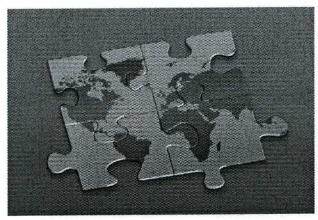
International Financial Reporting Standards (IFRS)

Kimberly Dwyer
Mellen School District
kdwyer@mellen.k12.wi.us

Why International Standards?

- Increased demand for global comparability
- Harmonize preferred accounting practices
- One set of financial statements



From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, p. 9:

In our ever-increasing global economy, external stakeholders have propelled demand for accounting reports that are comparable world-wide. The driving focus revolves around the need for companies to raise capital from lenders and investors all over the world. The International Accounting Standards Board (IASB), an independent organization with representatives from many countries, issues International Financial Reporting Standards that identify preferred accounting practices.

If there were world-wide, accepted standards, an individual company could potentially use a single set of financial statements in all financial markets. As the Financial Accounting Standards Board (FASB) works with the IASB in pursuit of the convergence process, a goal to achieve a single set of international accounting standards, the differences between the US Generally Accepted Accounting Principles (GAAP) and IFRS are gradually being resolved.

What's the Status?

- Currently over 115 countries
- Convergence process continues
- Proposed US corporation adoption range
  - By 2014 – large companies
  - By 2015 – midsize companies
  - By 2016 – small companies

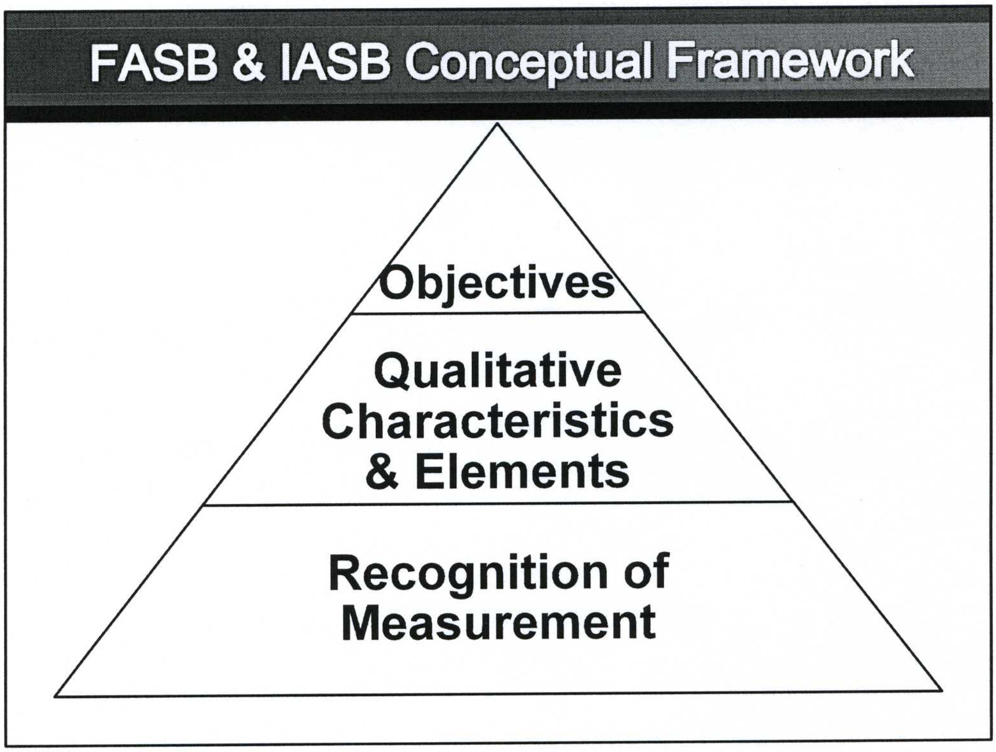
IFRS

From <u>Fundamental Accounting Principles</u>, by John J. Wild, et. al., 20th edition, 2011, p. 9:

Over 115 countries require or permit companies to prepare financial reports following IFRS. Non-US SEC registrants are allowed to use IFRS in their financial report filings with the SEC (without modifying them first to US GAAP). As a result, there are actually two sets of accepted accounting principles in the US: 1) US GAAP for US SEC registered corporations, and 2) either IFRS or US GAAP for non-US SEC registrants.

Convergence continues, yet there are still many areas of uncertainty relating to US SEC adoption. The proposed convergence road map indicates that large US corporations will adopt IFRS by 2014, midsize by 2015, and small companies by 2016.

Numerous resources are available on the Internet, and will be shared in this presentation.



From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, p. 9:

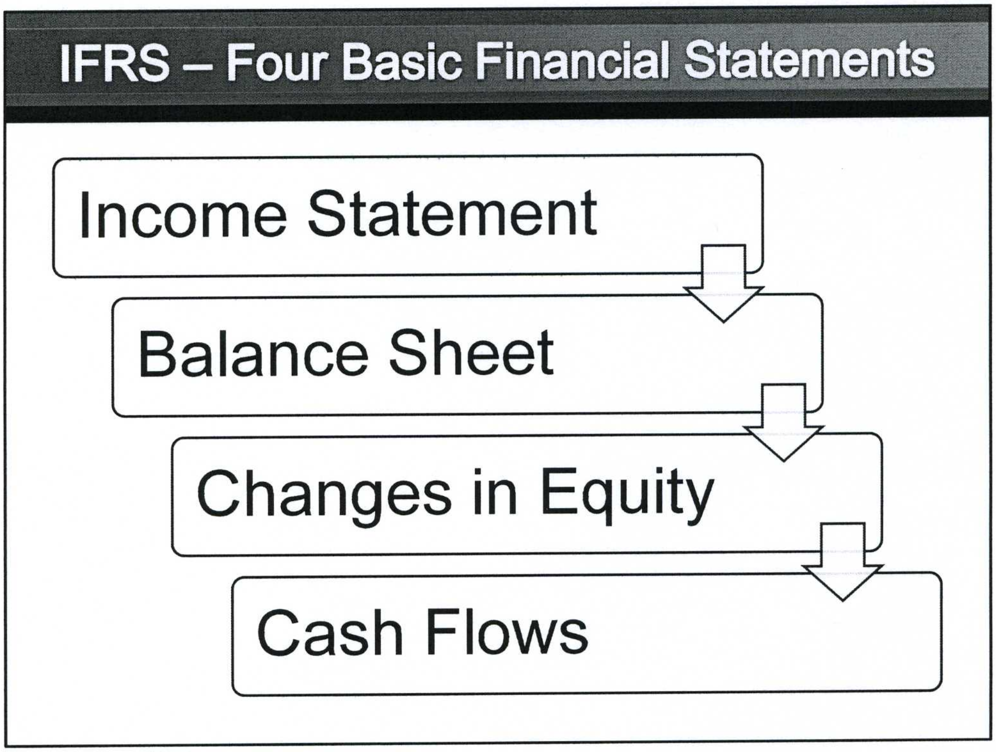
The FASB and IASB are working together to converge and improve the **conceptual framework** used to guide standard setting. It contains the following broad categories:

Objectives – to provide information useful to external stakeholders.

Qualitative Characteristics – to require information that is relevant, reliable, and comparable.

Elements – to define items that financial statements can contain.

Recognition and Measurement – to set criteria that an item must meet for it to be recognized as an element; and how to measure that element.



From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, pp. 57, 68-69:

IFRS requires that companies report the four basic financial statements with explanatory notes. IFRS does not stipulate specific formats; and comparative information is required for the prior period only.

