depreciation and amortisation expense</td>
<td>(19)</td>
<td>(17)</td>
</tr>
<tr>
<td>Administrative expenses</td>
<td>(20)</td>
<td></td>
</tr>
<tr>
<td>Other expenses</td>
<td>(6)</td>
<td>(8)</td>
</tr>
<tr>
<td>Finance costs</td>
<td>(16)</td>
<td>(18)</td>
</tr>
<tr>
<td><strong>Profit before tax</strong></td>
<td>170</td>
<td>140</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>(40)</td>
<td>(40)</td>
</tr>
<tr>
<td><strong>PROFIT FOR THE YEAR</strong></td>
<td>$130</td>
<td>$100</td>
</tr>
</tbody>
</table>

Profit attributable to:
- Owners of the parent $104 $80
- Minority interest $26 $20

Earnings per share, basic and diluted (in dollars) $0.46 $0.30

Impressive Corp
Statement of Comprehensive Income
Year Ended December 31, 20X8
(dollar amounts are in millions)

<table>
<thead>
<tr>
<th></th>
<th>20X8</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profit for the year</strong></td>
<td>$130</td>
<td>$100</td>
</tr>
<tr>
<td>Other comprehensive income (loss)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Available for sale investments</td>
<td>(3)</td>
<td>10</td>
</tr>
<tr>
<td>Cash flow hedge</td>
<td>(5)</td>
<td>(5)</td>
</tr>
<tr>
<td>Income tax related to other comprehensive income (loss)</td>
<td>3</td>
<td>(2)</td>
</tr>
<tr>
<td><strong>Other comprehensive income (loss) for the year, net of tax</strong></td>
<td>(5)</td>
<td>3</td>
</tr>
<tr>
<td><strong>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</strong></td>
<td>$125</td>
<td>$103</td>
</tr>
</tbody>
</table>

Total comprehensive income attributable to:
- Owners of the parent $100 $83
- Minority interest $25 $20
Presentation and Classification

According to IAS 1 *Presentation of Financial Statements*, the balance sheet is a required component of an entity’s financial statements. IFRS require the balance sheet to present information on the entity’s assets, liabilities, and equities. IAS 1 does not require a specific format for the balance sheet. It should classify each section as current and noncurrent unless the liquidity presentation is more appropriate. However, there is no requirement that current items precede noncurrent items or vice versa. IAS 1 allows entities to use the liquidity presentation if it increases the reliability and relevance of the information. If the liquidity presentation is used, assets and liabilities must be reported in order of liquidity. IFRS requires one year of comparative financial information.

IFRS presentation differs from U.S. GAAP, which allows entities to choose between a classified or nonclassified balance sheet. U.S. GAAP presents assets and liabilities in order of liquidity within the balance sheet. U.S. GAAP does not detail requirements for comparative information.

At a minimum, IAS 1 requires entities to present the following items on the balance sheet:

- Cash and cash equivalents
- Trade and other receivables
- Financial assets
- Investments accounted for under the equity method
- Investment property
- Inventories
- Intangible assets
- Biological assets
- Property, plant, and equipment
- Trade and other payables
- Financial liabilities
- Provisions
- Liabilities and assets for current tax
- Deferred tax liabilities and assets
- Minority interests
- Issued capital and reserves
In the equity section, IAS 1 requires entities to disclose:

- Number of shares authorized
- Number of shares issued and fully paid, and issued but not fully paid
- Par value per share
- Reconciliation of the shares outstanding at the beginning and end of period
- Description of rights, preferences, and restrictions
- Shares held by the entity, subsidiaries or associates
- Reserved shares
- Description of nature and purpose of reserves

**Offsetting**

IFRS does not allow assets and liabilities to be offset unless specifically allowed under a standard. U.S. GAAP permits offsetting when there is an intention to offset, the amount is determinable, and offsetting is enforceable by law.

**Revaluation of Assets**

A major area of difference between IFRS and US GAAP relates to reporting the value of property, plant, and equipment. According to IAS 16 *Property, Plant and Equipment*, these assets can be reported on the balance sheet at cost or fair value. See Unit 9 – *Property, Plant & Equipment* for additional information.

**Minority interest**

US GAAP and IFRS also differ on the presentation of minority interests on the balance sheet. Current US GAAP prohibits minority interests from being included in equity. While firms may present minority interests as a liability, the common treatment is to include them in “mezzanine equity” – a section between liabilities and equity. Under IFRS, minority interests are presented in the equity section. This difference will be eliminated when FAS 160 becomes effective, requiring minority interests to be presented in the equity section for years beginning on or after December 15, 2008.

**Resources**

IAS 1 *Presentation of Financial Statements*

**Exercises**

1. According to IFRS, all entities must present a classified balance sheet.  
   True or False

2. Thompson Corporation’s general ledger trial balance is presented below.
   
   a. Cash and cash equivalents $100,000  
   b. Trade receivables 25,000  
   c. Property, plant and equipment 75,000  
   d. Goodwill 30,000  
   e. Prepaid expenses 15,000  
   f. Intangible assets 50,000  
   g. Short term borrowings 35,000  
   h. Current tax payable 80,000  
   i. Accounts payable 60,000  
   j. Current portion on long term debt 20,000  
   k. Long term provisions 12,000  

   Assume Thompson Corporation classifies assets and liabilities as current and noncurrent. Prepare the current assets and current liabilities sections of the balance sheet under IAS 1.

3. Venus Company’s general ledger trial balance includes the following accounts:
   
   a. Cash $60,000  
   b. Property, plant and equipment 50,000  
   c. Trading liabilities 110,000  
   d. Minority interest 4,500  
   e. Trading assets 35,000  
   f. Goodwill 65,000  
   g. Deferred tax liabilities 25,000  
   h. Liabilities to customers 95,000  
   i. Subscribed capital 1,500  
   j. Additional paid in capital 4,000  
   k. Deferred tax assets 15,000  
   l. Retained earnings 2,500  
   m. Translation reserve 7,500  
   n. Other assets 25,000  

   Prepare the balance sheet for Venus Company assuming the assets and liabilities are presented in order of liquidity.
Similar to US GAAP, entities must present a statement of cash flows. IAS 7 *Cash Flow Statements* does not provide exemptions to certain investment entities as does US GAAP. According to IAS 7, entities should provide information about historical changes in cash and cash equivalents and classify cash flows according to operating, investing, or financing activities. US GAAP and IFRS define cash and cash equivalents similarly. As discussed in *Unit 6 – Cash and Receivables*, one difference is that IFRS includes bank overdrafts in the cash and cash equivalents category and US GAAP does not. The primary difference between US GAAP and IFRS is the classification of cash flows. IAS 7 provides entities greater flexibility concerning classifying cash flows as operating, investing, or financing activities.

### Major Classification Differences

<table>
<thead>
<tr>
<th>Transaction</th>
<th>US GAAP Classification</th>
<th>IFRS Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Received</td>
<td>Operating</td>
<td>Operating or Investing</td>
</tr>
<tr>
<td>Dividends Received</td>
<td>Operating</td>
<td>Operating or Investing</td>
</tr>
<tr>
<td>Interest Paid</td>
<td>Operating</td>
<td>Financing or Operating</td>
</tr>
<tr>
<td>Dividends Paid</td>
<td>Financing</td>
<td>Financing or Operating</td>
</tr>
<tr>
<td>Income Taxes</td>
<td>Operating</td>
<td>Operating unless specifically associated with financing or investing activity</td>
</tr>
</tbody>
</table>

IAS 7 requires entities to separately disclose interest and dividends received and paid. Entities also must separately disclose income taxes on the statement of cash flows. While IAS 7 is flexible concerning the classification of interest, dividends, and income taxes, it states that entities must classify these items in a consistent manner from period to period.

Both IFRS and US GAAP allow entities to use the direct or indirect method to prepare the statement of cash flows. The indirect method is more common for entities following both standards. However, both frameworks encourage entities to follow the direct method.

### Resources

IAS 7 *Cash Flow Statements*  
[http://www.iasb.org/NR/rdonlyres/6BD06200-0FC6-43B4-B312-A918E333B65F/0/IAS7.pdf](http://www.iasb.org/NR/rdonlyres/6BD06200-0FC6-43B4-B312-A918E333B65F/0/IAS7.pdf)
Exercises

1. IAS 7 requires entities to present a statement of cash flows.  
   True or False

2. US GAAP provides entities greater flexibility than IFRS in the classification of  
   cash flows as operating, investing, or financing activities.  
   True or False

3. IAS 7 requires entities to use the indirect method to prepare the statement of cash  
   flows.  
   True or False

4. According to U.S. GAAP and IFRS, cash flows are divided into all of the  
   following activities except  
   a. Operating  
   b. Investing  
   c. Financing  
   d. Directing

5. Unlike IFRS, which of the following would not be considered cash and cash  
   equivalents according to US GAAP?  
   a. Bank overdrafts  
   b. Marketable securities  
   c. Treasury bills  
   d. Money market holdings

6. According to U.S. GAAP, which of the following cash flow transactions would be  
   considered an operating activity?  
   a. Interest received  
   b. Dividends received  
   c. Interest paid  
   d. All of the above
7. Below is a summary of cash transactions for Harris Furniture Store during the current year. For each cash flow transaction, indicate whether it is an investing, operating, or financing activity under US GAAP and IFRS.

<table>
<thead>
<tr>
<th>Cash Flow Transaction</th>
<th>Type of Activity- US GAAP</th>
<th>Type of Activity- IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Received</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Borrowed Long Term Debt</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Paid Dividend</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Paid Suppliers for goods</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sold Land</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receipt from sale of goods</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Paid Interest</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Received Dividend</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

8. During fiscal year 2008, Mavor’s Metals completed several transactions. Net income for the year was $42,400 and the beginning cash balance was $25,000. Use the summary of transactions to complete the following:

   a. Prepare Mavor’s statement of cash flows in accordance with US GAAP using the indirect method.
   b. Prepare the cash flow statement in accordance with IFRS, creating the most differences from US GAAP.
   c. Analyze the effect of those differences on the cash flow statement.

**Summary of Transactions:**
1) Cash sales, $200,000  
2) Sales on account, $75,000  
3) Collections on account, $40,000  
4) Paid accounts payable, $20,000  
5) Purchased land for cash, $70,000  
6) Borrowed long term debt, $110,000  
7) Issued Common Stock, $40,000  
8) Sold investment (long term), $25,000  
9) Interest expensed and paid, $15,000  
10) Depreciation expense, $17,000  
11) Prepaid expenses, $9,000  
12) Sold Building $15,000
Cash and Cash Equivalents

IFRS and US GAAP define cash and cash equivalents similarly. According to both standards, cash includes cash on hand and demand deposits. IAS 7 *Cash and Cash Equivalents* defines cash equivalents as short-term highly liquid investments that are readily convertible to known amounts of cash and are subject to insignificant risks. Cash equivalents mature within 90 days. The definition under US GAAP is similar. There is one difference in classification relating to bank overdrafts. US GAAP does not offset bank overdrafts against the cash account. There is one exception to this rule. When there is cash available in another account in the same bank on which the overdraft occurred offsetting against the cash account is required. IFRS includes bank overdrafts in the cash and cash equivalents category if they are repayable on demand and form an integral part of an entity’s cash management.

Receivables

According to IFRS, loans and receivables is one of four financial assets categories. The loans and receivables category does not exist under US GAAP. IAS 39 *Financial Instruments: Recognition and Measurement* defines loans and receivables as financial assets that are created by the enterprise by providing money, goods or services directly to a debtor. The category of loans and receivables does not include the following:

- loans and receivables that an entity has designated as held at fair value with gains or loss going through profit or loss
- loans and receivables classified as held for trading because an entity intends to sell them in the near future
- loans and receivables designated as available for sale
- loans and receivables that the holder may not recover substantially all of its initial investment

Examples of items in the loans and receivables category include accounts receivable and loans to other entities. US GAAP does not include trade accounts receivable and loans receivable in the same category as debt securities. IAS 39 requires loans and receivables to be measured initially at fair value. Valuation changes subsequent to the initial purchase are accounted for at amortized cost using the effective interest method. IFRS requires financial assets including loans and receivables to be reported on the face of the balance sheet. Loans and receivables are classified as current if they are expected to be realized within 12 months or the normal operating cycle. Otherwise, the loans and receivables are classified as non-current. Entities following IFRS may subclassify receivables as receivables from trade customers and receivables from related parties and other amounts. US GAAP reports receivables at net realizable value and must separately disclose material related party receivables.
Uncollectible Accounts Receivable

An entity may not be able collect all of its accounts receivable balance. IFRS and US GAAP have similar requirements for recording uncollectible accounts receivable. Both standards require entities to use the allowance method. Under the allowance method, entities estimate the amount of expected uncollectible accounts. The estimate is recorded as an expense and reduces accounts receivable through an allowance account. Collection of accounts receivable previously written off is accounted for similarly under US GAAP and IFRS. The only difference between the two standards relates to terminology. IFRS refers to the allowance accounts as a ‘provision.’

Example:
Jones Company estimates that 3% of credit sales will be uncollectible. Assuming the company uses the allowance method and sales are $300,000, the company will record the following entry.

| Bad Debt Expense | 9,000 |
| Provision for Bad and Doubtful Debts | 9,000 |

Impairment of Notes Receivables

IAS 39 specifies that entities should assess whether its financial assets are impaired. If a portion of accounts receivable is impaired, the loss is measured as the difference between the asset’s carrying value and the present value of expected future cash flows discounted at the asset’s original effective interest rate. Entities can choose to recognize the uncollectible amount either directly or through an allowance account. IFRS refers to the allowance account as a ‘provision.’ The amount of the loss is recognized in profit or loss. IFRS allows entities to subsequently reverse impairment losses provided there is objective evidence to warrant reversing the original impairment. Reversal of impairment is recognized in profit and loss.

Similarly to IFRS, US GAAP requires entities to assess whether financial assets are impaired and recognize the impairment. If a note receivable is impaired, the loss is measured by the creditor as the difference between the investment in the loan (usually the principle plus accrued interest) and the expected future cash flows discounted at the loan’s historical effective interest rate. US GAAP recognizes the uncollectible amount through an allowance account. Unlike IFRS, US GAAP prohibits the reversal of impairment losses.

Sale of Receivables

US GAAP and IFRS have similar conceptual requirements for the sale of receivables. However, the derecognition model under IFRS is different from US GAAP. US GAAP derecognizes financial assets (removes them from the balance sheet) based on a control test. US GAAP considers a transaction a sale if control of the receivable is transferred from the seller to the buyer. Specifically, US GAAP outlines three key tests that must be satisfied to derecognize financial assets including:

1. Assets must be legally isolated from the transferor (out of reach from the transferor and its creditors)
2. The transferee has the right to pledge or sell the asset to another party; and
3. The transferor does not maintain effective control through a right or obligation to repurchase the transferred asset
IFRS derecognizes financial assets based on a test of risk and rewards first and considers a test of control second. According to IFRS, an entity may derecognize a financial asset when any of the following conditions are met:

- The rights to the cash flows arising from the asset expire
- The rights to the asset’s cash flows and substantially all risks and rewards of ownership are transferred
- An entity assumes an obligation to transfer the asset’s cash flows, transfers substantially all risks and rewards and meets the following conditions:
  - No obligation exists to pay cash flows unless equivalent cash flows have been collected from the transferred asset
  - Prohibited from selling or pledging the asset besides as security to future recipients for the obligation to pass through cash flows; and
  - Cash flows must be remitted without material delay
- Control of the asset is transferred even though substantially all of the risks and rewards are neither transferred nor retained

**Resources**

IAS 7 *Cash Flow Statements*
http://www.iasb.org/NR/rdonlyres/6BD06200-0FC6-43B4-B312-A918E333B65F/0/IAS7.pdf

IAS 39 *Financial Instruments: Recognition and Measurement*

**Exercises**

1. How do the standards differ related to classifying bank overdrafts? Which standard would more frequently require bank overdrafts to be offset against the cash account?