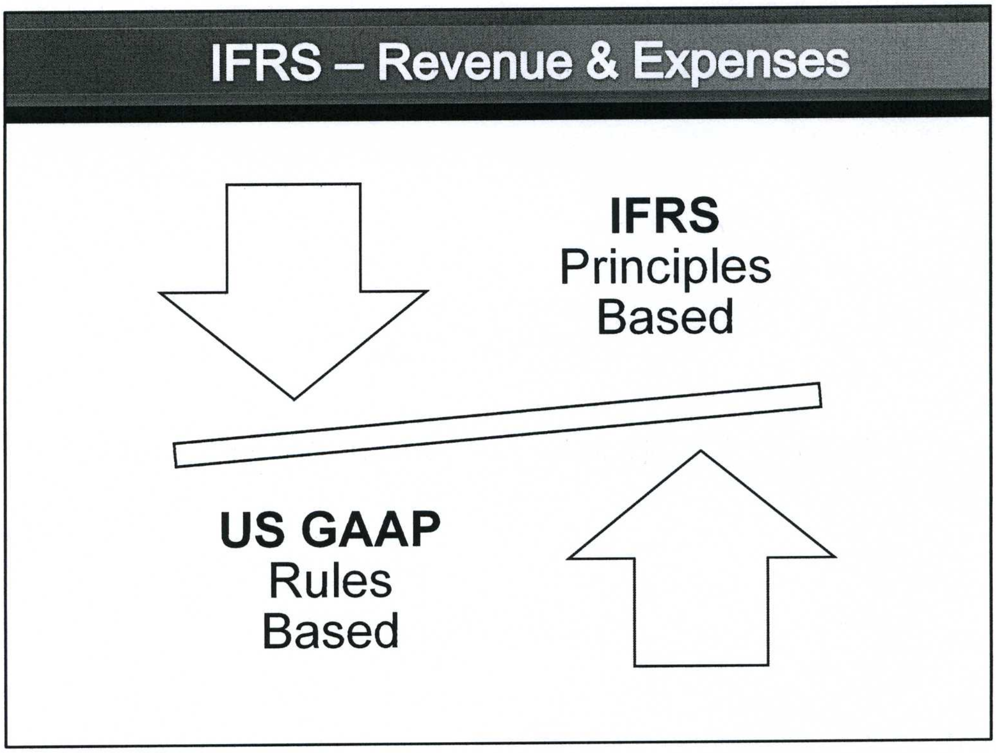
While financial accounting based on US GAAP is similar to IFRS, there are some differences.

Analyzing and Recording Transactions: Both US GAAP and IFRS will be working toward a common conceptual framework over the next few years, resulting in fewer differences. Additionally, they apply transaction analysis and entry recording using the same debit and credit system and accrual accounting. There are some variations in revenue and expense recognition and other accounting principles, most transactions are going to be accounted for the same way regardless of which system was in place.

Financial Statements: As mentioned, both US GAAP and IFRS prepare the same four basic financial reports. A few differences within each statement do exist. For example, both US GAAP and IFRS require balance sheets to separate current items from noncurrent items. Unlike US GAAP balance sheets which show current items first, IFRS balance sheets normally (but are not required to) show noncurrent items first, and equity before liabilities.

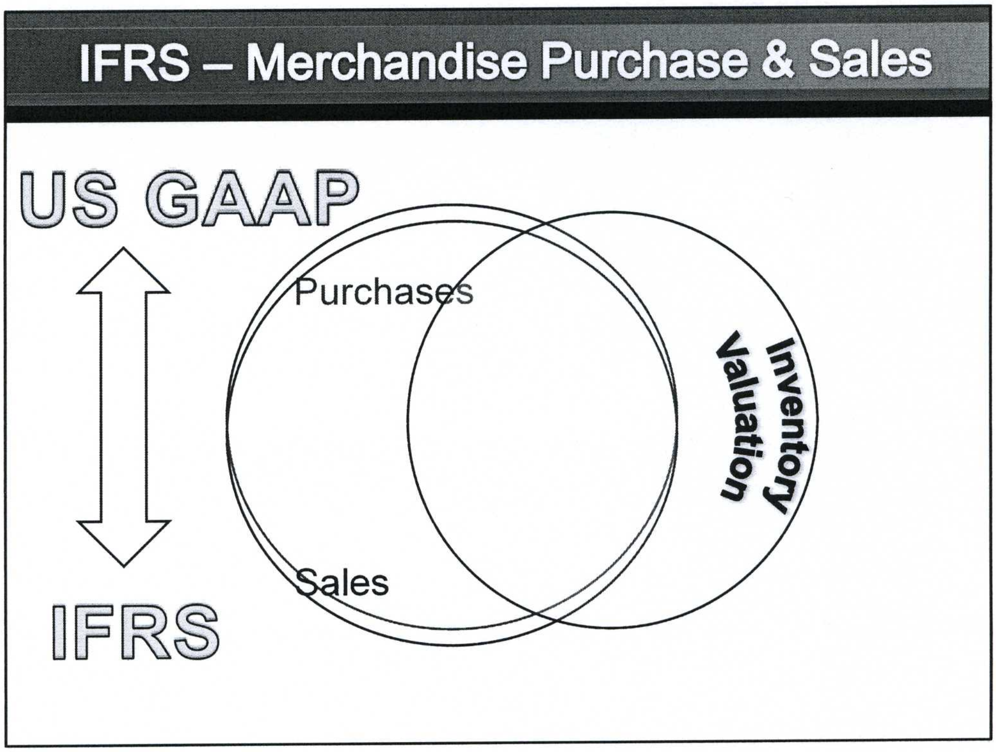
Accounting Controls and Assurance: Accounting systems rely on control procedures that assure the proper principles were applied in processing accounting information. The Sarbanes-Oxley legislation has improved US control procedures in recent years. However, global standards for control are varied along with enforcement activities. Therefore, while global accounting standards are converging, their application in different countries can yield different results depending on the quality of their auditing standards and enforcement.

NOTE: Cash basis accounting is consistent with neither US GAAP nor IFRS.



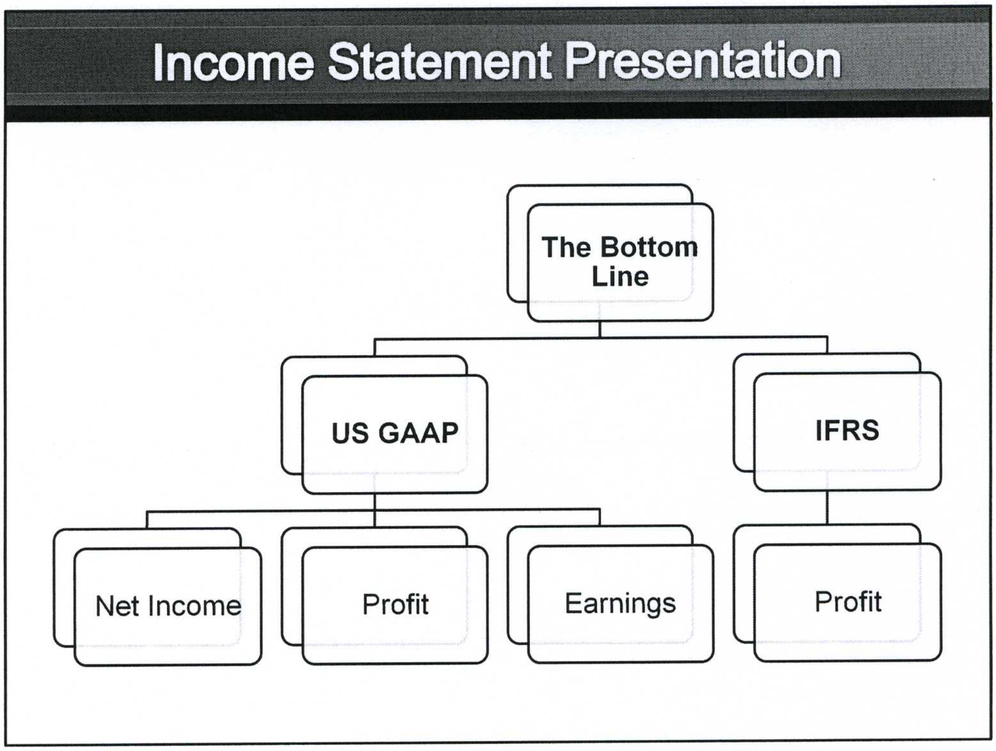
From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, p. 109:

Revenue and expense recognition are fundamental to recording adjusting entries. IFRS is more principles-based as compared to US GAAP, which is more rules-based. A principles-based system depends much more on control procedures to lessen the chances for fraud or misconduct. Failure in judgment led to improper accounting of adjustments at Fannie Mae, Xerox, WorldCom, and others. A KPMG 2009 survey of accounting and finance employees revealed that 13% of them had witnessed falsification or manipulation of accounting data within the past year. Internal controls and governance processes are directed at curbing that type of behavior.



From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, p. 195:

Accounting for merchandise purchases and sales for both US GAAP and IFRS include broad and similar guidance. The closing process is also the same. Inventory valuation can, in some cases, be different for the two systems.