2. Discuss the method used under IFRS and US GAAP to account for uncollectible accounts receivable.

3. US GAAP and IFRS have a similar loans and receivables category of financial assets.
   True or False

4. Subsequent measurement of loans and receivables is at amortized cost using the effective interest method under IFRS.
   True or False

5. Is there a difference in terminology between US GAAP and IFRS regarding the allowance account? If yes, what is the difference?
6. How should the following accounts be classified under IFRS? Is the classification the same under US GAAP?
   a. Coins and currency
   b. Petty cash
   c. Saving account
   d. Checking account
   e. Deposits in transit
   f. Post dated check expected to be collected in one month
   g. Bank overdrafts repayable on demand and an integral part of the entity’s cash management.
   h. Long term loan to another entity
   i. Trade receivables due in two months

7. Based on the scenarios below, indicate whether the entity can derecognize the financial asset according to the derecognition tests set forth in IAS 39.
   a. Cole Company sold a financial asset, which included an option to repurchase the financial asset at its fair value at the time of repurchase.
   b. Draper Company entered into a sale and repurchase transaction where the repurchase price of the financial asset was fixed.
   c. Jones Inc. entered into a securities lending agreement.
   d. Thomas Corporation completed an unconditional sale of 20 percent of all principal and interest cash flows.

8. Becker Company has accounts receivables of $500,000. At year end, the company determined that 5% of accounts receivables will be uncollectible and the company intends to write off the balance. Record the journal entry according to IFRS and US GAAP.

9. On December 31, 2006, Jones Company sold manufacturing equipment to Steel Corporation. Steel Corporation gave Jones Company a 5 year $200,000, zero interest note. The market rate of interest for a note with similar risks is 10%. At December 31, 2008 Jones Company reviews its financial assets for impairment. Jones Company concludes that the value of the note is impaired and it only expects to collect $150,000 of the principal at maturity. By December 31, 2009 Jones Company has determined that $10,000 of the impairment loss on the manufacturing equipment should be reversed. Prepare the appropriate journal entries for December 31, 2008 and December 31, 2009 according to a) IFRS b) US GAAP. Explain why the journal entries differ under the two sets of standards.
US GAAP and IFRS define inventories similarly. According to both sets of standards inventories are assets:
- Held for sale in the ordinary course of business;
- Being produced for sale in the ordinary course of business;
- In the form of materials or supplies to be used in production or to provide services

US GAAP and IFRS both measure inventories initially at cost. Inventories are classified as current assets on the face of the balance sheet, because they are expected to be realized within the entity’s normal operating cycle. Both standards require entities to disclose the composition of inventory in the financial statements.

**Included costs**
To determine cost, both standards include the costs of purchase, costs of conversion, and costs to bring the inventories to their current location and condition. According to IAS 2 \textit{Inventories}, costs to bring the inventories to their current condition could include specific design expenses. US GAAP does not consider design expenses when calculating the cost of inventory. Both standards exclude selling costs, general administrative costs, and most storage costs from the cost of inventory.

**Cost flow assumptions**
US GAAP and IFRS differ related to cost flow assumptions. Under US GAAP and IFRS specific identification should be used to assign costs for inventory items that are not interchangeable. Specific identification assigns specific costs to identifiable inventory items. For inventory items that are interchangeable, IAS 2 allows entities to use the FIFO or weighted average methods. The FIFO method follows the assumption that items purchased or produced first are sold first and the ending inventory is made up of items recently purchased or produced. The weighted average method prices inventory based on the average cost of similar items purchased or produced throughout the period. IAS 2 prohibits entities from using the last in, last out (LIFO) method of inventory valuation. The LIFO method assumes that items purchased or produced last are sold first and the ending inventory is made up of items purchased or produced first. The prohibition of LIFO as a method of determining the cost of inventory is a major departure from US GAAP. US GAAP allows entities to use the LIFO method as well as FIFO or weighted average. Changing the cost flow assumption may have a significant impact on the carrying value of inventory. Note that companies must use the same inventory costing method for tax purposes as they do for financial accounting, and the Internal Revenue Service has estimated elimination of LIFO for tax purposes would raise an additional $10 billion in tax revenue.

Both standards also allow entities to use the standard cost and retail methods as long as the results approximate actual cost. IFRS requires entities to apply the same cost formula to all inventories similar in nature or use. US GAAP does not have a similar specific requirement. IFRS and US GAAP require entities to consistently apply the selected cost formula.
Resources
IAS 2 Inventories

Exercises
1. The following inventory information relates to Camden Corporation’s purchasing activities.
   - July 1  Balance  500 units @ $7
   - August 1  Purchased  300 units @ $9
   - September 1  Purchased  150 units @ $10

   Assume there are 250 units on hand at the end of the year.
   a) Compute the ending inventory and costs of goods sold assuming Camden Corporation follows IFRS and chose to use FIFO.
   b) Compute the ending inventory and costs of goods sold assuming Camden Corporation follows US GAAP and chose to use LIFO.
   c) How will the differences between FIFO and LIFO affect the Camden Corporation’s financial statements?

2. On January 1, 2007 Loren Company had 400 units of inventory on hand at a cost of $12 per unit. The company purchased inventory four times during the year. The following information relates to the inventory purchases.
   - March 1  Purchased  300 units @ $15
   - June 1  Purchased  200 units @ $16
   - August 1  Purchased  250 units @ $17
   - October 1  Purchased  300 units @ $18

   Assume Loren company sold 1000 units of inventory during 2007.
   a) Compute the ending inventory and costs of goods sold assuming Camden Corporation follows IFRS and chose to use the weighted average method.
   b) Compute the ending inventory and costs of goods sold assuming Camden Corporation follows US GAAP and chose to use LIFO.
   c) What are the differences in ending inventory and costs of goods sold using weighted average and LIFO?

3. Which method of assigning costs to inventory is not permitted under IFRS?

4. US GAAP and IFRS classify inventories on the balance sheet as
   a. Non-current assets
   b. Current assets
   c. Current liabilities
   d. None of the above
5. IAS 2 requires entities to consistently apply their selected cost formula. True or False

6. IFRS permits the following methods of assigning costs to inventories
   a. FIFO
   b. Weighted Average
   c. LIFO
   d. Both a and b

7. According to IFRS, the choice of using FIFO or weighted average is a matter of management judgment. True or False
According to US GAAP and IFRS, inventory should be written down if it declines in value below its original cost. However, the guidance differs between the two frameworks. IAS 2 Inventories requires inventories to be measured at the lower of cost and net realizable value. Net realizable value is defined by IAS 2 as “the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.” According to IFRS, the journal entry to write down inventory debits Inventory write down expense and credits inventory. IAS 2 requires entities to reverse the value of inventory previously written down when there is a subsequent increase in the inventory’s value. Reversals are limited to the amount of the original write down.

Unlike IFRS, US GAAP requires inventories to be measured at the lower of cost or market as opposed to the lower of cost or net realizable value. Market refers to the cost to replace the item of inventory by purchase or reproduction. There is an upper and lower limit to the lower of cost or market rule. The upper limit is net realizable value and the lower limit is net realizable value less a normal profit margin. The value of inventory under US GAAP and IFRS will only be the same when replacement cost is greater than net realizable value. The measurement differences can produce different amounts of expense recognized by IFRS and US GAAP in a given accounting period.

To write down inventory, entities can use the direct or indirect method. The journal entry under the direct method debits cost of goods sold and credits inventory. The journal entry under the indirect method debits loss due to market decline of inventory and credits allowance to reduce inventory to market. Unlike IFRS, US GAAP prohibits the reversal of write downs to market if replacement costs subsequently increase.

Resources
IAS 2 Inventories

Exercises
1. The following information relates to Broom Company’s inventory:
   Historical Cost $10,000
   Net Realizable Value 7,000
   Replacement Cost (Market Value) 5,000
   Net Realizable Value less normal profit 4,500

Which two amounts would Broom Company compare to determine whether its inventory should be written down according to 1) IFRS 2) US GAAP? How much would the inventory be written down according to 1) IFRS 2) US GAAP?
2. The following information relates to an inventory item of Sanchez Company. Sanchez’s normal profit margin is 10%.

| Description                        | Amount  
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Historical cost</td>
<td>$50,000</td>
</tr>
<tr>
<td>Replacement cost (Market Value)</td>
<td>40,000</td>
</tr>
<tr>
<td>Estimated selling price</td>
<td>44,000</td>
</tr>
<tr>
<td>Estimated cost to complete and sell</td>
<td>8,000</td>
</tr>
<tr>
<td>Net Realizable Value</td>
<td>36,000</td>
</tr>
</tbody>
</table>

Assuming Sanchez Company follows IFRS, determine the amount at which inventory should be reported on the Sanchez Company’s December 31, 2008 balance sheet. At what amount would inventory be reported following US GAAP?

3. Loudon Company has inventory on hand with a historical cost of $6,000. It estimates that it would cost $4,500 to replace the inventory. The inventory’s estimated selling price is $5,500 and its estimated cost to complete and sell is $500. Assuming the company’s normal profit margin is 15%, record the journal entries to write down the inventory under a) IFRS and b) US GAAP.

4. Jeffers Company purchased inventory for $10,000. The current cost to replace the inventory is $9,300. The company estimates it can sell the inventory for $9,700 but will have to spend $300 to complete the inventory. The company’s normal profit margin is 12%. How much would the company need to write down the inventory assuming it follows a) IFRS b) US GAAP? Assume that next period the selling price increases to $9,900, the replacement cost increases to $9,500 and the estimated cost to complete remains $300. How would the company reverse the prior write down using a) IFRS b) US GAAP?

5. How do the requirements under IFRS differ from US GAAP related to the value of inventory reported on the balance sheet?

6. How do IFRS and US GAAP differ related to reversing inventory write-downs?

7. According to IAS 2, the reversal of previously written down inventory is limited to the original write down. True or False
Property, Plant, and Equipment

US GAAP and IFRS define property, plant, and equipment similarly. Both standards require the assets to be tangible, long-term in nature, and acquired for specific uses within the entity. US GAAP and IFRS do not include assets that are held for sale in the category of property, plant, and equipment.

Initial Recognition of PPE

US GAAP and IFRS recognize PPE if future economic benefits attributable to the asset are probable and it is possible to reliably measure the cost of the asset. Both standards initially measure property, plant, and equipment at cost. The cost to acquire the asset includes all costs incurred to bring the asset to the location and condition for its intended use. Both standards include the cost of dismantling and removing the asset and restoring the site. Both standards prohibit entities from capitalizing start-up costs, general administrative and overhead costs, or regular maintenance.

Capitalization of Interest in PP&E

IAS 23 Borrowing Costs considers exchange rate differences from foreign currency borrowings an eligible borrowing cost. IFRS allows entities to offset borrowing costs by investment income earned on those borrowings. Under IFRS, the actual borrowing costs are capitalized.

US GAAP does not include exchange rate differences in borrowing costs and they generally do not allow interest earned on borrowings to be offset against interest costs incurred during the period. Under US GAAP, the amount of interest to capitalize is limited to the lower of actual interest cost incurred during the period or avoidable interest.

Through 2008, IAS 23 provides two methods to account for interest cost. According to the benchmark treatment, an entity should expense all borrowing costs in the period incurred. Under the allowed alternative treatment an entity may capitalize borrowing costs that are related to the acquisition, construction, or production of a qualifying asset. The benchmark treatment under IFRS is a departure from US GAAP. The allowed alternative approach is similar to the US GAAP approach to capitalizing interest. Entities must consistently apply the method chosen to all qualifying assets. IAS 23 is currently being revised. With the adoption of the revised standard in 2009, entities will be required to capitalize borrowing costs related to the acquisition, construction or production of a qualifying asset.

US GAAP requires entities to capitalize interest costs incurred only during construction as part of the cost of a qualifying asset.

Subsequent Valuation of PPE

A major area of difference between IFRS and US GAAP relates to reporting the value of property, plant, and equipment. According to IAS 16 Property, Plant and Equipment, entities can follow the cost model or the revaluation model. The cost model carries an item of property, plant and equipment at its cost less any accumulated depreciation and any
accumulated impairment losses (see Unit 10 – Depreciation and Impairment). The revaluation model carries an item of property, plant and equipment at a revalued amount, which is its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Reporting PPE at cost is the benchmark treatment but revaluation is a permitted alternative. This is a significant departure from US GAAP, which requires entities to use the cost model.

**Initial Revaluation**

The revaluation model revalues property, plant, and equipment to its fair value. PPE is carried on the balance sheet at its fair value less accumulated depreciation (revalued) and any impairment losses. In order to qualify for the revaluation treatment, an entire class (e.g. land, buildings, vehicles, etc.) of property, plant, and equipment must be revalued. To account for a revaluation increase, a credit is made to equity as a revaluation surplus and a debit is made to the asset account. To account for a revaluation decrease, a credit is made to the asset account and a debit is made to an expense account.

**Example 1**

During the current year, Piazza Company elected to measure property, plant, and equipment at revalued amounts. Assume Piazza owns a building with a cost of $190,000 and a current fair value of $200,000. The journal entry to increase the carrying amount of the building to its fair value follows.

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Building</td>
<td>$10,000</td>
<td></td>
</tr>
<tr>
<td>Revaluation surplus-Building</td>
<td>$10,000</td>
<td></td>
</tr>
</tbody>
</table>

**Subsequent Revaluation**

Subsequent decreases in value of an asset should first be charged against any previous revaluation surplus in respect to that asset, and the excess should be expensed. If previous revaluations resulted in an expense, subsequent increases in value should be charged to income to the extent of the previous expense. The excess should be credited to equity. Once an asset has been revalued, its value on the balance sheet must represent its current fair value. At each year end, management should consider whether the asset’s fair value differs from its carrying value. The carrying value should not differ materially from the asset’s fair value.

**Example 1 Continued**

In the following year, Piazza Company determines that the fair value of the building is no longer $200,000. Assuming the fair value has decreased to $160,000, the following entry should be made.

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revaluation surplus- buildings</td>
<td>$10,000</td>
<td></td>
</tr>
<tr>
<td>Loss on Revaluation- buildings</td>
<td></td>
<td>$30,000</td>
</tr>
<tr>
<td></td>
<td>Buildings</td>
<td>$40,000</td>
</tr>
</tbody>
</table>

**Treatment of Accumulated Depreciation on Revaluation**

Accumulated depreciation must be revalued. The following two methods are permitted.

1. Accumulated depreciation is restated proportionately with the change in the gross carrying amount of the revalued asset. The carrying amount of the asset after revaluation should equal its revalued amount.
2. Accumulated depreciation is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset.

**Example 2: Accumulated Depreciation under Treatment 1**
Clark Company owns a building that cost $800,000. The building has accumulated depreciation of $200,000 so the carrying value is $600,000. Assume Clark revalues the building to its current fair value of $1,000,000. Under treatment 1, Clark would restate the building account and the accumulated depreciation account such that the ratio of net carrying amount to gross carrying amount is 75% (600,000/800,000).

<table>
<thead>
<tr>
<th>Buildings</th>
<th>533,333</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated Depreciation- buildings</td>
<td>133,333</td>
</tr>
<tr>
<td>Revaluation Surplus</td>
<td>400,000</td>
</tr>
</tbody>
</table>

**Example 2: Accumulated Depreciation under Treatment 2**
Under treatment 2, Clark would eliminate accumulated depreciation of $200,000 and then increase the buildings account by $400,000.

| Accumulated depreciation | 200,000 |
| Buildings                | 200,000 |
| Buildings                | 400,000 |
| Revaluation Surplus      | 400,000 |

Note: All journal entries exclude the impact on deferred taxes. See Unit 18 – Income Taxes for details.