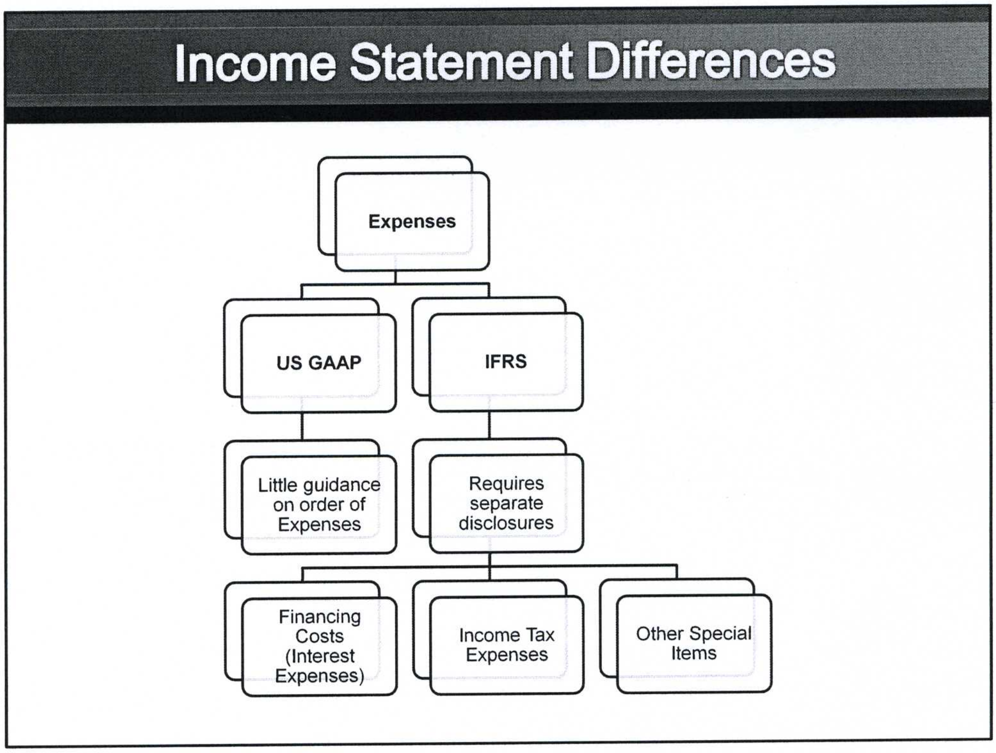


From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, pp. 195 & 603:

While US GAAP refers to the bottom line as "Net Income, Profit and Earnings"; IFRS tends to use "Profit" more than any other.

Both US GAAP and IFRS income statements begin with the net sales or net revenues, for merchandisers and manufacturers, the cost of goods sold follows. Then the remaining presentation is similar, but with some differences which are explained on the next several slides.

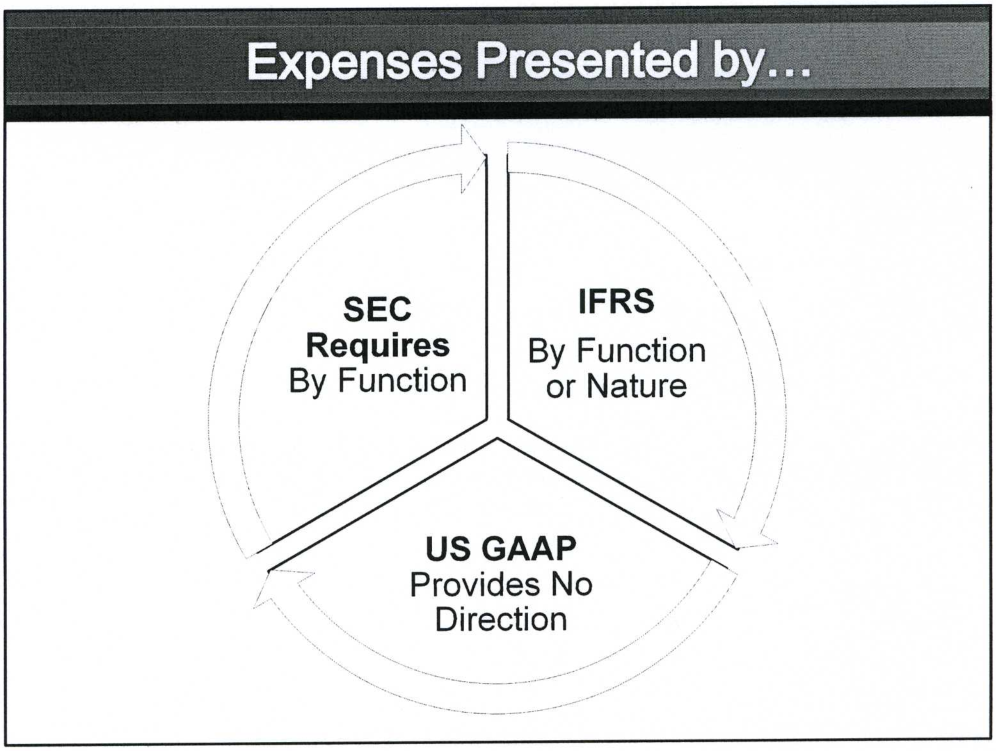
Consolidated Financial Statements
Unlike US GAAP, IFRS requires uniform accounting policies be used throughout the group of consolidated subsidiaries. Also, unlike US GAAP, IFRS offers no detailed guidance on valuation procedures.



From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, pp. 195 & 574:

US GAAP offers little guidance about the presentation or order of expenses. However, IFRS requires separate disclosures for financing costs (interest expense), income tax expense and some other special items. Unlike US GAAP, IFRS requires that interest expense be computed using the effective interest method with no exemptions.

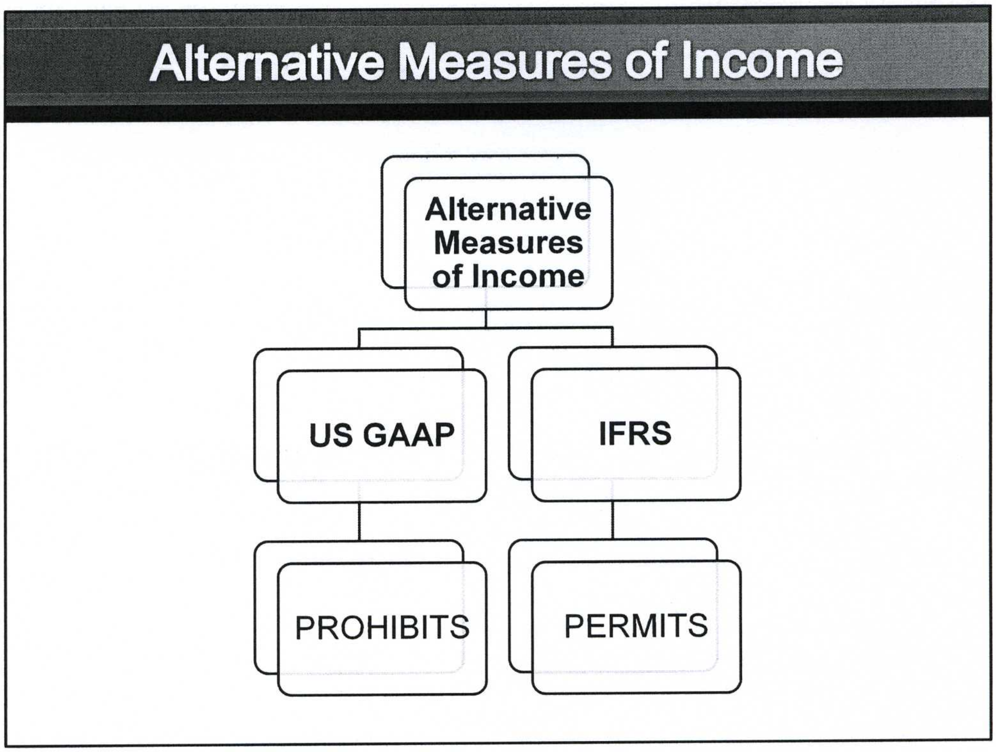
Both systems require separate disclosure of items when their size, nature or frequency are important for proper interpretation.