**Subsequent Costs**
Both US GAAP and IFRS capitalize subsequent expenditures when it is probable that it will give rise to future economic benefits.

**Resources**
IAS 16 *Property, Plant and Equipment*

IAS 23 *Borrowing Costs*

**Exercises**
1. According to IFRS, what are the benchmark and allowed alternative treatments for recognizing borrowing costs?
2. According to IFRS, how do entities measure property, plant, and equipment subsequent to its original acquisition?
3. The revised version of IAS 23 will require entities to capitalize interest costs related to the acquisition, construction, or production of a qualifying asset.
   True or False
4. The benchmark treatment to account for borrowing costs under IFRS requires entities to expense all borrowing costs in the period incurred. True or False

5. Unlike IFRS, US GAAP does not allow property, plant and equipment to be carried at revalued amount. True or False

6. During the current year, Piazza Company elected to measure property, plant, and equipment at revalued amounts. Assume Piazza owns land with a cost of $70,000 and a current fair value of $200,000. Record the journal entry to adjust the carrying amount of land to its fair value.

7. Gentry Corporation owns a building with a cost of $350,000. Earlier this year, a downturn in the real estate market caused the fair value of the building to decrease to $330,000. Assuming Gentry Corp. uses the revaluation model to measure property, plant, and equipment, what is the journal entry to record the decrease in fair value?

8. Candy Company owns a building that cost $700,000. The accumulated depreciation on the building is $200,000 so its carrying value is $500,000. Candy Company wishes to revalue all of its building on the December 31, 2008 balance sheet. The fair value is currently $900,000. Prepare the necessary journal entry to carry the building at fair value. Assume Candy Company accounts for accumulated depreciation by eliminating the accumulated depreciation against the gross carrying amount of the asset and restating the net amount to the revalued amount of the asset.

9. Quinn Company began constructing a building on January 1, 2006. Construction of the building was completed on January 2, 2007. The total cost of construction was $20 million. Quinn obtained a construction loan and began drawing down funds as costs were incurred on the project. Quinn incurred interest expense of $2 million between January 1, 2006 and December 31, 2006. Assuming Quinn Company follows the benchmark treatment for borrowing costs under IFRS, how should the cost of interest be accounted for in 2006? How would it be treated under US GAAP?

10. The following information relates to land owned by Connor Company.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>$100,000</td>
</tr>
<tr>
<td>Fair value at 12/31/06</td>
<td>120,000</td>
</tr>
<tr>
<td>Fair value at 12/31/07</td>
<td>90,000</td>
</tr>
</tbody>
</table>

Record the journal entry at 12/31/06 and 12/31/07 to adjust the carrying amount of the land to fair value. Would the journal entries change if the fair value at 12/31/07 was $110,000?
Depreciation

According to US GAAP and IFRS, entities are required to depreciate PPE on a systematic basis. IFRS does not require entities to use a particular method of depreciation. According to IAS 16 Property, Plant and Equipment, the method of depreciation should reflect the expected pattern of consumption of the future economic benefits embodied in the asset. US GAAP similarly allows entities to use a number of depreciation methods provided the method is systematic and rational. Both standards require entities to depreciate items of PPE that are idle, but do not depreciate items of PPE held for sale. IFRS requires the estimates of useful life, residual value, and the method of depreciation to be reviewed on an annual basis. US GAAP only requires review when events or changes in circumstances indicate that the current estimates and depreciation methods are not appropriate. Both standards treat changes in depreciation method, residual value, and useful life as a change in accounting estimate. US GAAP and IFRS have different policies regarding depreciation of asset components. Component depreciation specifies that any part or portion of PPE that can be separately identified as an asset should be depreciated over its useful life. IFRS requires component depreciation if components of an asset have differing patterns of benefits. For example, if components of an asset have different useful lives, the entity should identify the components and separately account for them. US GAAP permits component depreciation but it is not common in practice.

Impairment

According to US GAAP and IFRS, a company must record a write-off when the carrying amount of an asset is not recoverable. Both standards refer to the write-off as impairment. US GAAP relies on a recoverability test to determine whether impairment has occurred. If the sum of expected future cash flows (undiscounted) is less than the carrying amount of the asset, the asset is considered impaired. The impairment loss should be measured as the difference between the carrying amount of the asset and its fair value. US GAAP prohibits entities from reversing impairments.

Under IAS 36 Impairment of Assets, an asset is impaired when its recoverable amount is less than its carrying amount. The recoverable amount is the greater of net selling price and value in use. Net selling price is the market value of the asset less disposal costs. Value in use is the present value of future net cash flows expected over the remaining life of the asset. The impairment loss is the difference between the asset’s carrying value and its recoverable amount and it is recognized in income.

For assets using the revaluation model, impairment is usually only recognized if disposal costs are significant, causing the recoverable amount (fair value less disposal costs) to be less than the carrying amount (fair value). When an asset is carried at a revalued amount, the impairment loss is taken against the revaluation surplus and any remainder is taken against income. According to IFRS, write-ups for subsequent recoveries of impairment are permitted. For the cost model, the write-up of the asset cannot exceed what the carrying value would have been if no impairment loss had been recognized.
Incorporating IFRS into Intermediate Accounting

Resources
IAS 16 Property, Plant and Equipment

IAS 36 Impairment of Assets
http://www.iasb.org/NR/rdonlyres/7FE0F357-3E74-4266-AF11-B388A52FF36A/0/IAS36.pdf

FAS 34, 58, 62, 143, 144, 154, ARB 43, APB 6, FIN 47

Exercises

1. Do IFRS and US GAAP differ related to determining whether an asset is impaired? If so, explain.

2. On January 1, 2006, Thompson Company purchased manufacturing equipment for $2.1 million. The equipment has a useful life of seven years and no residual value. Thompson Company plans to depreciate the equipment on a straight-line basis. On January 1, 2010, the equipment’s fair value (net of accumulated depreciation) has increased to $2.4 million. Assuming Thompson Company follows the revaluation model, what is Thompson’s depreciation expense in 2006-2012? How would depreciation expense differ using US GAAP?

3. The information provided below is related to equipment owned by Collier Company at December 31, 2007.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>$5,000,000</td>
</tr>
<tr>
<td>Accumulated Depreciation</td>
<td>2,000,000</td>
</tr>
<tr>
<td>Expected future net cash flows (undiscounted)</td>
<td>3,000,000</td>
</tr>
<tr>
<td>Expected future net cash flows (discounted)</td>
<td>2,700,000</td>
</tr>
<tr>
<td>Fair value</td>
<td>2,500,000</td>
</tr>
<tr>
<td>Remaining useful life of asset</td>
<td>3 Years</td>
</tr>
</tbody>
</table>

What is the impairment loss for Collier Company under a) IFRS and b) US GAAP?

4. An asset was purchased on January 1, 2006 for $1,000,000 with a useful life of 10 years and no salvage value. The company accounts for the asset under IFRS using the cost model. During the year, the asset is deemed impaired and written down by $400,000. Assuming the asset increases in value to $800,000, what is the carrying value of the asset on December 31, 2007? Assuming the asset increases in value to $900,000, what is the carrying value of the asset on December 31, 2007? How would the reversal of impairment be treated under US GAAP?
**Measurement**

Similar to U.S. GAAP, intangible assets with finite lives are typically carried at historical cost less accumulated amortization and impairment. Intangible assets with indefinite lives (no foreseeable limit to their benefit) are not amortized, but are carried at historical cost less impairment.

IAS 38 *Intangible Assets* differs significantly from U.S. GAAP in that it allows an alternative method of carrying intangible assets with finite lives. If a price is available on an active market, a condition rarely met in practice, the asset may be carried at fair value less accumulated amortization and impairment. Examples of intangible assets that may be priced on an active market include taxi licenses, fishing licenses, and production quotas. If the company chooses the alternative “revaluation” method, the asset fair value should be assessed regularly, typically annually. An increase in fair value of the asset is credited to an equity account “revaluation surplus”, except to the extent it reverses a previously recorded decrease reported directly in profit and loss. A decrease in fair value is debited to the revaluation surplus account, until the account surplus for the specific asset is reduced to zero. Any remaining decrease is recognized in profit and loss.

Another significant difference between IFRS and U.S. GAAP is the treatment of internally generated intangibles. According to U.S. GAAP, research and development costs are generally expensed as incurred, making the recognition of internally generated intangible assets rare. Separate rules apply for development costs of computer software and websites.

For IFRS, the costs associated with the creation of intangible assets are identified as belonging to the research or development phase. Costs in the research phase are always expensed. Costs in the development phase are expensed unless the entity can demonstrate all of the following:

1. Technical feasibility of completing the intangible asset
2. Intention to complete the intangible asset
3. Ability to use or sell it
4. Generation of future economic benefits – the existence of a market, or internal usefulness of the asset
5. Adequate resources (technical, financial, and other) to complete the development
6. Ability to measure reliably the expenditure attributable to the intangible asset during its development

Costs include all expenditures directly attributed or allocable to creating, producing and preparing the asset from the date recognition criteria are met. Staff training costs, marketing costs and selling costs are excluded from development costs and expensed as incurred. Development costs initially expensed cannot be capitalized in a subsequent period. Normally, subsequent expenditures on an intangible asset after it has been acquired or completed must be expensed as incurred; under rare circumstances, asset recognition criteria
may be met. It is important to note, however, that for both IFRS and US GAAP, internally generated goodwill, brands, mastheads, publishing titles, customer lists and items similar in substance shall are not recognized as intangible assets.

**Impairment**

For both U.S. GAAP and IFRS, intangible assets must be tested for impairment whenever changes in events or circumstances indicate an asset’s carrying amount may not be recoverable. Goodwill and other assets with an indefinite life must be reviewed at least annually.

Reversal of impairment losses is an area of significant difference between the two methods of accounting. U.S. GAAP prohibits any reversal of impairment losses. IAS 36 *Impairment of Assets* allows reversals of impairment losses under special circumstances, except in the case of goodwill.

Additional differences are found in the impairment calculation, which is performed at the Cash-Generating Unit (CGU) level for IFRS and the Reporting Unit level for GAAP. The CGU is the “smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets”. The reporting unit is an operating segment, or one-step below an operating segment, for which management regularly reviews financial information. In some companies, this may result in a different level of analysis (the reporting may be at a more aggregated level), and therefore different results, for the two methods. IFRS also uses a one-step process, rather than the two-step recoverability test/impairment assessment required by GAAP. In this one-step process, an impairment loss is recognized if the asset’s (or CGU’s) carrying amount is greater than both its (discounted) fair value less cost to sell and its (discounted) value in use. Finally, impairment losses are allocated to assets differently under the two methods. For IFRS, an impairment loss identified at the CGU level is first applied against goodwill. Once goodwill has been eliminated, any remaining impairment is allocated to the other assets of the CGU on a prorated basis based on their carrying amounts. For US GAAP, the fair value of goodwill is implied by identifying the fair value of the total reporting unit and the fair value of all other assets and liabilities of the reporting unit. Impairment loss is then calculated individually for each asset by comparing its fair value to its carrying amount.

For IFRS, an impairment identified in the current year is reported on the same line of the income statement as the amortization charge for the asset or, if it is material, in a separate line. The impairment loss is recorded against the revaluation surplus equity account to the extent that it reverses a previous revaluation for that asset.

**Resources**

IAS 38 *Intangible Assets*


IAS 36 *Impairment of Assets*

[http://www.iasb.org/NR/rdonlyres/7FE0F357-3E74-4266-AF11-B388A52FF36A/0/IAS36.pdf](http://www.iasb.org/NR/rdonlyres/7FE0F357-3E74-4266-AF11-B388A52FF36A/0/IAS36.pdf)
Exercises

1. NewDrugs, Inc., an international corporation, has identified a list of expenditures it believes to be intangible assets. Which items would be recognized as assets under US GAAP? Which items would be capitalized under IFRS?
   a. Research on potential pharmaceutical formulas
   b. Development of new pharmaceutical formulas, after feasibility and business plans have been established
   c. Legal fees to patent the newly developed formula
   d. Customer list purchased from a competitor
   e. Patent purchased from a competitor
   f. Legal fees to defend the purchased patent
   g. Goodwill included in the purchase of OldDrugs, Inc.
   h. Internally developed customer list

2. During 2007, a company began researching and developing a new product for market. By June 30, 2008, the company had determined the new product was technologically feasible and developed a business plan including identification of a ready market for the product, and a commitment of resources to ready the product for market. The company has tracked costs of the product as follows:
   
<table>
<thead>
<tr>
<th>Description</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Research and development, Jan-June</td>
<td>€   130,000</td>
</tr>
<tr>
<td>Research and development, July-Dec</td>
<td>80,000</td>
</tr>
<tr>
<td>Training costs</td>
<td>15,000</td>
</tr>
<tr>
<td>Legal fees – patent</td>
<td>20,000</td>
</tr>
<tr>
<td>Mass production</td>
<td>120,000</td>
</tr>
<tr>
<td>Marketing launch</td>
<td>75,000</td>
</tr>
</tbody>
</table>

   What amount will be included in intangible assets on the company’s December 31, 2008 financial statements prepared in accordance with IFRS? What amount will be reported as intangible assets under US GAAP?

3. At the end of its reporting year, SunnySide shows the following intangible assets on its books: $30,000 patents with estimated remaining useful life of 10 years, and $46,000 goodwill with an indefinite life. Before closing its books, the company evaluates its intangible assets and identifies a $10,000 impairment in patents and a $15,000 impairment in goodwill. For IFRS, SunnySide accounts for its intangible assets using the cost method.
   a. How will the impairment loss be reported for US GAAP and IFRS?
   b. At the end of the following year, SunnySide determines the company has recovered $6,000 of the patent impairment and $8,000 of the goodwill impairment. How will this be reported for US GAAP and IFRS?
4. During 2007, a company began researching and developing a new technology. By March 31, 2008, the company had determined the new product was technologically feasible. As of April 30, 2008, the company had developed a business plan including identification of a ready market for the product, and a commitment of resources to ready the product for market. After completion of the second prototype in June 2008, the product was considered ready for mass production and marketing. The company has tracked costs of the product as follows:

- Market research costs, 2007: €30,000
- Research costs, 2007: €100,000
- Research costs, Jan-Mar 2008: €50,000
- Legal fees – patent: €25,000
- Development costs, Apr 2008: €20,000
- Management time to develop business plan: €15,000
- Development cost – initial prototype: €500,000
- Testing of initial prototype: €150,000
- Cost of revisions and second prototype: €75,000
- Legal fees to defend patent: €30,000
- Mass production: €200,000
- Marketing launch: €120,000

What amount will be included in intangible assets on the company’s December 31, 2008 financial statements prepared in accordance with IFRS? How much would be included in intangible assets under US GAAP?
5. Excerpts from the reconciliation of Nokia’s 2006 IFRS financial statements to GAAP are provided below.

**Nokia 2006 Financial Statements – US GAAP Reconciliation**

Amortization and impairment of identifiable intangible assets acquired

… The net carrying amount of other intangible assets under US GAAP is EUR 447 million in 2006 (EUR 425 million in 2005) and consists of capitalized development costs of EUR 149 million (EUR 213 million in 2005) and acquired patents, trademarks and licenses of EUR 298 million (EUR 212 million in 2005). The Group does not have any indefinite lived intangible assets. Amortization expense under US GAAP of other intangible assets as of December 31, 2006, is expected to be as follows….

Amortization of goodwill

…The US GAAP impairment of goodwill adjustment reflects the cumulative reversal of impairments recorded under IFRS that did not qualify as impairments under US GAAP….