From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, p. 195:

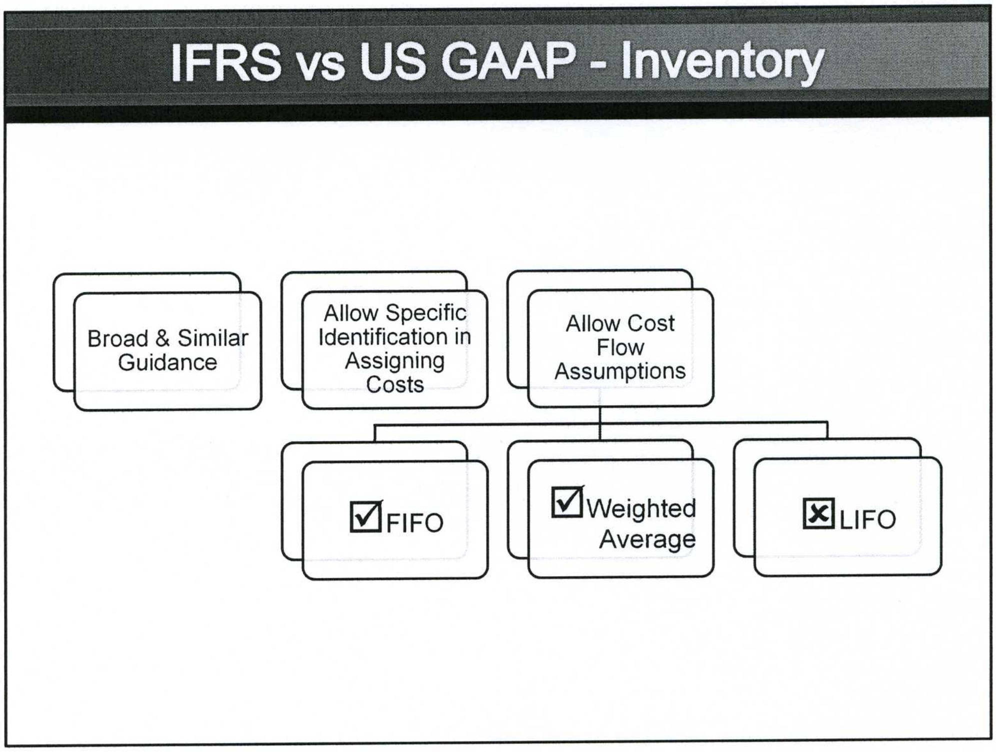
IFRS allows expenses to be presented by either function or nature. US GAAP does not give direction on this; however, the SEC requires expenses be presented by function.

Neither US GAAP nor IFRS define operating income, which leaves to management's discretion how they classify expenses as operating or non-operating.



From *Fundamental Accounting Principles*, *by John J. Wild, et. al., 20th edition, 2011, p. 195:*

IFRS allows alternative measures of income on the income statement; while US GAAP does not allow disclosure of alternative income measures in financial statements.

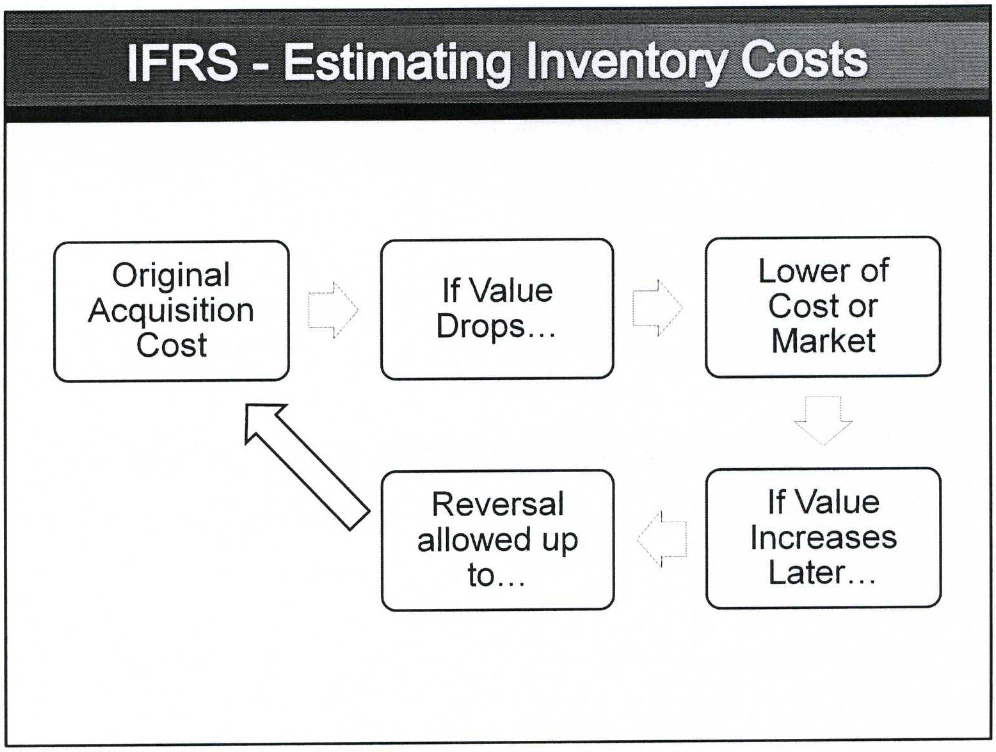


From *__Fundamental Accounting Principles__*, *by John J. Wild, et. al., 20th edition, 2011, p. 240.*

Both US GAAP & IFRS

- ♦Include broad and similar guidance for items and costs making up merchandise inventory. Merchandise inventory includes all items a company owns and holds for sale, and includes costs of expenditures necessary, directly or indirectly, to bring those items to a salable condition and location.
- ♦Allow specific identification in assigning costs to inventory.
- ♦Allow companies to apply a cost flow assumption.

The usual cost flow assumptions are FIFO, Weighted Average, and LIFO. However, IFRS currently does not allow the use of LIFO. Through the convergence process this restriction has yet to be determined whether it will remain.



From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, p. 240.

Estimating Inventory Costs

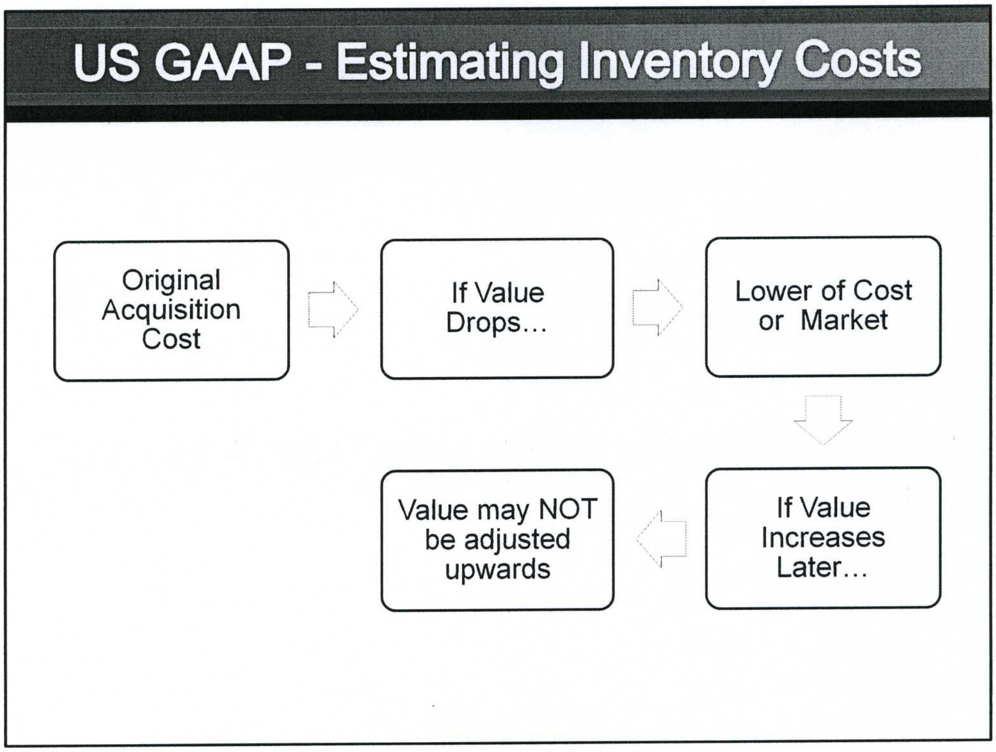
Decreases in Inventory Value

Both US GAAP and IFRS require companies to write down (or reduce the cost recorded for) inventory when its value falls below the cost recorded (the ***lower of cost or market*** method). Then, US GAAP disallows any later increase in the recorded value of that inventory even if that decline in value has reversed through value increases in future periods. However, IFRS permits reversals up to the original inventory acquisition cost.