Consider the information provided in the reconciliation and answer the following questions:

a. Do US GAAP financial statements typically include capitalized development costs as intangible assets? Why would Nokia’s US GAAP financial statements include €149 million of capitalized development costs?

b. What could cause a difference in the calculation of impairments for the two accounting methods?
6. Following is a summary of the intangible assets for Cash Generating Unit #1 of Mayflower Technologies at December 31, 2007, before considering impairment losses. Amortization is calculated on a straight-line basis using an estimated life of 12 years. Management has calculated estimated cash flows of $1,360 for the CGU using reasonable cash flow forecasts, declining growth rates, and an appropriate discount rate. No fair market value is available.

a. Complete the chart below by calculating the amount of impairment loss, allocating the impairment to the individual assets of the CGU, and determining the carrying values at 12/31/2007 in accordance with IFRS.

<table>
<thead>
<tr>
<th>Historical cost, acquired 1/1/2007</th>
<th>Goodwill</th>
<th>Patents</th>
<th>Other Intangibles</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 1,000</td>
<td>1,500</td>
<td>500</td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td>Amortization expense 2007</td>
<td>0</td>
<td>-125</td>
<td>-42</td>
<td>-167</td>
</tr>
<tr>
<td>Carrying amount</td>
<td>1,000</td>
<td>1,375</td>
<td>458</td>
<td>2,833</td>
</tr>
<tr>
<td>Impairment loss</td>
<td>?</td>
<td>?</td>
<td>?</td>
<td>?</td>
</tr>
</tbody>
</table>

b. In 2008, management revised their cash flow forecasts due to favorable changes in export laws. The forecasted increase in production results in a revised estimated cash flow of $1,910. Complete the table by calculating the revised amortization rate on the 12/31/2007 carrying amount after impairment loss. Then calculate the carrying amount at 12/31/2008 and any impairment loss/recovery for the year in accordance with IFRS.

<table>
<thead>
<tr>
<th>Carrying amount after impairment loss, 12/31/07</th>
<th>Goodwill</th>
<th>Patents</th>
<th>Other Intangibles</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>?</td>
<td>?</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Amortization expense 2008</td>
<td>?</td>
<td>?</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Carrying amount, 12/31/2008</td>
<td>?</td>
<td>?</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Impairment loss/recovery</td>
<td>?</td>
<td>?</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Carrying amount after accumulated impairment loss, 12/31/2008</td>
<td>?</td>
<td>?</td>
<td>?</td>
<td>?</td>
</tr>
</tbody>
</table>
Current liabilities

The basic accounting for current liabilities is similar for US GAAP and IFRS. However, there are a few differences in details:

- Classification of refinanced short-term debt
- Reclassification of amounts payable on demand due to violation of debt covenants
- Bank overdrafts

US GAAP and IFRS have different requirements for the classification of short-term debt that has been refinanced. US GAAP (FAS 6) allows these amounts to be classified as long-term debt if a refinancing agreement is completed before the report date. IFRS (IAS 1) requires refinancing be completed before the balance sheet date to classify the debt as long-term. Refinancing completed between the balance sheet and issuance date is disclosed in the notes to the financial statements. Similarly, if debt becomes payable on demand due to a debt covenant violation, the amount is classified as a current liability unless a 12-month waiver is obtained from the lender before the report date (US GAAP) or the balance sheet date (IFRS). FASB and the IASB are considering this difference as part of the joint project on financial statement presentation.

As discussed in Unit 6 – Cash and Receivables, bank overdrafts result in additional classification differences. Material bank overdrafts are classified as current liabilities for US GAAP. For IFRS, these amounts are netted against cash if the overdrafts form an integral part of the entity’s cash management.

Contingent Liabilities

IAS 37 Provisions, Contingent Liabilities and Contingent Assets uses the term “provision” for a liability of uncertain timing or amount. A provision is required to be recognized when an outflow of resources to settle the liability is probable and the amount can be reasonably estimated. These recognition requirements match the US GAAP criteria for recognizing a contingent liability. There are, however, differences in treatment of the provision/contingent liability.

Under both accounting methods, a liability should be recognized using the best estimate of the settlement amount. However, if the entity has a range of estimates that are all equally probable, IFRS recognizes the liability at the mid-point of the estimates, while US GAAP uses the low end of the estimates. IFRS requires amount be updated to the current risk-adjusted discounted rate for each financial statement period.

Resources

IAS 1 Presentation of Financial Statements

IAS 7 Cash Flow Statements
Exercises

1. Under IFRS, what requirements must be met to classify debt due within one year of the balance sheet date as long-term?
   a. A refinancing agreement must be completed by the balance sheet date
   b. A refinancing agreement must be completed by the report date
   c. The company must document its intent to refinance the amount by the balance sheet date
   d. The company must document its intent to refinance the amount by the report date
   e. None of the above

2. What term does IFRS use for a liability of uncertain timing or amount that must be recognized on the balance sheet?
   a. Contingent liability
   b. Possible obligation
   c. Provision
   d. Obligation
   e. None of the above

3. Skylark Co. has financed its operations through a number of debt agreements. It considers bank overdrafts an integral part of its cash management. The auditor’s report for its 12/31/2008 financial statements was dated 3/31/2009. Of the following items, how much will be included as current liabilities according to IFRS? How much will be recognized as current liabilities for US GAAP?

   $350,000 Overdraft on the company’s cash account.
   1,800,000 Bank note issued 11/1/2005, payable on 11/30/2009. A 5-year refinancing agreement was obtained on 1/15/2009.
   2,500,000 Bank note issued 11/1/2006, payable on 11/10/2009. On 12/31/2008, the company obtained a 3-year refinancing agreement from the bank.

4. A former employee of Dreams Unlimited filed a lawsuit against the company in 2008. Based on consultation with legal representation, management of the company believes the suit will probably conclude in January 2009, resulting in a liability between $300,000 and $900,000, with all amounts in that range equally likely. At what amount should the liability be recorded on the December 31, 2008 IFRS financial statements of the company? At what amount should it be recorded for US GAAP?
Unit 13 – Long-term Liabilities

While IFRS and US GAAP define debt in similar terms, both recognize there are complex financial instruments that may contain characteristics of both debt and equity. Determining the proper classification of these instruments can be difficult, and the results sometimes differ between the two accounting standards.

Complex financial instruments

In FAS 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, US GAAP specifically identifies certain conditions under which equity instruments must be classified as liabilities:

- Mandatorily redeemable – i.e. that include an unconditional obligation to redeem the instrument at a specified date(s) or event that is certain to occur (other than liquidation or termination of the issuer)
- Obligation to repurchase the issuer’s equity shares that may require the issuer to transfer assets (e.g. a forward purchase contract or written put option on equity shares that is to be physically settled or net cash settled)
- Obligation that may require issuing a variable number of equity shares. For outstanding shares, this obligation must be unconditional to require liability treatment. For financial instruments other than outstanding shares, this obligation may be conditional.

Classification of instruments for IFRS, however, focuses on the substance of the transaction. An instrument, or its component parts, should be classified as equity if, and only if, it meets both conditions listed in IAS 32 Financial Instruments: Presentation. (1) The instrument includes no contractual obligation to deliver or exchange cash or financial assets to another entity and (2) If the instrument will/may be settled in the issuer’s own equity instruments it is (a) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its shares or (b) a derivative that will be settled by the issuer exchanging a fixed amount of cash/other financial assets for a fixed number of its own equity instruments. Under these rules, preferred shares are classified as equity if they are not redeemable, or redeemable at the option of the issuer. They are classified as liabilities if they are mandatorily redeemable, redeemable at the option of the shareholder, or contingently redeemable based on future events outside of the control of either party. Puttable instruments, that give the holder the right to put the instrument back to the issuer for cash or another asset, are liabilities.

While application of these rules is complex, it results in one clear difference. For financial instruments that are conditionally redeemable (at the option of the shareholder, or based on circumstances outside of the issuer’s control), IFRS classifies the amounts as liabilities while US GAAP classifies the instruments as equity. Note that if the redemption event occurs, or becomes certain to occur, the fair value of the instrument would be reclassified as a liability for US GAAP. No gain or loss would be recognized on this transaction.
SEC registrants are subject to additional guidance from Rule 5-02.28 of Regulation S-X, which requires these same conditionally redeemable securities to be classified outside of permanent equity. In practice, these instruments are reported as “mezzanine equity”, also called temporary equity, which is presented on the balance sheet between senior debt and equity.

**Convertible debt**

An additional area of difference is accounting for convertible debt (also called “compound financial instruments” for IFRS) – for example, a bond that can be exchanged for stock of the company (or other corporate security) at the discretion of the bondholder. IFRS requires “split accounting” for compound financial instruments whereby the proceeds are allocated between a liability component (at its fair value) and an equity component (the residual amount). In contrast, US GAAP recognizes the entire amount of proceeds for convertible debt as a liability unless it contains a beneficial conversion feature. EITF 00-27 specifies that if convertible debt includes an embedded beneficial conversion feature (i.e. convertible into common stock at a fixed conversion rate or fixed discount rate below the price of the common stock on the issue date), then the intrinsic value of the conversion feature (difference between the conversion price and the fair value of the common stock times the number of convertible shares) should be recorded to additional paid in capital.

**Resources**

IAS 32 Financial Instruments: Presentation
http://www.iasb.org/NR/rdonlyres/0242B440-1174-4BED-B399-B5BA248D0D06/0/IAS32.pdf

IAS 39 Financial Instruments: Recognition and Measurement

**Exercises**

1. How are proceeds from convertible stock recorded for IFRS?
   a. As a liability
   b. As equity
   c. Allocated to a liability component (at its fair value) with the remainder to equity
   d. Allocated to an equity account (at intrinsic value of the conversion option) with the remainder to liabilities
   e. Any of the above

2. How is preferred stock reported for IFRS when it is mandatorily redeemable upon death of the owner?
   a. As a liability
   b. As mezzanine equity
   c. As temporary equity
   d. As equity
   e. None of the above
3. How is preferred stock reported for IFRS when it is redeemable at the option of the issuer?
   a. As a liability
   b. As mezzanine equity
   c. As temporary equity
   d. As equity
   e. None of the above

4. Vidalia Corp issued €2 million of convertible bonds at par value. The bond is a five-year issue with interest payable annually at a nominal interest rate of 4%. Each bond has a face value of €1,000 is convertible at any time up to maturity into 250 ordinary shares. At the date of issue, the prevailing rate for similar debt without convertible options is 6% and the fair value of Vidalia Corp stock is €3. How will the bond be recorded for IFRS and US GAAP?

5. Which of the following financial instruments would be classified as liabilities for IFRS? For a private company under US GAAP? For an SEC registrant?
   a. Preferred stock with mandatory redemption upon death of shareholder
   b. Preferred stock redeemable at the option of the issuer
   c. Preferred stock redeemable at the option of the shareholder
   d. Preferred stock redeemable only at a specified maturity date
   e. Written put option that requires net cash settlement

6. Software Tycoons has issued $1 million of preferred stock that is redeemable if, and only if, the prime interest rate falls below 2.5%. How will the preferred stock be reported for US GAAP, IFRS, and the SEC? What could occur to eliminate differences between reporting for US GAAP and IFRS?

7. Smith & Colbert, Inc. issued $1 million of convertible bonds at par value on June 30, 2009. The bonds are convertible at a conversion price of $10 per share (holder would receive 100,000 shares of Smith & Colbert, Inc. common stock upon conversion). The fair value of the company’s stock at the commitment date is $12. Interest is paid at a nominal annual interest rate of 6% over the three-year life of the bonds. The current prevailing interest rate is 9%. How would the amount be allocated between liabilities and equity on the June 30, 2009 financial statements for US GAAP and IFRS?
IFRS and US GAAP have similar guidance for the measurement and presentation of equity. Differences in this area include terminology, the treatment of treasury stock, and the classification of certain complex instruments that have characteristics of both debt and equity (see Unit 13 – Long-term Liabilities for further details).

**Terminology**

<table>
<thead>
<tr>
<th>US GAAP</th>
<th>IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common stock</td>
<td>Share capital</td>
</tr>
<tr>
<td>Paid-in-capital in excess of par/</td>
<td>Share premium</td>
</tr>
<tr>
<td>Additional paid in capital</td>
<td></td>
</tr>
<tr>
<td>Retained earnings/Reinvested earnings</td>
<td>Retained earnings/retained profits/</td>
</tr>
<tr>
<td></td>
<td>accumulated profit and loss</td>
</tr>
<tr>
<td>Accumulated other comprehensive income</td>
<td>General reserve &amp; other reserve accounts</td>
</tr>
</tbody>
</table>

As with US GAAP, equity under IFRS can be categorized as contributed capital or non-contributed capital. Contributed capital includes share capital (the par value of shares sold) and share premium (the excess of share price over its par value). Contributed capital is often presented combined on the balance sheet as “issued capital” with note disclosure of the share capital and share premium components. Similar to US GAAP, if shares are issued with no par value, the entire contribution is recorded as share capital. IFRS uses the term “preference share” (vs. US GAAP “preferred stock”) for shares that provide preferential treatment (e.g. dividend distributions) to the shareholder.

Reserves is the term used in IFRS for all equity accounts other than contributed capital. Retained earnings is typically the primary component of a firm’s reserves. Additional reserve accounts reflect components of other comprehensive income (e.g. revaluation of assets and certain foreign exchange differences). See Unit 3 – Income Statement and Other Comprehensive Income for the IFRS equivalent of comprehensive income per US GAAP.

**Treasury Stock**

Under IFRS, when an entity repurchases its own shares of stock (treasury stock), it is shown as a reduction of stockholders’ equity. No guidance is provided for allocation to individual accounts, thus the transaction may be recorded as an increase to treasury stock, share capital and premium, retained earnings, or some combination of the above. If treasury stock is subsequently sold, no gain or loss is recognized for the excess of sale price over cost; the difference is shown as a change in equity.

This is similar to the treatment under US GAAP, except when shares are repurchased with the intention of retiring the stock. If the stock is to be retired, the firm may choose to allocate the excess of treasury stock cost over its par value (1) entirely to retained earnings, (2) entirely to additional paid in capital, or (3) between retained earnings and additional paid in capital.
Resources
IAS 1 Presentation of Financial Statements

IAS 32 Financial Instruments: Presentation
http://www.iasb.org/NR/rdonlyres/0242B440-1174-4BED-B399-B5BA248D0D06/0/IAS32.pdf

Exercises
1. Which accounts are classified as reserves for IFRS?
   a. Issued capital
   b. Retained earnings
   c. Revaluation of assets
   d. b and c
   e. All of the above

2. Which categories of equity represent capital contributions?
   a. Share capital
   b. Share premium
   c. Issued capital
   d. a and b
   e. All of the above

3. Under IFRS, how should the purchase of treasury stock be recorded?
   a. Debit to “Treasury stock” account
   b. Debit “Share capital” account for par value and “Share premium” for remainder
   c. Debit “Share capital” account for par value, “Share premium” for the original sale price in excess of par value, and retained earnings for the remainder
   d. a or c
   e. Any of the above

7. Convert the following excerpt from a US GAAP balance sheet to a presentation in accordance with IFRS.

   Stockholders’ equity
   Paid-in capital
     Common stock, $1 par value, 100,000 shares issued and outstanding $ 100,000
     Additional paid-in capital 800,000
     Total paid-in capital 900,000
   Retained earnings 250,000
   Total paid-in capital and retained earnings 1,150,000
   Accumulated other comprehensive income 175,000
   Total stockholders’ equity $ 1,325,000

8. The company from Exercise #4 above has repurchased 5,000 of its own shares for $12,000. Identify three different journal entries that would be acceptable for recording the transaction in accordance with IFRS.
Accounting for earnings per share and share-based compensation is similar under the two frameworks. There are, however, a few differences in the detailed application. For earnings per share, US GAAP (SFAS 128) and IFRS (IAS 33) differ in disclosure requirements as well as the detailed calculation of diluted EPS. For share-based compensation, the two frameworks differ in a variety of details including the scope of the guidance, the classification criteria for equity-settled and cash-settled awards, the definition of grant date, the impact on taxes, and the application to non-employee transactions.

**Earnings per share**

**Disclosures**

Under both frameworks of accounting, firms are required to disclose earnings per share information on the face of the income statement if their common stock is publicly traded, or if they are in the process of issuing stock for public trade. Required disclosures include both basic and diluted calculations of per share income from continuing operations and net profit or loss. US GAAP requires additional per share disclosures (on the face of the financial statements or in the notes) for discontinued operations, extraordinary income/loss, and the cumulative effect of a change in accounting policy.

**Diluted earnings per share**

Incremental shares – The treasury stock method is used to calculate diluted EPS for both IFRS and US GAAP, but there are differences in the application. US GAAP accounts for dilutive securities using a year-to-date weighted average of the number of incremental shares included in each quarterly calculation. The number of incremental shares included in each quarterly calculation is based on average market prices during the three-month period. IFRS, however, calculates incremental shares using a weighted average at the end of the year, rather than on a quarterly basis. Thus different average stock prices are used to determine the dilutive effect of convertible financial instruments under the two different frameworks.

Contracts settled in cash or shares – An additional difference is found in the treatment of contracts that may be settled in cash or shares, at the option of the entity. IFRS assumes the contract will be settled in shares, and it should be included in diluted earnings per share if the impact is dilutive. US GAAP starts with that assumption, but allows exceptions if reasonable evidence (past experience or stated policy) is provided to the contrary.

Since 2003, FASB and IASB have been jointly working toward convergence in accounting for earnings per share. In 2005, FASB issued its second exposure draft on the topic. The proposed guidance would conform US GAAP to IASB guidance for the differences in diluted EPS calculation described above. However, as the two standard setting bodies continued to review the topic, they reached different conclusions regarding other aspects of reporting. The two boards remain committed to resolving the remaining differences in this area of accounting, and plan to issue an exposure draft in the third quarter of 2008.
Share-Based Compensation

Scope

The scope of IFRS 2 Share-Based Payment and FAS 123 (R) Share-Based Payment
differ in a number of areas – employee share plans, awards by shareholders, and cash
bonuses. For US GAAP employee share plans are typically considered noncompensatory,
but for IFRS these plans are treated in the same manner as other share-based compensation
transactions. While both IFRS 2 and FAS 123(R) are applicable to transactions in which a
shareholder of the company uses an equity instrument to compensate a third party for
goods/services provided to the company, FAS 123(R), has an even broader application as it
includes not only shareholders, but other related/interested parties.

Classification of awards

Similar to US GAAP, IFRS recognizes two classes of share-based compensation. Equity-
settled (called equity classified for US GAAP) transactions occur when a company enters
into an agreement to acquire goods and/or services in exchange for shares of its stock (or
other equity instruments). These transactions are recorded at the fair value of the services
received. When shares are used to compensate employees, the fair value is determined using
the market value of the stock. Cash-settled (liability classified for US GAAP) transactions
occur when a company enters into an agreement in which it incurs a liability linked to the
company’s stock price. These liabilities are typically settled by the transfer of cash or other
assets. Equity-settled transactions are recorded at the grant date. Cash-settled transactions
are recorded at the grant date, but remeasured to fair value in each period until the liability is
settled.

While the basic criteria are similar, the two frameworks differ in certain instances. While
IFRS classification is typically determined based on the method of settlement (cash versus
equity instrument), US GAAP includes several additional reasons to classify a transaction as
a liability. If the award is linked to factors other than market, service or performance
conditions, (e.g. price of a commodity) US GAAP classifies it as a liability, regardless of the
method of settlement.

If the agreement provides an option for settlement by equity shares or cash, US GAAP
classifies the award as a liability. IFRS requires the award be separated into separate
components for cash-settled (to the extent any liability is expected to be settled in cash or
other assets) and equity-settled (the excess of the transaction’s fair value over the liability
incurred).

If an agreement specifies a fixed amount (such as a $5,000 bonus) to be settled in a
variable number of shares ($5,000 / share price at the settlement date) US GAAP classifies
the amount as a liability while IFRS classifies the amount in equity due to its settlement
method.
Grant date

IFRS and US GAAP provide slightly different definitions for the grant date – the date at which the share-based compensation is initially measured. IFRS defines the grant date as the time at which the two parties come to an agreement on the terms and conditions of the arrangement. US GAAP defines the grant date as the first date at which two conditions are met: (1) a mutual understanding is agreed upon (similar to the IFRS date) and (2) the employee (or service provider) begins to be affected by the terms of the agreement.

Recognition

Under both IFRS and US GAAP, awards are recognized over the related period of employee service. US GAAP specifies that the service period may be explicit, implicit or derived. IFRS does not include the concept of derived service period. In most cases awards will be recognized over the same period of time under the two frameworks, but certain situations in which the employee.

There is a difference, however, for recognition of awards with graded vesting (e.g. a company awards 100,000 share options vesting 50% the first year, 30% the second year and 20% the third year). IFRS requires the company to account for each separately vesting amount, as if the company made three separate awards. US GAAP allows this method of accounting, but also allows companies the option to account for the entire award on straight-line basis over the entire award period. Under either US GAAP option, at any given date the company must at least recognize the amount of award vested by that date.

Taxes

Both payroll and income taxes are affected differently by share-based compensation under the two frameworks. For IFRS, payroll taxes are recognized at the same time as the compensation expense, and will be accrued over time. For US GAAP, the payroll tax is not recognized until the date of the event triggering measurement and payment of tax – typically the exercise date for options and the vesting date for restricted stock.

The amount and recognition of deferred taxes will differ between US GAAP and IFRS. Under IFRS, a deferred tax asset is recognized when share options have current intrinsic value. Adjustments, primarily recognized in the income statement, are made to the deferred tax asset each reporting period based on the current market value of the stock. For US GAAP, a deferred tax asset is recognized when the compensation is recorded for book purposes based on the grant date fair value of the award. The deferred tax asset is not revalued as the market value of the company’s stock changes over time. Therefore, IFRS introduces greater volatility into the income statement than US GAAP, through the periodic adjustment of the deferred tax asset.
Non-employee transactions

Both IFRS 2 and FAS 123(R) are applicable to non-employee transactions, but differences in valuation may occur due to differences in the definition of an employee (a strict definition is used for US GAAP based on common law and an Internal Revenue Service Ruling), the valuation method (typically based on the value of the service/goods for IFRS and the value of the equity instrument for US GAAP), and the measurement date (the date goods/services are received for IFRS, while US GAAP uses the earlier of that date or the date a commitment is reached).

Resources

IAS 33 Earnings per Share

IFRS 2 Share-based Payment

Exercises

1. What components of earnings per share are required disclosures for IFRS?
   a. Basic EPS for continuing operations
   b. Basic EPS for discontinued operations
   c. Diluted EPS for net profit/loss
   d. a and c
   e. All of the above

2. How do the calculations for the dilutive effect of incremental shares differ between IFRS and US GAAP?
   a. IFRS uses the weighted average of quarterly incremental shares
   b. US GAAP uses the weighted average of quarterly incremental shares
   c. IFRS uses the treasury stock method
   d. US GAAP uses the treasury stock method
   e. a and c

3. How are contracts that may be settled in cash or shares (at the option of the entity) treated for the IFRS calculation of diluted earnings per share?
   a. Assumes contract will be settled in shares
   b. Assumes contract will be settled in shares unless reasonable evidence to the contrary
   c. Impact included in diluted EPS if the effective is antidilutive
   d. a and c
   e. b and c
4. How are compensation arrangements that may be settled in cash or shares reported on the IFRS balance sheet?
   a. As a liability
   b. As an increase in equity
   c. Split into components of liability and equity
   d. b or c
   e. None of the above

5. What condition(s) are necessary to recognize the IFRS grant date for share-based compensation?
   a. The two parties must agree on the terms of the arrangement
   b. The two parties must agree on the conditions of the arrangement
   c. The employee/service provider must begin to be affected by the terms of the agreement.
   d. a and b
   e. All of the above

6. How does the tax treatment of share-based compensation differ between the two frameworks?
   a. IFRS will generate greater volatility in the income statement
   b. US GAAP will generate greater volatility in the income statement
   c. It depends

7. Which transactions are outside the scope of IFRS 2 Share-Based Payments?
   a. Employee share purchase plans
   b. Share-based payments to non-employees
   c. Share-based payments by shareholders
   d. Share-based payments by other related parties
   e. None of the above

8. How does IFRS account for awards with graded vesting?
   a. Straight-line basis over the entire period of the award
   b. Each separately vesting amount is accounted for as a distinct award
   c. Either a or b
   d. None of the above
9. On January 1, 20X7, Milo Corporation awarded 100,000 share options to employees with a vesting schedule of 25% the first year, 25% the second year, and 50% the third year. Management of the company calculates the value of the options as follows:

<table>
<thead>
<tr>
<th>Vesting Date</th>
<th>Value per Option</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X7</td>
<td>$13.44</td>
</tr>
<tr>
<td>20X8</td>
<td>$14.17</td>
</tr>
<tr>
<td>20X9</td>
<td>$14.69</td>
</tr>
</tbody>
</table>

Assuming all employees meet the vesting requirements, determine the pre-tax cost of compensation to be recorded each year 20X7-20X9:

a. Under IFRS
b. Under US GAAP, accounting for each vesting date as a separate award
c. Under US GAAP, using the straight-line method over the life of the award

10. On January 1, 20X1, a company issues warrants to buy 500,000 shares of common stock at $60 per share for a period of five years. All outstanding warrants were exercised on September 1, 20X1. Average market prices of the common stock are as follows:

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>First quarter</td>
<td>$59</td>
</tr>
<tr>
<td>Second quarter</td>
<td>$70</td>
</tr>
<tr>
<td>Third quarter</td>
<td>$72</td>
</tr>
<tr>
<td>Fourth quarter</td>
<td>$72</td>
</tr>
<tr>
<td>1/1/X1 – 9/1/X1</td>
<td>$66.125</td>
</tr>
<tr>
<td>7/1/X1 – 9/1/X1</td>
<td>$71</td>
</tr>
</tbody>
</table>

How many incremental shares should be included in the annual diluted EPS calculation for US GAAP and IFRS?
11. Using the following information, calculate 20X1 diluted earnings per share for Fusion Corp in accordance with both IFRS and US GAAP.

Common stock – The number of shares of common stock outstanding at the beginning of 20X1 was 600,000. On February 1, 20X1, 100,000 shares of common stock were issued for cash.

Convertible debentures – In the last quarter of 20X0, 4 percent convertible debentures with a principal amount of $10,000,000 due in 20 years were sold for cash at $1,000 (par). Interest is payable semiannually on November 1 and May 1. Each $1,000 debenture is convertible into 10 shares of common stock. No debentures were converted in 20X0. The entire issue was converted on April 1, 20X1, because the issue was called by the Corporation. The Corporation paid bondholders interest accrued through March 31, 20X1. Note: For IFRS purposes, Fusion Corp determined the fair value of the liability represented 87% of the $10,000,000. Therefore 87% of the semiannual interest payments will be recorded as interest expense, with the remainder recorded as a reduction of equity.

Warrants – On April 1, 20X1, the company issued warrants to buy 500,000 shares of common stock at $50 per share for a period of five years. All outstanding warrants were exercised on December 1, 20X1.

The tax rate for 20X1 was 40%.

Average market prices of Fusion Corp common stock are as follows:
- First quarter $45
- Second quarter $49
- Third quarter $64
- Fourth quarter $72
- 10/1/X1 – 11/30/X1 $68
- 7/1/X1 – 11/30/X1 $63

Net income/(loss) for Fusion Corp is as follows:

<table>
<thead>
<tr>
<th></th>
<th>US GAAP</th>
<th>IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>First quarter</td>
<td>$ 750,000</td>
<td>$ 757,800*</td>
</tr>
<tr>
<td>Second quarter</td>
<td>1,250,000</td>
<td>1,250,000</td>
</tr>
<tr>
<td>Third quarter</td>
<td>500,000</td>
<td>500,000</td>
</tr>
<tr>
<td>Fourth quarter</td>
<td>800,000</td>
<td>800,000</td>
</tr>
</tbody>
</table>

*Difference in first quarter income is due to difference in classification of convertible debentures between the two frameworks described above.
Definition of Financial Instruments including assets, liabilities, and equity

IAS 32 Financial Instruments: Presentation defines financial instruments and sets forth disclosure requirements. Definitions of financial instruments are consistent with US GAAP.

Classification of financial assets

IAS 39 Financial Instruments: Recognition and Measurement specifies four categories of financial assets including:

1. Financial assets at fair value through profit or loss
2. Held to maturity investments
3. Loans and receivables
4. Available for sale financial assets

The category of financial assets at fair value through profit or loss includes debt securities that the entity purchased with the intent to sell in the short term. IFRS allows entities to designate any financial asset to be measured at fair value with changes in valuation recognized in profit or loss. According to FASB Statement 159, companies may elect to measure certain financial instruments at fair value with changes recognized in earnings each reporting period. This standard brings US GAAP closer to IFRS in terms of fair value election. Statement 159 requires the election to be made when an asset is initially recognized and the election is irrevocable in future periods.

The held to maturity investments and available for sale categories are defined similarly under US GAAP and IFRS. The loans and receivables category does not exist under US GAAP. IAS 39 defines loans and receivables as “financial assets that are created by the enterprise by providing money, goods or services directly to a debtor, other than those that are originated with the intent to be sold immediately or in the short term, which should be classified as held-for-trading [available for sale].” Examples of items in the loans and receivables category include accounts receivable and loans to other entities. US GAAP does not include trade accounts receivable and loans receivable in the same category as debt securities. IAS 39 allows entities to classify loans and receivables as available for sale. This classification requires loans and receivables to be measured at fair value and any valuation changes are recognized in equity. This option is not available under US GAAP.
Subsequent Measurement

Valuation changes subsequent to the initial purchase are accounted for similarly under US GAAP and IFRS. The following chart depicts subsequent measurement requirements.

<table>
<thead>
<tr>
<th>Category of Financial Asset</th>
<th>Valuation on Subsequent Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>At fair value through profit or loss*</td>
<td>Fair Value</td>
</tr>
<tr>
<td>Held to Maturity</td>
<td>Amortized Cost</td>
</tr>
<tr>
<td>Loans and Receivables**</td>
<td>Amortized Cost***</td>
</tr>
<tr>
<td>Available for Sale</td>
<td>Fair Value (through equity)</td>
</tr>
</tbody>
</table>

* Both IFRS and US GAAP allow entities to designate any financial asset (except for specific ineligible financial instruments) to be measured at fair value through profit and loss. This category also includes the equivalent of trading securities under US GAAP.

** Loans and Receivables is not a category of debt securities under US GAAP.

*** Or Fair Value (through equity) for IFRS if classified as Available for Sale.

Transfers between Categories

Unlike US GAAP, IAS 39 prohibits the transfer of debt and equity securities into or out of the financial assets at fair value through profit or loss (trading category). US GAAP accounts for transfers between categories at fair value.

Reversal of Impairment

US GAAP prohibits the reversal of impairment losses. IFRS reverses impairment losses when certain conditions have been met.

Derecognizing Financial Assets

The main difference between IFRS and US GAAP concerns derecognizing parts of financial assets (see Unit 6 – Cash and Receivables). US GAAP does not allow entities to derecognize part of a financial asset. Following certain criteria, IAS 39 allows entities to derecognize part of a financial asset as long as the entity has lost control over the asset.