Another difference is that value refers to ***replacement cost*** under US GAAP, but ***net realizable value*** under IFRS.

Increases in Inventory Value

Neither allow inventory values to be adjusted higher than the original acquisition cost. **One IFRS exception** to this is a requirement for agricultural assets such as animals, forests, and plants to be measured at fair value less point-of-sale costs.



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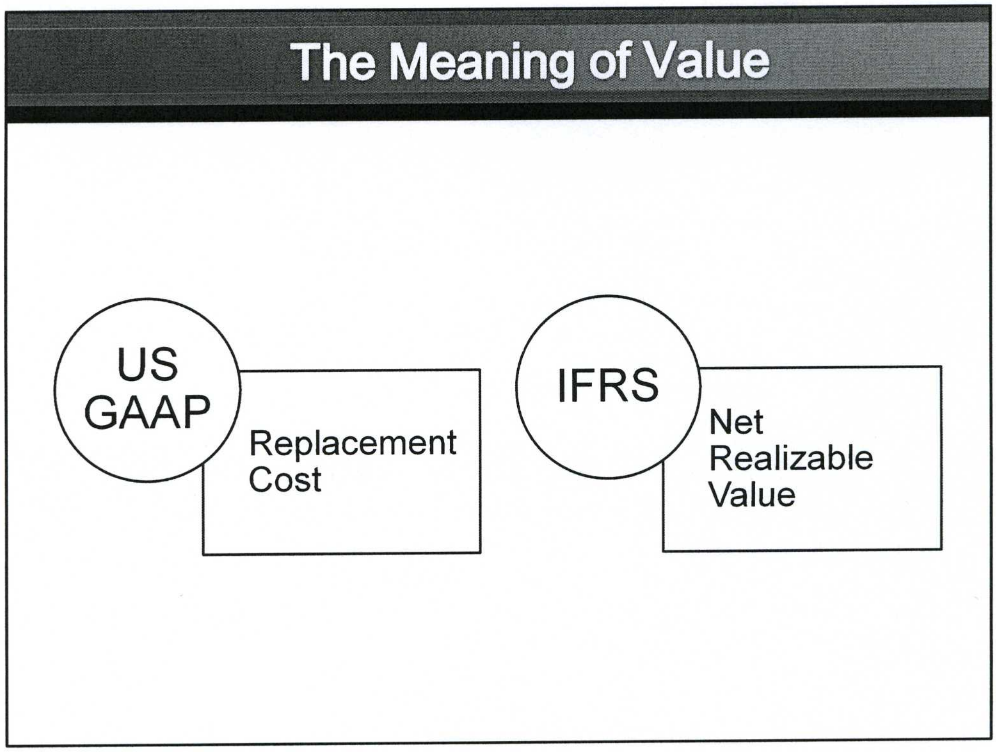

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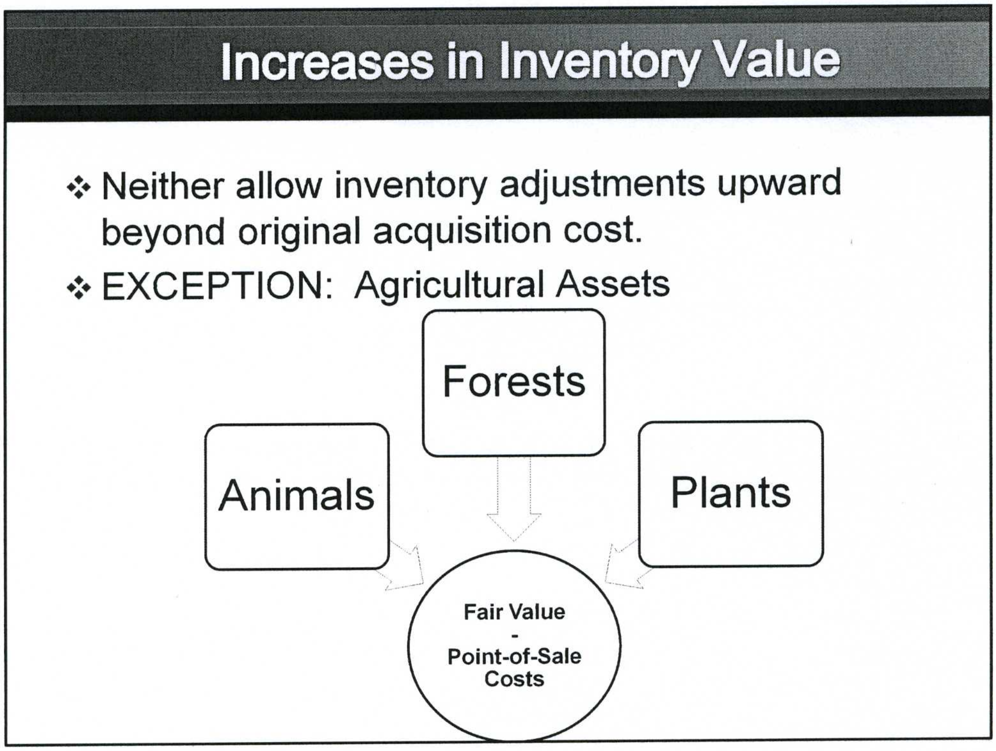

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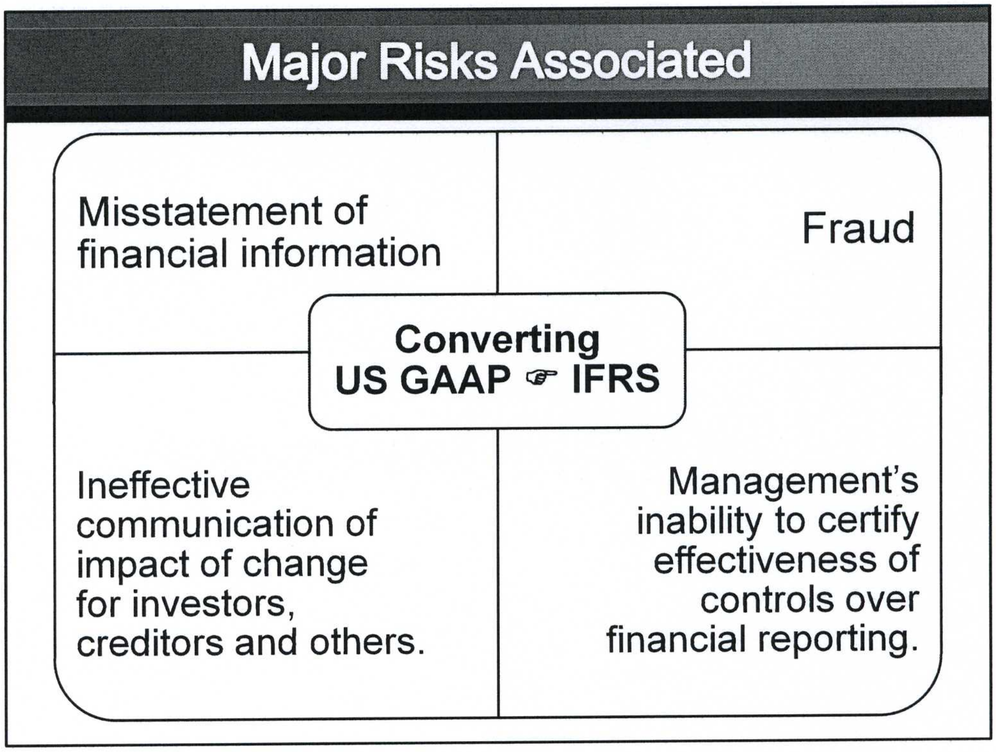
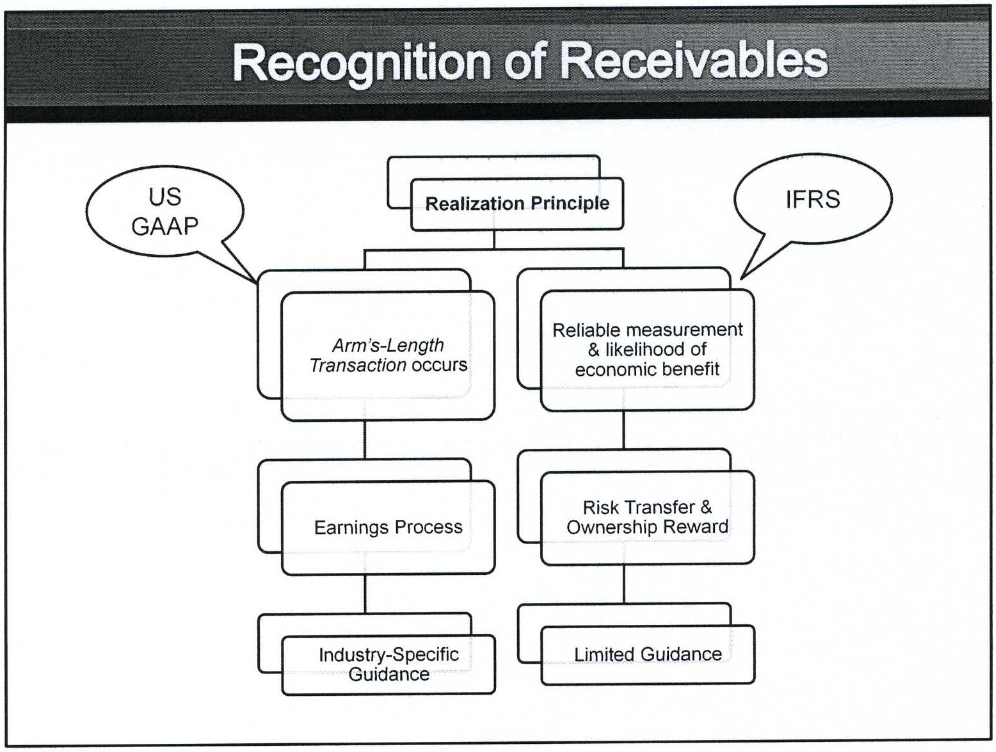


From <u>Fundamental Accounting Principles</u>, by John J. Wild, et. al., 20th edition, 2011, p. 335.

Internal controls are crucial to companies that convert from US GAAP to IFRS. Major risks include misstatement of financial information and fraud. Other risks are ineffective communication of the impact of this change for investors, creditors and others, and management's inability to certify the effectiveness of controls over the financial reporting.



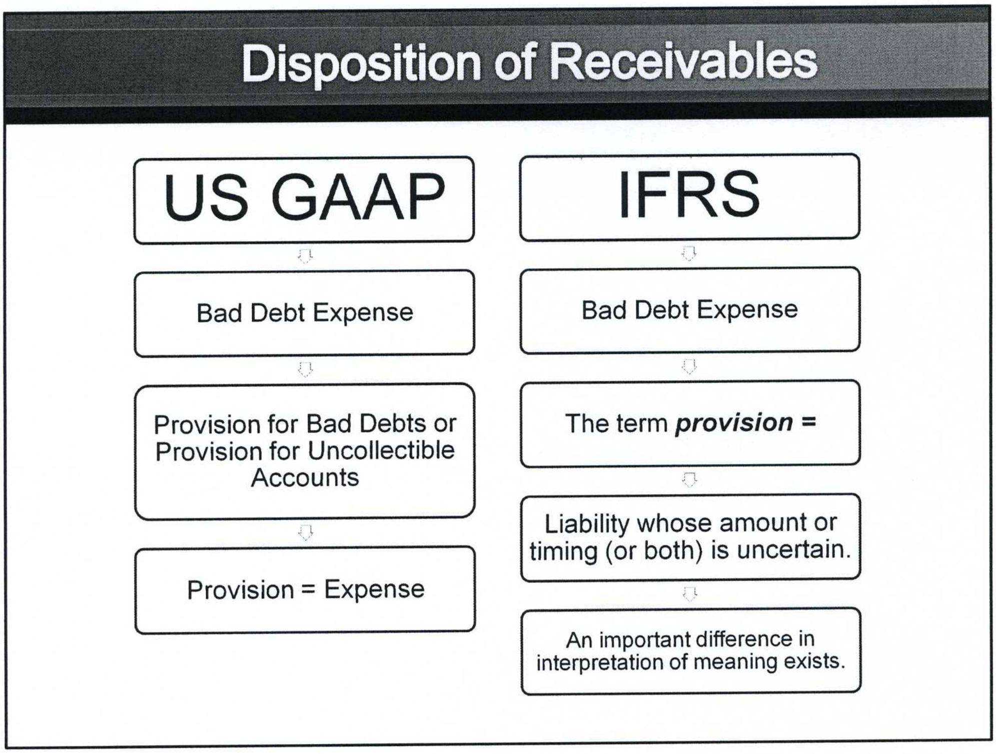
From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, p. 374.

Recognition of Receivables

Both US GAAP and IFRS have similar asset criteria that apply to recognition of receivables. Moreover, receivables from revenue-producing activities are subject to broadly similar criteria. In particular, both refer to the realization principle and an earning process. The realization principle under US GAAP implies an *arm's-length transaction* occurs, whereas under IFRS this notion is applied in terms of reliable measurement and likelihood of economic benefits. Regarding US GAAP's reference to an earnings process, IFRS alternatively refers to risk transfer and ownership reward. While these criteria are broadly similar, differences do exist, and they emerge mainly from industry-specific guidance under US GAAP, which is very limited under IFRS.

Valuation of Receivables

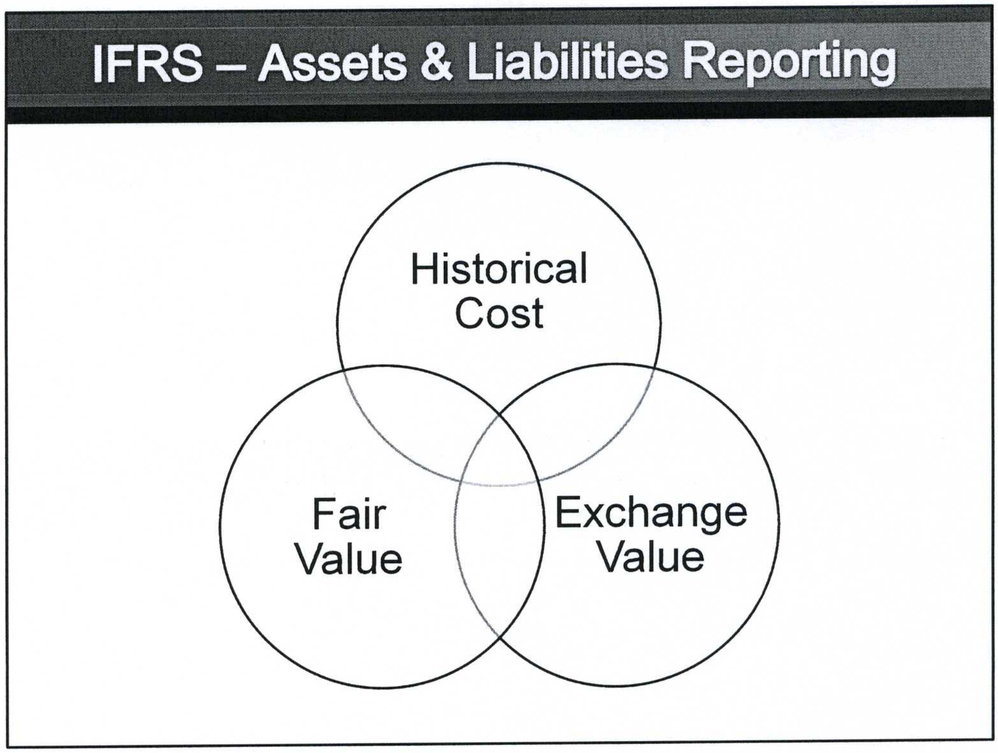
Both US GAAP and IFRS require that receivables be reported net of estimated uncollectibles. In addition, both require the expense for estimating uncollectibles be recorded in the same period when related revenues are recorded. Both US GAAP and IFRS require the allowance method for uncollectibles (unless uncollectibles are immaterial).



From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, p. 374.