Qualifying Special Purpose Entities

When the transferee is not allowed to sell or pledge transferred assets, US GAAP allows entities to use qualifying SPEs for derecognition of financial assets. FASB is considering eliminating the category of qualified SPEs. IAS 39 does not have a category for QSPEs.

Offsetting assets

US GAAP permits offsetting under certain conditions. The parties must owe each other determinable amounts, intend to offset, and it must be enforceable by law. According to IFRS, offsetting assets and liabilities is only allowed when specifically permitted by a standard. IAS 39 allows entities to offset amounts if there is a legal right to offset and the entity intends to settle the transactions on a net basis or to simultaneously realize the asset and settle the liability.
Equity Instruments

Similar to US GAAP, IFRS determines the method of accounting for equity instruments based on the level of control the investor has over the organization. Under both sets of accounting standards, holdings for which the investor lacks significant influence are accounted for using the fair value method. Both IFRS and US GAAP presume an investor lacks significant influence over a company if he/she holds less than 20% of the voting power, unless there is evidence to the contrary. A difference exists between US GAAP and IFRS for investments in unlisted equity instruments. IFRS requires the instrument to be measured at fair value if it can be determined, otherwise at cost. US GAAP measures unlisted equity instruments at cost.

Like US GAAP, IFRS accounts for investments in which the investor has significant influence over the company using the equity method. Both frameworks presume investors holding between 20% and 50% of the voting power have significant influence, but lack control over the company. IFRS uses the terminology investment in associate rather than the US term equity investment. According to IAS 28 Investment in Associates, the initial recognition of the investment is at cost and the investor’s share of profit or loss increases or decreases the carrying amount of the investment. Distributions decrease the carrying amount and changes in the investor’s share of the associate’s reserves increase or decrease the carrying amount (US GAAP does not have reserves and would not change the carrying amount for these transactions). IAS 28 classifies investments in associates accounted for using the equity method as noncurrent assets and requires separate line disclosure on the balance sheet. The investor’s share of profit or loss must be reported on the income statement.

One difference between US GAAP and IFRS concerns differences in accounting policy between the investor and associate. According to IFRS, the investor and associate must have the same accounting policies. US GAAP has no such requirement. Both US GAAP and IFRS require the reporting dates of the investor and associate to be within three months of one another. IFRS requires the investor and associate to adjust for any significant intervening transactions. US GAAP only requires disclosure of such transactions.

IAS 27 Consolidated and Separate Financial Statements defines the requirements for preparing and presenting consolidated financial statements and accounting for investments in subsidiaries, jointly controlled entities, and associates. Similar to US GAAP, a parent is required to prepare consolidated financial statements if it controls a subsidiary. Under both frameworks, control is presumed to exist when an investor holds 50% or more of the voting rights of a company. However, control can exist when an entity holds less than 50% of the voting rights through legal or contractual agreements.

A difference exists between IFRS and US GAAP relating to potential voting rights. Under IFRS, share warrants, share call options, and debt or equity instruments that are convertible into ordinary shares should be considered when evaluating the investor’s percentage of voting rights. US GAAP does not include potential voting rights in its evaluation of control.
According to IFRS, the parent and subsidiary must use uniform accounting policies in the consolidated financial statements. US GAAP has a similar requirement but provides an exception for subsidiaries in industries with specialized accounting policies. IFRS allows the parent and subsidiary to have different reporting dates as long as there is not more than a three month difference. If significant intervening transactions take place, entities must make adjustments. US GAAP has a similar time period rule, but only requires disclosure of significant intervening transactions.

**Resources**
IAS 27 Consolidated and Separate Financial Statements  

IAS 28 Investments in Associates  

IAS 32 Financial Instruments: Presentation  

IAS 39 Financial Instruments: Recognition and Measurement  

**Exercises**
1. The FASB recently passed Statement 159 that allows fair value measurement for financial assets.  
   True or False

2. According to US GAAP, which of the following is not a category for debt securities  
   a. Available for Sale  
   b. Trading Securities  
   c. Held to Maturity  
   d. Loans and Receivables

3. According to US GAAP and IFRS, unless there is evidence to the contrary, investor holdings of between 20%-50% in an entity are assumed to have  
   a. Control  
   b. Significant influence  
   c. No influence  
   d. None of the above

4. IAS 28 classifies investments in associates accounted for using the equity method as  
   a. Current assets  
   b. Current liabilities  
   c. Noncurrent assets  
   d. Noncurrent liabilities
5. According to US GAAP and IFRS, how many months must the reporting dates of the investor and associate be within one another
   a. One month
   b. Two months
   c. Three months
   d. Four months

6. IAS 39 prohibits the transfer of debt and equity securities into or out of the
   a. Financial asset at fair value through profit or loss category
   b. Held to maturity category
   c. Available for Sale category
   d. Loans and Receivables category

7. According to IFRS, identify whether the following financial assets are:
   1. Financial assets at fair value through profit or loss
   2. Held to Maturity
   3. Loans and Receivables
   4. Available for Sale

   Consider each case independently.
   a. Credit card receivable due from customer
   b. Government Bonds the company intends to hold until maturity
   c. Convertible notes paying 5% interest
   d. Ordinary share investments held for capital gains
   e. Share portfolio held for short term gain
   f. Loan made to another entity

8. Martin Manufacturing purchases with cash 250 shares of stock in Elliot Company for $10 a share. Martin classifies the stock as a financial asset at fair value through profit or loss. By year end the stock price has increased to $12 a share. Prepare the journal entries on Martin’s books at the initial purchase and year end.

9. Castle Company spends $2,000 cash to purchase 400 shares of stock priced at $5 a share. At the end of the year the stock price has increased to $8 a share. Assuming Castle classifies the stock as available for sale, how would Castle record the initial and year end journal entries?

10. Davidson Furniture owes Kenneth Decorators $1,000 for providing decorating services. Kenneth Decorators owes Davidson Furniture $1,000 for a recently purchased sofa. Assuming a legal right to offset exists under IFRS, what is the journal entry on Davidson’s books?
11. Jersey Company purchases $130,000 of 5% bonds of Giles Corporation for $100,000 cash. The bond has a ten year term and pays interest annually. The effective interest rate is 10%. Provide the journal entry to record the initial transaction and the recognition of interest in year one. Assume Jersey Company classifies the bond as held for maturity.

12. On January 15, 2007 Kent Company purchases 60,000 shares of Harris Company for $15 a share. This gives Kent Company a 20 percent interest in Harris Company. During 2007, Harris reports net income of $300,000. As of December 31, 2007, the fair value of Harris Company is $20 a share. On January 20, 2008, Harris pays a cash dividend of $15,000 to Kent Company. According to IAS 39, Kent Company elects to recognize all unrealized gains and losses as part of net income.
   a) Assuming that Kent Company does not have the ability to exercise significant influence and the securities are classified as available for sale, record the appropriate journal entries.
   b) How are the journal entries different if Kent Company has significant influence over Harris Company?

13. On January 1, 2006 Roland Company invests in an equity instrument. The cost and the fair value at the date of investment is $200,000. Roland classifies the investment as available for sale and measures it at fair value. Any changes in fair value are reported in equity. During 2006, the fair value of the investment declines by $15,000 but there is no evidence of impairment. During 2007, the fair value declines by $20,000 and there is objective evidence of impairment. Finally, in 2008 the fair value increases by $40,000 and the impairment is reversed.

Record the journal entries for 2006, 2007, and 2008. How would U.S. GAAP treat the fair value increase of $40,000 in 2008?
The general principles of revenue recognition are similar under IFRS and US GAAP, however this is an area where the difference between the principle-based nature of IFRS and the US GAAP rule-based approach is clearly evident. IFRS guidance is primarily found in IAS 18 Revenue Recognition, while US GAAP includes extensive guidance in FAS, SABs SOPs, EITFs and AAERs. These additional sources of US GAAP provide guidance for specific industries (e.g. software, construction) and transactions (multiple element arrangements).

**Construction contracts**

One area of difference between the two frameworks is in accounting for construction contracts. IFRS requires the percentage-of-completion method of accounting unless the outcome cannot be reasonably estimated. If the outcome cannot be reasonably estimated, the zero-profit method should be used, in which revenue is only recognized to the extent of costs. For US GAAP, the percentage-of-completion method is preferred, but not required. The completed contract method should be used in situations when the costs to complete cannot be reasonably estimated. Under this method, costs are accumulated to the Construction in Process account, but there are no entries to income statement accounts until the contract is completed. Instead, an amount is carried on the balance sheet for costs in excess of billings (or billings in excess of cost). The completed contract method is prohibited for IFRS. While the zero-profit and completed contract methods do not result in different gross profit calculations, the amounts reflected for revenue and cost will differ under the two methods.

**Service revenue**

For IFRS, service revenue is typically accounted for using the percentage-of-completion method of accounting. The straight-line method may be used if the services occur over a specified period of time. For US GAAP companies should follow specific industry guidance to determine the appropriate accounting method for service revenue.

**Multiple-element arrangements**

IFRS does not specifically address multiple-element arrangements, therefore revenue recognition criteria are typically evaluated for each individual component. For US GAAP, a transaction must meet criteria established in EITF 00-21 to divide the transaction into separate elements for accounting purposes. Specific guidance is established for multiple-element arrangements in the software industry.

**Note:**

*Limited exercises have been included for these topics since detailed coverage is beyond the scope of most intermediate textbooks.

**Resources**

IAS 18 Revenue Recognition
http://www.iasb.org/NR/rdonlyres/1A3771B8-5627-44E4-984E-AC90FEE1A971/0/IAS18.pdf
Exercises

1. How are multiple-element arrangements accounted for under IFRS?
   a. Straight-line method
   b. Completed-contract method
   c. Percentage of completion method
   d. Revenue recognition criteria applied to individual elements
   e. All of the above

2. What method of contract accounting is allowable for US GAAP but prohibited for IFRS?
   a. Completed contract
   b. Percentage-of-completion
   c. Straight-line
   d. Zero-profit
   e. None of the above

3. Blythe Construction, Inc. secured a $2,000,000 fixed-price contract to construct a new gymnasium for the local high school. The company has incurred $500,000 of costs, and estimates an additional $1,200,000 to complete the project. The company has billed the school district for $800,000, but no payments have been received.

   a. How will this project be reported on the company’s financial statements for US GAAP? For IFRS?

   b. If Blythe Construction could not reasonably estimate the cost of completion, and therefore the outcome of the project, how would the contract be reflected on the financial statements for US GAAP? For IFRS?
4. Part I
Use the following excerpt from Elan Corporation’s 2006 annual statement to answer questions a through c?
   a. By what amount do IFRS and US GAAP 2006 net income differ due to principles of revenue recognition?
   b. What type of transaction(s) generated this difference?
   c. Do you consider this amount material? Why or why not?

Part II
Obtain the 2007 annual statement from the company’s website www.elan.com to answer questions a through c. (Hint: Most companies make their financial statements available in a section for Investors.)
   a. What is the amount of the 2007 IFRS/US GAAP net income reconciling item for revenue recognition?
   b. If no additional transactions are entered into, what amount do you anticipate in the 2008 IFRS/US GAAP net income reconciliation for revenue recognition?
   c. Do you consider the 2007 and 2008 adjustments for revenue recognition material? Why or why not?
IAS 12 *Income Taxes*, similar to US GAAP, establishes guidelines for the recognition of deferred taxes generated by temporary differences between book and taxable income. While US GAAP and IFRS provide different guidance for the recognition and calculation of deferred taxes, additional clarification from the two boards have reconciled these basic differences. The remaining differences relate to financial statement presentation and specific applications such as revaluation of assets.

**Recognition**

While the two frameworks use different criteria for recognition of deferred tax assets, the net result for the financial statements is the same. Using IFRS, a deferred tax asset is recognized only if it is probable (more likely than not) than the asset will be applied against future taxable profits. US GAAP initially recognizes the full deferred income tax asset, but requires a valuation allowance if it is more likely than not that some or all of the asset will not be realized.

**Calculation**

IFRS and US GAAP utilize different terminology regarding the tax rates used in deferred tax calculations, but the IASB has issued clarification that reconciles the difference. IFRS utilizes tax rates and laws that have been enacted or substantively enacted as of the balance sheet date. US GAAP allows only the use of enacted laws and rates as of the balance sheet date. Substantively enacted laws and rates cannot be used for US GAAP. As part of the convergence project, IASB has defined the term substantively to mean “virtually certain” and clarified that it only applies if the remaining steps in the process cannot change the outcome. They pointed out that, in the US, a substantively enacted tax rate requires the signature of the president, but in other countries “royal assent” may not be necessary to meet the “virtually certain criteria. The FASB is expected to release an exposure draft in the fourth quarter of 2008 that will modify the language of Statement 109 to be consistent with that of the IASB for tax jurisdictions outside the US.

**Presentation**

For IFRS, deferred tax assets and liabilities are classified as non-current. Supplemental disclosures indicate the nature of each temporary difference and the amounts to be realized within 12 months. US GAAP, however, classifies deferred tax assets and liabilities based on the classification of the related asset or liability. The IASB is expected to release an exposure draft by the end of 2008, conforming the classification of deferred tax assets and liabilities to that of US GAAP.

**Revaluation of assets**

When property, plant and equipment are revalued for IFRS, this often results in a temporary difference between book and tax bases, as the assets are not revalued for tax purposes. Deferred tax calculated on this difference is recognized directly to equity. US GAAP does not allow revaluation of property plant and equipment, therefore there is no deferred income tax effect.
Exercises

1. What tax rates are used for IFRS deferred tax calculations?
   a. Enacted rates
   b. Substantively enacted rates
   c. Proposed rates
   d. a and b
   e. All of the above

2. Under IFRS, what would be required for a substantively enacted tax rate change in the US?
   a. Bill passed in the Senate
   b. Bill passed in the House
   c. Signed by the President
   d. a and b

3. When is a deferred tax asset presented with current assets for IASB?
   a. When it is expected to be realized within one year
   b. When it is created by a timing difference in a current asset
   c. When it is created by a timing difference in a current asset or liability
   d. a and c
   e. None of the above

4. During the current year, Noble Enterprises began offering a warranty on its products. The company estimated warranty expense at $500,000 for its financial statements. For tax purposes, the warranty expense is not deductible until paid.

   As of the balance sheet date, the company is currently taxed at 35%, but is expecting to benefit from a reduction in the tax rate. Both houses of Congress, upon request of the President, have passed legislation reducing the federal tax rate, and the President is expected to sign the bill into law. The company’s rate after the tax change will be 30%.

   What is the value of the deferred tax asset for IFRS and US GAAP?
5. Apex, Inc. has calculated the following deferred tax assets and liabilities based on temporary differences related to its operations. Classify the following deferred tax items as current/non-current and asset/liability. Then determine the financial statement presentation for IFRS and US GAAP.

<table>
<thead>
<tr>
<th>Deferred Tax</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 20,000</td>
<td>Rent collected one month in advance, recognized upon receipt for tax purposes.</td>
</tr>
<tr>
<td>$ 15,000</td>
<td>Installment sales, profit recognized during current year for accounting purposes (period of sale) and following year for tax purposes (period of collection)</td>
</tr>
<tr>
<td>$115,000</td>
<td>Tax depreciation in excess of books</td>
</tr>
</tbody>
</table>

6. As of December 31, 20X9, Foresyte Corp. holds an asset with a cost of $140 and accumulated depreciation of $56 for book and $98 for tax. The asset has been revalued to $100 for book purposes and the following journal entry has been recorded.

\[
\begin{align*}
\text{Accumulated depreciation} & \quad \text{€56DR} \\
\text{Equity – Asset revaluation surplus} & \quad \text{€16CR} \\
\text{Plant} & \quad \text{€40CR}
\end{align*}
\]

No adjustment has been made for deferred tax during the current year. As of December 31, 20X8, a deferred tax liability of €6.3 had been recorded. Determine the appropriate journal entry to record the income tax effect of the revaluation for IFRS, using the tax rate of 30%. How would this transaction be treated for US GAAP?
With the issuance of SFAS 158 *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans: an amendment of FASB Statements No. 87, 88, 106, and 132(R)*, FASB made strides toward converging U.S. pension accounting with international standards found in IAS 19 *Employee Benefits*. A few differences remain in the current standards, however, including recognition of the defined benefit asset/liability, actuarial gains and losses, and prior service costs.