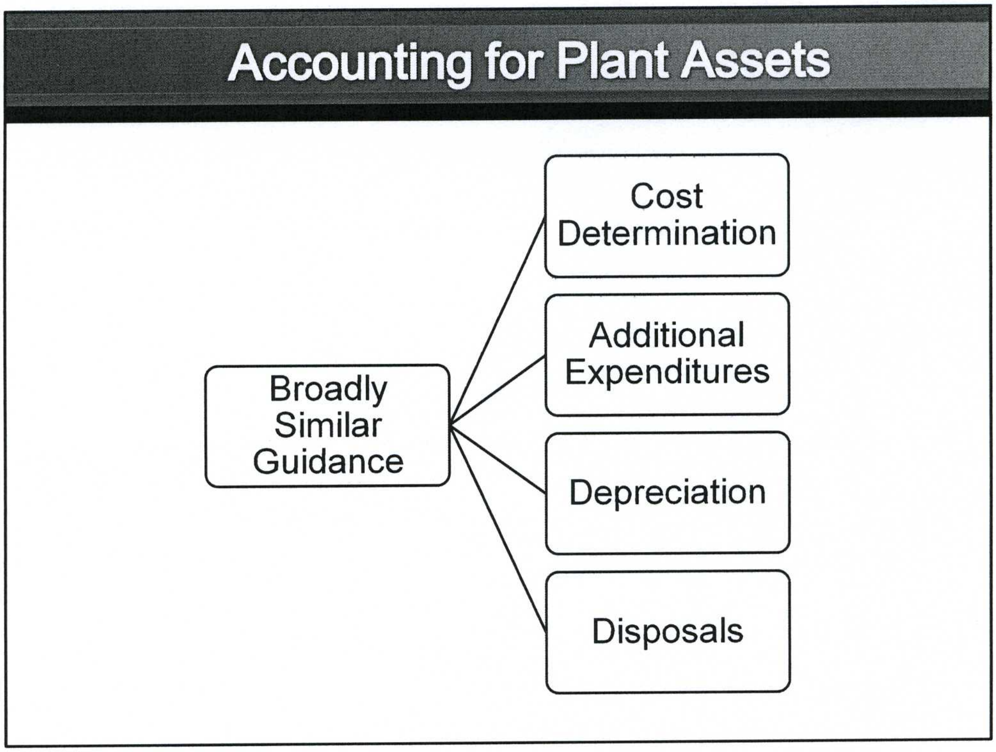
Disposition of Receivables

Again, both US GAAP and IFRS apply broadly similar rules in recording disposition of receivables. An important difference exists in terminology. Under US GAAP, companies disclose Bad Debts Expense, also known as Provision for Bad Debts or the Provision for Uncollectible Accounts. For US GAAP, *provision* refers to expense. Under IFRS, the term *provision* usually refers to a liability whose amount or timing (or both) is uncertain.



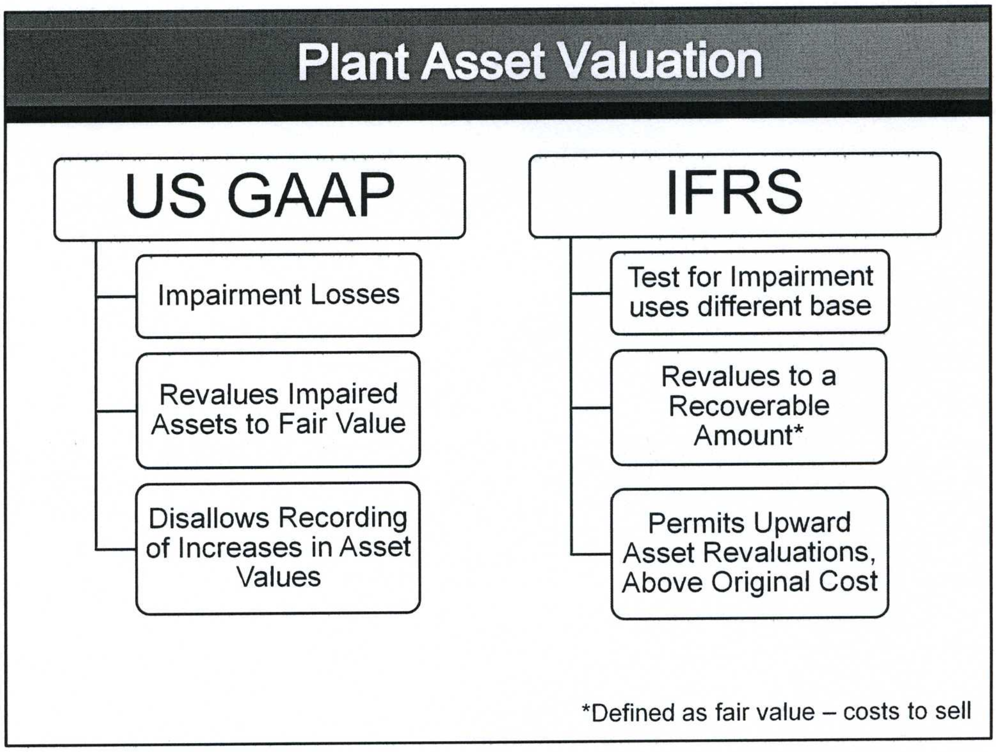
From <u>Fundamental Accounting Principles</u>, by John J. Wild, et. al., 20th edition, 2011, p. 150:

Reporting Assets and Liabilities: The definitions of assets and liabilities are similar under both US GAAP and IFRS; however, while the original value of an asset is its historical cost, IFRS defines fair value as exchange value, either replacement cost or selling price. As with assets, both systems apply one of two measurement systems to liabilities: historical cost or fair value.



From *<u>Fundamental Accounting Principles</u>, by John J. Wild, et. al., 20th edition, 2011, p. 412:*

Accounting for Plan Assets
Issues involving cost determination, depreciation, additional expenditures, and disposals of plant assets are subject to broadly similar guidance for both US GAAP and IFRS. Although there are differences, the similarities greatly outweigh the differences. One area where significant differences exist is in accounting for changes in the value of plant assets (between the time they are acquired and when disposed of). Namely, how does IFRS and US GAAP treat decreases and increases in the value of plant assets following acquisition?



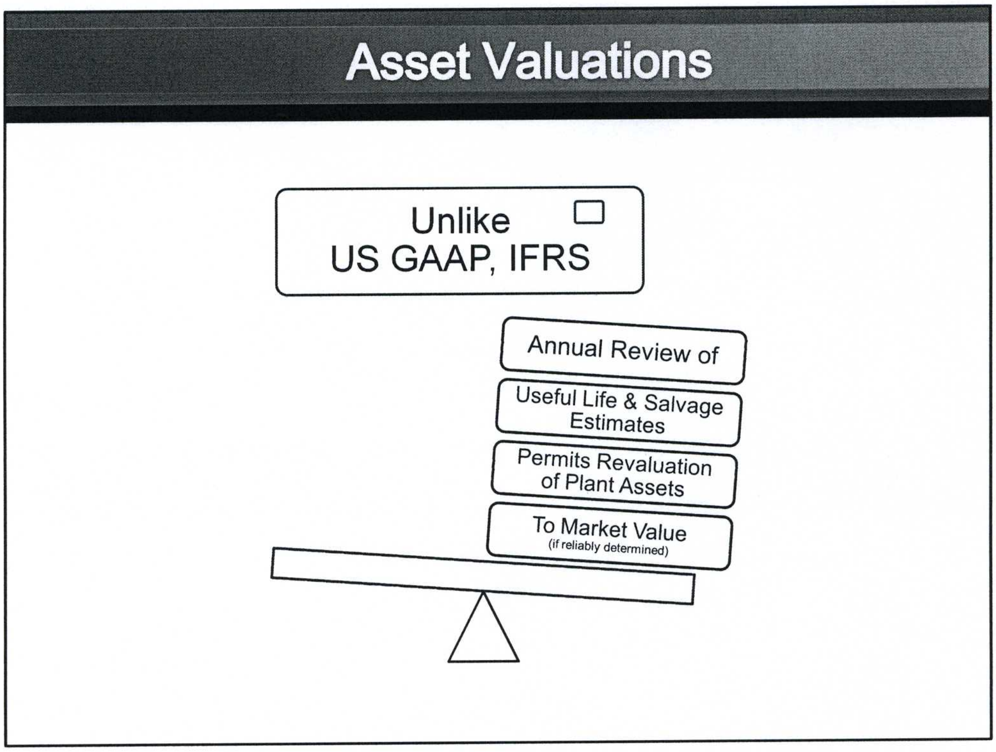
From <u>*Fundamental Accounting Principles*</u>*, by John J. Wild, et. al., 20th edition, 2011, p. 412:*

Decreases in the Value of Plant Assets

When the value of plant assets drop after acquisition, but before disposition, both US GAAP and IFRS require companies to record those declines as impairment losses. While the test for impairment uses a different base between US GAAP and IFRS, a more important difference is that US GAAP revalues impaired plant assets to fair value whereas IFRS revalues them to a recoverable amount (defined as fair value less costs to sell).