In the long-term plan for convergence, both frameworks may make significant changes to accounting for defined benefit plans. In March 2008, the IASB issued a discussion paper proposing amendments to IAS 19. Most notable among the changes are the proposed elimination of the corridor approach, and the introduction of a new category of benefit plans. The IASB is accepting comments on the discussion paper through September 26, 2008 and hopes to issue a final standard in 2011. FASB has indicated its intention to leverage this work of the IASB. “That is, once the IASB completes development of its new standard, the FASB will consider whether adopting similar measurement requirements would improve reporting in the United States.”

**Current standards**

**Defined benefit asset/liability**

Under SFAS 158, US GAAP recognizes the funded status of the defined benefit plan (present value of the projected benefit obligation less the fair value of plan assets) on the balance sheet. IFRS, on the other hand, recognizes the funded status of the plan less any unrecognized actuarial gains/losses and unrecorded prior service costs. It places a ceiling on the defined benefit asset equal to the amount of unrecognized actuarial losses and prior service costs.

**Actuarial gains and losses**

Both US GAAP and IFRS use the corridor approach to determine the minimum amount of actuarial gains/losses to be recognized in the income statement. Any systematic approach that results in earlier recognition in profit and loss is allowable under either framework. For US GAAP, gains and losses outside of the corridor must be recognized in other comprehensive income with the corresponding entry to the balance sheet (to reflect the funded status of the plan). These amounts may be amortized and reported in profit and loss in subsequent years. The IASB refers to this practice of reclassifying amounts from other comprehensive income to profit and loss as “recycling” and IFRS prohibits its application to actuarial gains and losses. Actuarial gains and losses outside of the corridor are not required to be recognized on the face of the financial statements, but are disclosed in the notes. IFRS provides an option for firm’s to recognize the full amount directly to retained earnings in the Statement of Other Recognized Income and Expenses (SORIE), the equivalent of the US GAAP Statement of Other Comprehensive Income. Unlike US GAAP, however, amounts recorded directly to retained earnings in the SORIE may not be reported in profit and loss in subsequent periods.
Prior service costs

Under IFRS, prior service costs are recognized as a component of net periodic benefit cost over the related vesting period. This results in immediate expensing of benefits that are fully vested. US GAAP, on the other hand, requires prior service cost to be recorded in other comprehensive income during the period of the amendment. The cost is then amortized and expensed as a component of periodic benefit cost over the remaining service period of active participants.

Proposed Amendments

New Categorization of Benefit Plans

In the proposed amendment, the IASB eliminates use of the terms defined benefit plans and defined contribution plans. Instead, the guidance uses two new classifications: contribution-based promises and defined benefit promises. This changes the unit of accounting from a plan to a promise. A given plan that includes multiple promises would be subject to multiple accounting treatments under the proposed guidance.

Contribution-based promises include the promises currently classified as defined contribution plans, plans that guarantee a specified interest rate on contributions (either a fixed rate or one linked to an index, such as the one-year Treasury bill rate), and plans commonly called cash balance plans (which typically include defined contributions plus a specified interest rate). Any promise not meeting the definition of a contribution-based promise is classified as a defined benefit promise, including those plans for which benefits are calculated based on a participant’s anticipated salary at the date of retirement.

Elimination of Corridor Approach

In the discussion paper released in March 2008, the IASB proposes elimination of the corridor approach currently allowed by IAS 19. Companies will be required to recognize all changes in the fair value of plan assets and defined benefit obligations in the period in which they occur. Return on assets will be reported in total, rather than dividing the return into its current components – expected return and actuarial gains/losses.

The IASB has not made a specific recommendation on how the transactions should be recorded and presented in the financial statements. Instead, the board has requested feedback from its constituents on three alternatives:

- Recognize all changes in value of plan assets and the defined benefit obligation in profit and loss.
- Present service cost in profit and loss; all other components in other comprehensive income.
- Report remeasurements due to changes in assumptions (i.e. discount rate) in other comprehensive income; all other components (i.e. service cost, interest income, and interest expense) in profit and loss.
Prior service costs

The IASB believes recognition of prior service costs should follow the same three alternatives for recognition described in the previous section. Under all three alternatives, both vested and unvested prior service costs will be recognized in profit and loss in the period of the plan amendment. While this matches the current treatment for vested prior service costs, it changes the treatment for unvested prior service costs. The IASB cites the similarity to FAS 158 guidance, which requires immediate recognition of prior service costs in other comprehensive income.

Resources

IAS 19 Employee Benefits
http://www.iasb.org/NR/rdonlyres/7BD0B47D-7BBA-41CA-B3A8-51A0CDD70806/0/IAS19.pdf

Discussion Paper – Preliminary Views on Amendments to IAS 19 Employee Benefits

1Pension Minutes of the August 29, 2007 FASB Board Meeting
http://fasb.org/board_meeting_minutes/08-29-07_pbo.pdf

Exercises

1. When a firm uses the corridor approach to account for a defined benefit plan, what amount must be recorded in other comprehensive income/SORIE for IFRS?
   a. Actuarial gains and losses
   b. Benefits paid
   c. Prior service costs
   d. a and c
   e. None of the above

2. When are prior service costs recognized under IFRS?
   a. Over the related vesting period
   b. Over the remaining service period
   c. Over a fifteen year period
   d. a and b
   e. All of the above

3. By what amount will the defined benefit liability typically differ between US GAAP and IFRS financial statements?
   a. Unrecognized actuarial gains and losses
   b. Benefits paid
   c. Unrecognized prior service costs
   d. a and c
   e. None of the above
4. Which of the following would not be considered a contribution based promise under the proposed amendment to IAS 19?
   a. Cash balance plan
   b. Plan including a guaranteed interest rate of 5% on all contributions
   c. Plan guaranteeing interest on contributions, at a rate linked to the 5-year Treasury bill
   d. Plan guaranteeing annual distributions equal to 80% of the participant’s final salary
   e. None of the above

5. A firm uses the corridor approach to account for the first year of a defined benefit plan. Based on the information below, how will the firm’s financial statements differ between US GAAP and IFRS?

   Projected benefit obligation $ 850,000
   Service cost 95,000
   Benefits paid 89,000
   Interest 70,000
   Expected return on assets 35,000
   Actual return on assets 40,000
   Amortization of actuarial losses 2,000

   a. US GAAP comprehensive income will exceed IFRS by $5,000
   b. IFRS comprehensive income will exceed IFRS by $2,000
   c. US GAAP liabilities will exceed IFRS by $850,000
   d. US GAAP net income will exceed IRS by $40,000
   e. IFRS net income will exceed US GAAP by $15,000

6. Following is a list of accounting items related to a defined benefit plan. The firm uses the corridor approach for both IFRS and US GAAP. What amounts will be reflected in profit and loss for IFRS and for US GAAP? What amounts will be reflected in other comprehensive income/statement of other recognized income and expense for US GAAP? For IFRS?

   Projected benefit obligation $ 900,000
   Service cost 150,000
   Benefits paid 80,000
   Interest 90,000
   Expected return on assets 60,000
   Actual return on assets 70,000
   Amortization of actuarial gains 2,000
9. In January 20X2, New Corporation amended its defined benefit plan, resulting in prior service costs of $15,000,000 that are fully vested. The plan participants are expected to remain employed by the company until December 31, 20X7.
   a. How will the firm account for the prior service costs under US GAAP and IFRS for the year ended December 31, 20X2?
   b. How would the firm account for the prior service cost under the proposed changes to IAS 19?

10. Solo, Inc. accounts for its defined benefit plan using the corridor approach for both IFRS and US GAAP. Using the information listed below, determine the amounts included in the firm’s US GAAP and IFRS financial statement related to the plan.

<table>
<thead>
<tr>
<th>Description</th>
<th>US GAAP</th>
<th>IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount rate</td>
<td>10.0%</td>
<td></td>
</tr>
<tr>
<td>Expected rate of return on plan assets</td>
<td>12.0%</td>
<td></td>
</tr>
<tr>
<td>Current service cost</td>
<td>$350</td>
<td></td>
</tr>
<tr>
<td>Benefits paid</td>
<td>120</td>
<td></td>
</tr>
<tr>
<td>Contributions paid</td>
<td>90</td>
<td></td>
</tr>
<tr>
<td>Present value of obligation at 1/1/X1</td>
<td>1,141</td>
<td></td>
</tr>
<tr>
<td>Present value of obligation at 12/31/X1</td>
<td>1,295</td>
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<tr>
<td>Fair value of plan assets at 1/1/X1</td>
<td>1,092</td>
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</tr>
<tr>
<td>Fair value of plan assets at 12/31/X1</td>
<td>1,109</td>
<td></td>
</tr>
<tr>
<td>Expected average remaining working lives</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Net cumulative unrecognized actuarial gains 1/1</td>
<td>140</td>
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</tr>
</tbody>
</table>
Classification

Lease accounting under IFRS is similar to lease accounting under US GAAP. A terminology difference exists between the two standards. A capital lease under US GAAP is referred to as a finance lease under IFRS. A lease may be classified as either a finance or operating lease. The classification of finance lease occurs when substantially all the risks and rewards related to ownership are transferred from the lessor to the lessee. The classification of operating lease occurs when the risks and rewards related to ownership are not transferred from the lessor to the lessee.

US GAAP and IFRS contain four lease criteria that are indicators of a capital (finance) lease. The four criteria include:
1) The lessee acquires ownership of the leased asset at the conclusion of the lease
2) The lessee has a bargain purchase option
3) The term of the lease covers the majority of the leased asset’s economic life
4) The present value of minimum lease payments is equivalent to nearly all of the leased asset’s fair value.

IFRS has a fifth indicator of a finance lease that is not specified by US GAAP.
5) Leased assets are of a specialized nature and are only usable by the lessee unless substantial adjustments are made to the asset.

IFRS also provides three criteria that could lead to a finance lease including:
1) Upon early termination of the lease, the lessee is responsible for the lessor’s losses
2) Any gains and losses due to the fluctuation in the fair value of the residual are attributed to the lessee
3) The lessee has the option to continue the lease for a secondary period for a below market rate. (Note: For US GAAP purposes, periods covered by bargain renewal options such that the renewal appears “to be reasonably assured” are included in the consideration of the term of the lease in relation to the asset’s economic life.)

The main difference between the two standards is that IFRS are more principle based while US GAAP provides precise guidelines. US GAAP specifies that the “majority” of the leased asset’s economic life is equal to or greater than 75% of the asset’s life. US GAAP defines “substantially all” of the leased asset’s fair value as 90% of the fair value of the property less any investment tax credit retained by the lessor. IFRS does not provide specific percentages for determining the majority of the leased asset’s economic life or substantially all of the leased asset’s fair value and therefore requires greater professional judgment.

Lessor Accounting:

Operating Leases

IFRS is similar to US GAAP. IAS 17 Leases requires the leased asset meeting the criteria of an operating lease to be recognized by the lessor on the balance sheet and depreciated over its economic life in a manner consistent with IAS 16 and IAS 38. Income resulting from the
leased asset should be recognized on the income statement on a straight line basis or in a manner that more appropriately represents the transfer of benefits.

Finance Leases
IFRS is similar to US GAAP. Both standards specify that leased assets meeting the finance lease criteria should be recorded in the balance sheet as a receivable equal to the net investment in the lease. According to IFRS, minimum lease payments for a lessor include guarantees from the lessee, related party of the lessee, or third party that is not related to the lessor. Income from the lease is recognized at a constant periodic rate of return, receipt of capital and finance income, attributable to the lessor’s net investment in the finance lease.

Lessee Accounting:

Operating Leases
IFRS is similar to US GAAP. Payments made by the lessee should be recognized as an expense either on a straight line basis over the lease term or in a manner that more appropriately represents the transfer of benefits.

Finance Leases
IFRS is similar to US GAAP. The lessee should recognize the leased asset as both an asset and liability on the balance sheet at the lower of fair value or the present value of minimum lease payments. IFRS normally uses the interest rate implicit in the lease to calculate the present value of the minimum lease payments. The lessee’s incremental borrowing rate may be used if the implicit rate is unknown. US GAAP uses the lessee’s incremental borrowing rate to calculate the present value of minimum lease payments unless the implicit rate of the lease can be calculated and is lower than the incremental borrowing rate. Depreciation on the finance lease should be calculated according to IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets.

Sale and Leaseback Transactions
According to IFRS, the type of lease determines the accounting treatment of a sale and leaseback transaction. Profit from a finance sale and leaseback transaction is deferred and amortized. Accounting for profit from an operating sale and leaseback transaction depends on whether the transaction is at fair value. A sale at fair value requires immediate recognition. A sale at below fair value requires immediate recognition unless the lower value is made up for by lower future rentals. A sale above fair value requires the amount above fair value to be deferred over the period the asset will be used.

Resources
IAS 17 Leases
Exercises

1. According to IAS 17 a lease that transfers substantially all of the risks and rewards incident to ownership of an asset is referred to as a
   a. Finance lease
   b. Capital lease
   c. Operating lease
   d. Investing lease

2. Which of the following standards relies more on professional judgment to distinguish between lease type
   a. FASB Statement No. 13
   b. IAS 17
   c. Both standards rely equally on judgment

3. How are leases classified differently according to US GAAP and IFRS?

4. Waldrop Airline entered into an agreement to lease equipment from Wilson Company. In each scenario, identify whether Waldrop would classify the lease as an operating or finance lease under IAS 17. Next, indicate whether the lease would be classified as operating or capital under FASB Statement No. 13. Assume each scenario is independent and that Waldrop has not met any of the other requirements for capitalizing leases.
   a. At the end of the lease term, ownership of the equipment will be transferred to Waldrop Airline.
   b. The fair market value of the equipment is expected to be $100,000 at the end of the lease term. Waldrop has the option to buy the equipment at the conclusion of the lease for $20,000.
   c. The equipment has a useful life of 10 years and the term of the lease is 7 years.
   d. The present value of minimum lease payments is $22,300 and the fair value of the leased equipment is $25,000.

5. Adler Construction Company needs to lease a warehouse to store materials. Adler wants to avoid a large lease liability on its balance sheet. Assuming Adler follows US GAAP, what type of lease would he prefer? How could Adler structure the lease agreement to avoid the liability? Would it be more difficult to avoid the liability under international accounting standards?
6. Collier Pharmaceuticals leases production equipment. The term of the lease is 7 years and the economic life of the asset is 10 years. The present value of the lease payments is $112,000 for equipment with a fair market value of $126,000. The lease payment for year one is $17,000. Assume ownership is not transferred at the end of the lease term and there is no bargain purchase option. Under IFRS, how would Collier Pharmaceuticals record the entry for the lease payment in year one? Is the entry the same under US GAAP?

7. Could an operating lease under US GAAP be classified as a finance lease under IFRS? Explain.
In May 2005, the FASB issued Statement No. 154 to harmonize the treatment of accounting changes and error corrections under US GAAP and IFRS. Statement No. 154 treats changes in accounting policies and estimates and correction of errors similarly to IAS 8.

Correction of Errors
Similar to US GAAP. Material prior period errors should be corrected retrospectively in the financial statements issued after the error is realized. Comparative information should be restated for the prior periods in which the error existed or the beginning balances of assets, liabilities, and equity should be restated for the earliest prior period presented.

Changes in Accounting Policy
Similar to US GAAP. Upon adoption of a new standard, changes should be made in accordance with the transitional guidance within the standard. If guidance does not exist, changes in accounting policy should be recognized retrospectively in the financial statements. Comparative information should be restated and an adjustment should be made to the opening balance of retained earnings unless it is impracticable to determine the cumulative or prior period effects.

Changes in Accounting Estimate
Similar to US GAAP. Changes of accounting estimates should be recognized prospectively in either the current period or current/future period profit or loss depending on the period the change affects. If the change in estimate affects assets, liabilities, or equity, their carrying amount should be adjusted in the period of the change. IFRS and US GAAP account for a change in the depreciation method for existing assets as a change in accounting estimate.

Resources
IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

Exercises
1. In May 2005, the FASB adopted Statement No. 154 to harmonize US GAAP and IFRS concerning accounting changes and error corrections. True or False

2. According to US GAAP and IFRS, a change in accounting estimate requires
   a. Restatement to prior periods
   b. Reflection in current and future periods
   c. Treatment is different under US GAAP and IFRS
   d. Both a and b
3. Which of the following accounting changes would be considered a change in estimate:
   a. Change in the useful life of depreciable assets
   b. Change in warranty obligations
   c. Change in uncollectible receivables
   d. All of the above

4. According to US GAAP and IFRS, how would a company account for a change from the FIFO inventory method to LIFO inventory method
   a. Change in accounting policy
   b. Change in estimate
   c. Correction of error
   d. The change is not allowed

5. According to IAS 8, a change in accounting policy requires companies to
   a. Restate prior period comparative information
   b. Adjust retained earnings for any effect on income
   c. Both a and b
   d. None of the above

6. Randolph Roofing received payment of $500 for services to be performed in the future. Randolph’s accountant incorrectly recorded the payment as revenue when it was received. How would the accountant’s failure to record unearned revenue affect the financial statements?
   a. Revenue understated
   b. Net income understated
   c. Liabilities understated
   d. All of the above

7. According to IAS 8, all errors in the financial statements should be corrected when discovered.
   True or False

8. Collier Company purchased manufacturing equipment for $800,000. It had a useful life of ten years and no salvage value. The company elected to use double declining balance as its method of depreciation. Now the company wants to change to the straight line method of depreciation. Assuming, Collier has depreciated the asset for two years, what is the depreciation expense for the current year?

9. As of December 31, 2007 Alan Aquatics merchandise inventory was overstated by $2,500. Record the journal entry to correct the account balances in 2008.
Unit 22 – Disclosures and Segment Reporting

With the issuance of IFRS 8 Operating Segments, the IASB has eliminated the most significant differences between segment reporting for US GAAP and IFRS. The new guidance becomes effective for years beginning on or after January 1, 2009. Until that time, IFRS financial statements follow IAS 14 Segment Reporting. This standard, currently in effect, differs from US GAAP in the identification of reportable segments and the disclosure requirements. An additional difference between the two frameworks is found in disclosures of related-party transactions.

Reportable segments

Through 2008, the two frameworks differ on the identification of reportable segments. IAS 14 requires companies to disclose segment information by business (products or services) and by geographic location (of operations or customers). Management of the company must determine which of the two options should be presented as the primary format based on the risks and returns of the firm’s operations. Less disclosure is required for the secondary format. US GAAP, on the other hand, uses the “management approach” whereby segments are determined based on how information is presented to the chief decision maker for allocation of resources. Information regarding product revenue, as well as revenue and assets by geographic location, is required regardless of whether it is used by management to make decisions. IFRS 8 converges international accounting with US GAAP by utilizing the management approach to determine reportable segments. It also requires disclosure of revenue by product and location as well as assets by location.

Two minor differences will remain under IFRS 8. First, US GAAP requires companies with a matrix form of organization to report segments based on products or services. IFRS 8 allows these firms to use whichever criteria results in the most useful information for the financial statement users. Secondly, both IFRS 8 and IAS 14 (for the primary segment) require disclosure of segment liabilities. US GAAP requires disclosure of liabilities only if that information is provided to the chief decision maker for evaluation purposes.

Related-party transactions

IFRS and US GAAP include similar requirements for disclosure of related-party transactions, including the nature and amount of any transactions as well as outstanding balances. IFRS differs from US GAAP, however, by requiring disclosure of compensation for key management personnel. While this is required for public companies by the SEC, it is not required for private companies under US GAAP.

Resources

IFRS 8 Operating Segments
http://www.iasb.org/NR/rdonlyres/4DE81E34-D5FC-4829-86AD-D0F2E49A6A8B/0/IFRS8.pdf

IAS 24 Related Party Disclosures
Exercises

1. Under IAS 14, effective through 2008, how does a company determine reportable segments?
   a. By product or service line
   b. Geographically
   c. Using the management approach
   d. a and b
   e. None of the above

2. When IAS 8 goes into effect, for years beginning on or after January 1, 2009, how will reportable segments be determined?
   a. By product or service line
   b. Geographically
   c. Using the management approach
   d. a and b
   e. None of the above

3. Selenia Inc. utilizes a matrix form of management whereby managers are held accountable for performance using both product and geographic departmentalization. The CEO uses financial measures for both product and geographic performance in determining asset allocation, but believes geographic information is most useful for financial statement users. How will reportable segments be determined for US GAAP? For IFRS effective through 2008? And for IFRS in 2010?

4. United Corp included the following segment information in the notes to its US GAAP financial statements. Segments are based on legal entities. Each legal entity includes numerous products and operates in multiple geographic locations. How will the disclosure differ for IFRS effective through 2008? For IFRS in 2010?

<table>
<thead>
<tr>
<th></th>
<th>Truly United Inc.</th>
<th>Truly United, LLC</th>
<th>Truly Other</th>
<th>Truly Consolidated</th>
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</thead>
<tbody>
<tr>
<td>Net operating revenue:</td>
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<td></td>
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<td></td>
</tr>
<tr>
<td>Third party</td>
<td>$1,273</td>
<td>$970</td>
<td>$50</td>
<td>$2,293</td>
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<tr>
<td>Intersegment</td>
<td>54</td>
<td>114</td>
<td>3</td>
<td>171</td>
</tr>
<tr>
<td>Total net revenues</td>
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<tr>
<td>Operating income (loss)</td>
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<td>Interest income</td>
<td>0</td>
<td>2</td>
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<td>Interest expense</td>
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<td>2</td>
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<td>Depreciation and amortization</td>
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<td>Income before income taxes</td>
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<td>375</td>
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<tr>
<td>Noncurrent assets</td>
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<tr>
<td>Investments</td>
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<tr>
<td>Capital expenditures</td>
<td>39</td>
<td>38</td>
<td>5</td>
<td>82</td>
</tr>
</tbody>
</table>
Conversion Case: Using Form 20-F Reconciliation for Ratio Analysis

Introduction
Abigail Leon began working with New River, Inc. as an intern during her final year of college. The atmosphere at the small supplier of copiers and document management systems was exhilarating. A recent breakthrough in research and development provided the company with an edge over its competitors, and the company began expanding operations into Europe. When the CFO offered Abigail full-time employment upon her graduation, she accepted the position, eager to be part of the company’s globalization.

Shortly after graduation, Abigail’s boss, Dave Boone tasked her with a new assignment. New River would like to obtain a $100 million 15-year bank note to finance further expansion into Europe and Asia. In recent phone conversations, the bank’s loan managers had referenced the performance of Océ N.V. (pronounced Oh-say), the company’s closest competitor in the European and Asian markets. In an email, Dave asked Abigail to analyze New River’s 2006 financial performance in comparison to that of Océ.

By spending a little time on the internet, Abigail learned Océ filed with the U.S. Securities and Exchange Commission as a foreign private issuer and prepared its financial statements in accordance with International Financial Reporting Standards. Abigail questioned Dave about the best method of comparing New River’s US GAAP financial statements with Océ’s IFRS statements. He told Abigail he was not an expert in IFRS, but had heard the two sets of standards were converging. He asked her to first perform ratio analysis using amounts directly from the financial statements; then, she could perform any additional analysis she deemed appropriate.

Abigail remembered one of her professor’s mentioning that, until recently, foreign firms were required to reconcile financial statements to US GAAP if they were prepared using a foreign GAAP. She wondered if the reconciliation requirement was still in effect for the 2006 financial statements. If so, that should provide her with the necessary information to compare the two companies using US GAAP numbers. She wanted to make sure her analysis was accurate. Since this was her first big assignment as a full-time employee, she wanted to make a good impression!

Requirements
1. Obtain Océ’s 2006 20-F from the Edgar database on the Securities and Exchange Commission website [www.sec.gov](http://www.sec.gov) and answer the following questions:
   a. How do you know what set of generally accepted accounting principles were used to prepare the annual report?
   b. The company presents selected information in both Euros and US Dollars. What exchange rate does it use to translate currency?
2. Calculate the following financial ratios for Océ, using the IFRS financial statements (in dollars), and New River, Inc., using the US GAAP financial statements provided. Analyze the results and write a brief summary of your findings. Abigail downloaded a copy of Océ’s 2005 Form 20-F to determine the amount of equity as of November 30, 2005 – $920,601,000 for IFRS and $1,224,283,000 for US GAAP. She found all other necessary information about Océ in the 2006 Form 20-F, including earnings per share calculated for both IFRS and US GAAP. In addition to the information on New River’s 2006 financial statements, Abigail learned the company employed 2,680 employees in 2005 and 2,800 in 2006. New River’s equity totaled $150,753,000 as of December 31, 2005. The company has one class of common stock, with 10,500,000 shares outstanding at December 31, 2006.

a. Current ratio  
b. Return on equity  
c. Gross profit margin  
d. Net profit margin  
e. Debt to equity  
f. Sales per employee  
g. Selling and marketing expense as a percentage of revenue  
h. Research and development expense as a percentage of revenue  
i. Earnings per share.

3. Using the information provided in the 20-F reconciliation of IFRS to US GAAP, convert Océ’s consolidated income statement and balance sheet to US GAAP.

4. Calculate Océ’s financial ratios using the US GAAP financial statements and answer the following questions:
   a. Did your analysis of the two companies change based on the additional information provided in the reconciliation? Based on which ratios?  
   b. In general, how confident are you in the US GAAP ratios calculated for Océ? Why?  
   c. Which ratios do you have the greatest confidence in? Why?  
   d. Which ratios do you have less confidence in? Why?

5. What do you think about the SEC’s elimination of the reconciliation requirement for foreign private issuers filing annual statements in accordance with IFRS? Do you believe this change is beneficial for users of the financial statements?
New River, Inc.
Income Statement
December 31, 2006

<table>
<thead>
<tr>
<th></th>
<th>US GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>( in thousands)</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td>$518,253</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>-310,952</td>
</tr>
<tr>
<td><strong>Gross profit</strong></td>
<td>207,301</td>
</tr>
<tr>
<td>Selling and marketing expenses</td>
<td>-121,789</td>
</tr>
<tr>
<td>Research and development expenses</td>
<td>-51,825</td>
</tr>
<tr>
<td>General and administrative expenses</td>
<td>-25,913</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>-199,527</td>
</tr>
<tr>
<td><strong>Operating income</strong></td>
<td>7,774</td>
</tr>
<tr>
<td>Financial income</td>
<td>350</td>
</tr>
<tr>
<td>Financial expenses</td>
<td>-200</td>
</tr>
<tr>
<td><strong>Income before income taxes</strong></td>
<td>7,924</td>
</tr>
<tr>
<td>Income taxes</td>
<td>-2,377</td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td>$5,547</td>
</tr>
</tbody>
</table>
New River, Inc.
Balance Sheet
December 31, 2006

<table>
<thead>
<tr>
<th>Assets</th>
<th>US GAAP (in thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current assets</strong></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$15,044</td>
</tr>
<tr>
<td>Accounts receivable - trade</td>
<td>101,296</td>
</tr>
<tr>
<td>Inventories</td>
<td>60,023</td>
</tr>
<tr>
<td></td>
<td><strong>176,363</strong></td>
</tr>
<tr>
<td><strong>Non-current assets</strong></td>
<td></td>
</tr>
<tr>
<td>Accounts receivable - trade</td>
<td>32,456</td>
</tr>
<tr>
<td>Deferred income tax assets</td>
<td>8,327</td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>70,428</td>
</tr>
<tr>
<td>Intangible assets</td>
<td>7,720</td>
</tr>
<tr>
<td></td>
<td><strong>118,931</strong></td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>$295,294</td>
</tr>
</tbody>
</table>

| Liabilities and Equity      |                        |
|**Current liabilities**      |                        |
| Accounts payable            | $81,772                |
| Other liabilities           | 3,254                  |
| Accrued income taxes        | 301                    |
| Deferred income tax liabilities | 2,341               |
| Short-term debt             | 11,998                 |
| Current portion of long-term debt | 1,517              |
|                             | **101,183**            |
| **Non-current liabilities** |                        |
| Accounts payable            | 2,112                  |
| Long-term debt              | 31,465                 |
| Retirement benefit obligations | 4,234                |
|                             | **37,811**             |
| **Total liabilities**       | 138,994                |

| Equity                      |                        |
| Common stock                | 7,100                  |
| Additional paid-in capital  | 1,552                  |
| Retained earnings           | 147,648                |
| **Total equity**            | **156,300**            |
| **Total liabilities and equity** | **$295,294**         |
**IASB**  
The IASB website includes information on the organization, background on IFRS and summaries of the current standards. Full text of the standards and interpretations are available by subscription.  
http://www.iasb.org

**FASB**  
The new codification of US GAAP is available online.  
http://asc.fasb.org/home

**Convergence Plan**  
Both standard setting boards describes the status of the convergence plan.  

*FASB*  
http://fasb.org/project/index.shtml

*IASB Convergence Plan*  

**AICPA**  
The AICPA has created a new site to aid CPAs in the adoption of IFRS, including online videos and a list of resources and CPE offerings.  
www.ifrs.com

**Firm Guidance**  
Each of the Big Four accounting firms has provided resources to increase awareness of IFRS.  

*Deloitte*  
Deloitte’s IASplus website includes a variety of IFRS resources including summaries of each standard, with history of amendments, and links to interpretations; as well as US (and other national) GAAP comparisons; and illustrative financial statements.  
http://www.iasplus.com/index.htm

On a separate website, Deloitte provides downloadable modules for IFRS training. Each module includes real-life scenarios and worked examples to demonstrate application of the standards.  
http://www.deloitte.com/dtt/section_node/0,1042,sid%253D49563,00.html

Deloitte also produces webcasts on select IFRS topics.  
http://www.deloitte.com/dtt/article/0,1002,cid%253D184083,00.html


*Ernst & Young*

Ernst & Young provides bi-monthly newsletters on IFRS changes as well as interpretive guidance on select standards. [http://www.ey.com/global/content.nsf/International/Assurance - IAS - Tools and Resources](http://www.ey.com/global/content.nsf/International/Assurance - IAS - Tools and Resources)

*KPMG*

KPMG’s online library include briefing sheets providing monthly updates on IFRS changes, and the option to order additional resources such as IFRS/national GAAP comparisons and interpretive guidance for IFRS application.  

At a separate web address, KPMG has made news and insights related to IFRS, as well as webcasts summarizing the impact of IFRS on US markets.  

*PriceWaterhouseCoopers*

PriceWaterhouseCoopers includes numerous resources including IFRS guidance by topic, comparisons to US (and other national) GAAP, and illustrative financial statements by industry,  
[http://www.pwc.com/extweb/pwcpublications.nsf/docid/D7ECA7B0D78F3C7E8025699E0071ACBE](http://www.pwc.com/extweb/pwcpublications.nsf/docid/D7ECA7B0D78F3C7E8025699E0071ACBE)