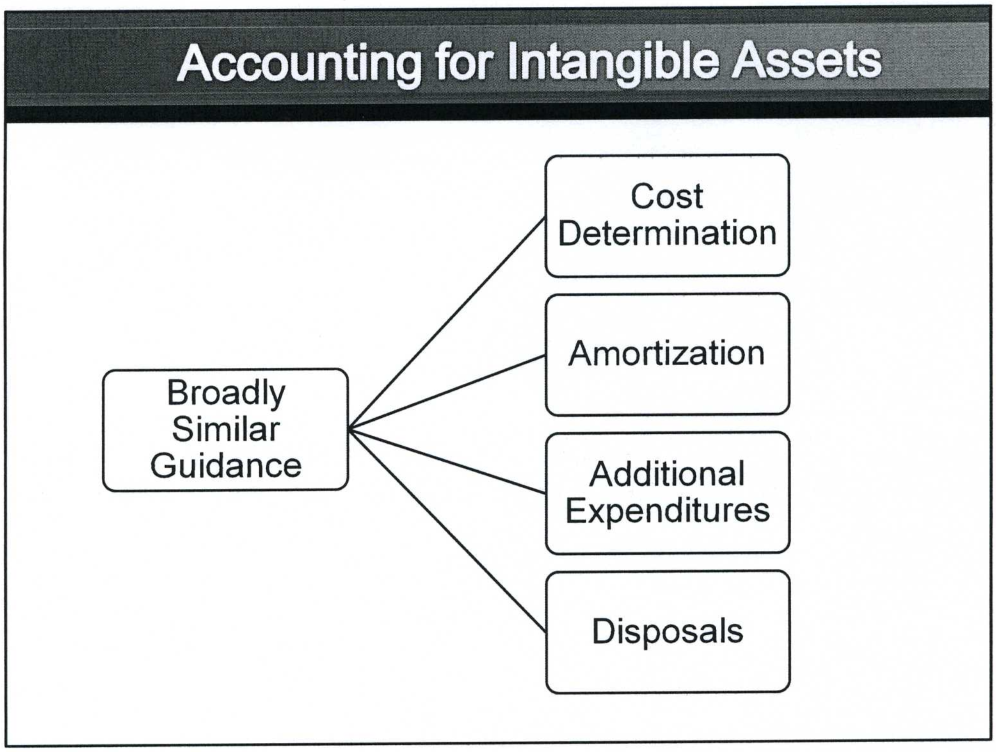
Increases in the Value of Plant Assets

US GAAP restricts companies from recording increases in the value of plant assets. However, IFRS allows upward asset revaluations. Namely, under IFRS, if an impairment was previously recorded, a company would reverse that impairment as needed and record that increase in income. If the increase would put the asset above the original cost, that increase is recorded in comprehensive income.



From *Fundamental Accounting Principles*, *by John J. Wild, et. al., 20th edition, 2011, p. 150:*

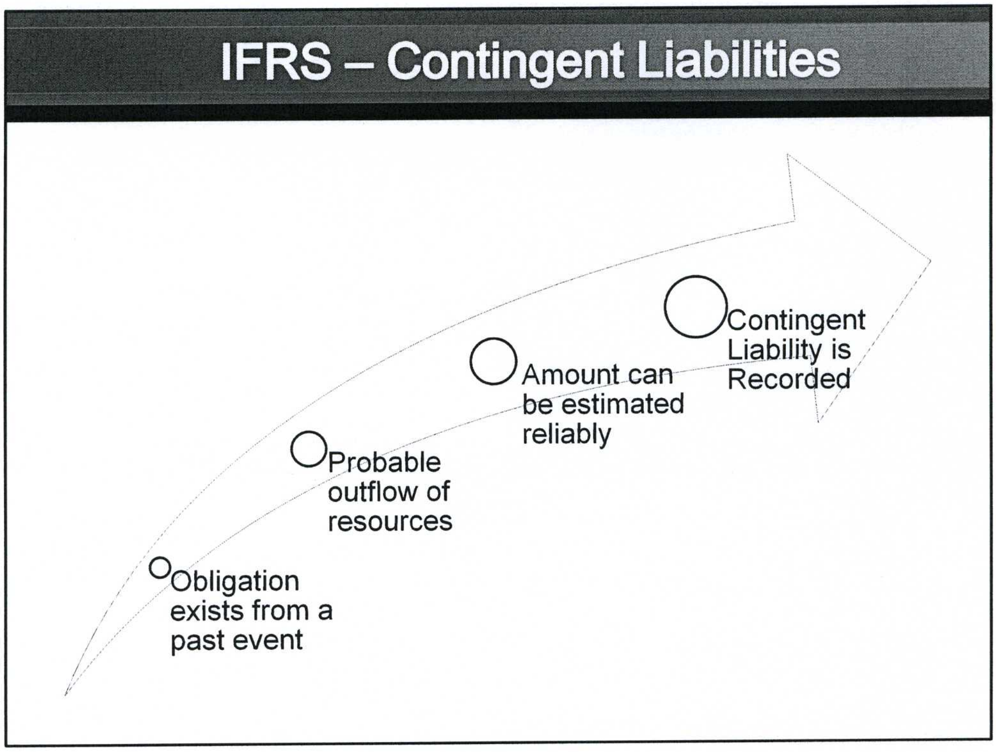
Unlike US GAAP, IFRS requires an annual review of useful like and salvage value estimates. IFRS also permits revaluation of plant assets to market value if market value is reliably determined.



From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, pp. 412-413:

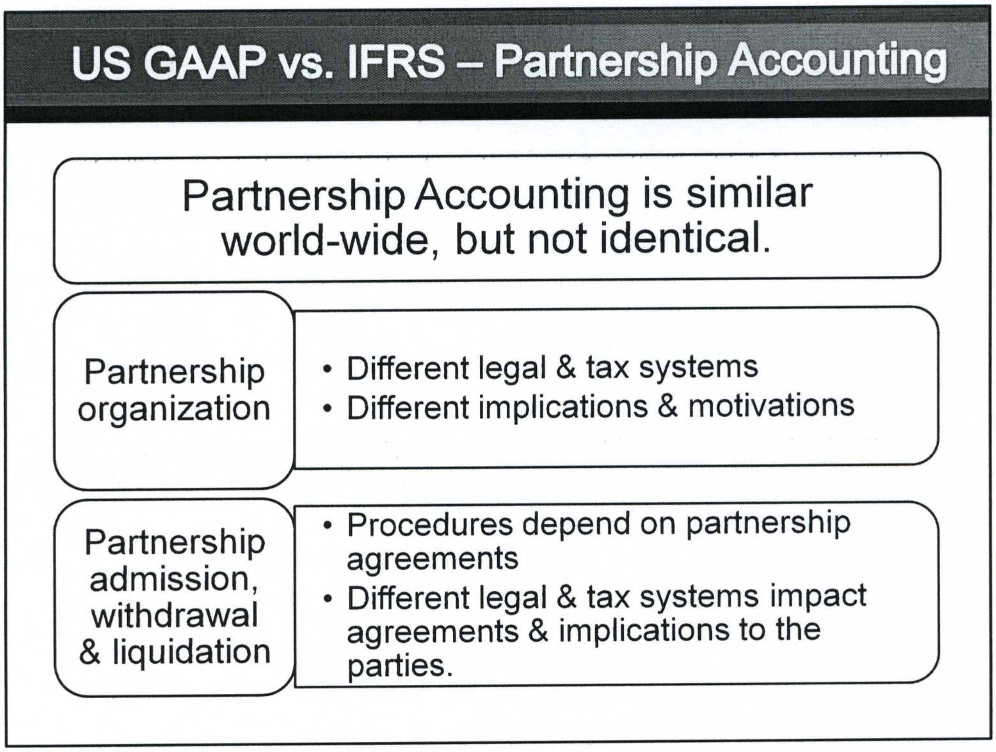
Decreases in the Value of Plant Assets

Although there are differences, the similarities are more prominent. Similar to how each handles plant assets valuations, US GAAP and IFRS handle decreases and increases in the value of intangible assets differently. However, IFRS requirements for recording increases in the value of intangible assets are so restrictive that such increases are rare.



From <u>Fundamental Accounting Principles</u>, by John J. Wild, et. al., 20th edition, 2011, p. 438:

Recording Contingent Liabilities
IFRS records a contingent liability when an obligation exists from a past event if there is a probable outflow of resources and the amount can be estimated reliably. However, IFRS defines probable as "more likely than not" while US GAAP defines it as "likely to occur."

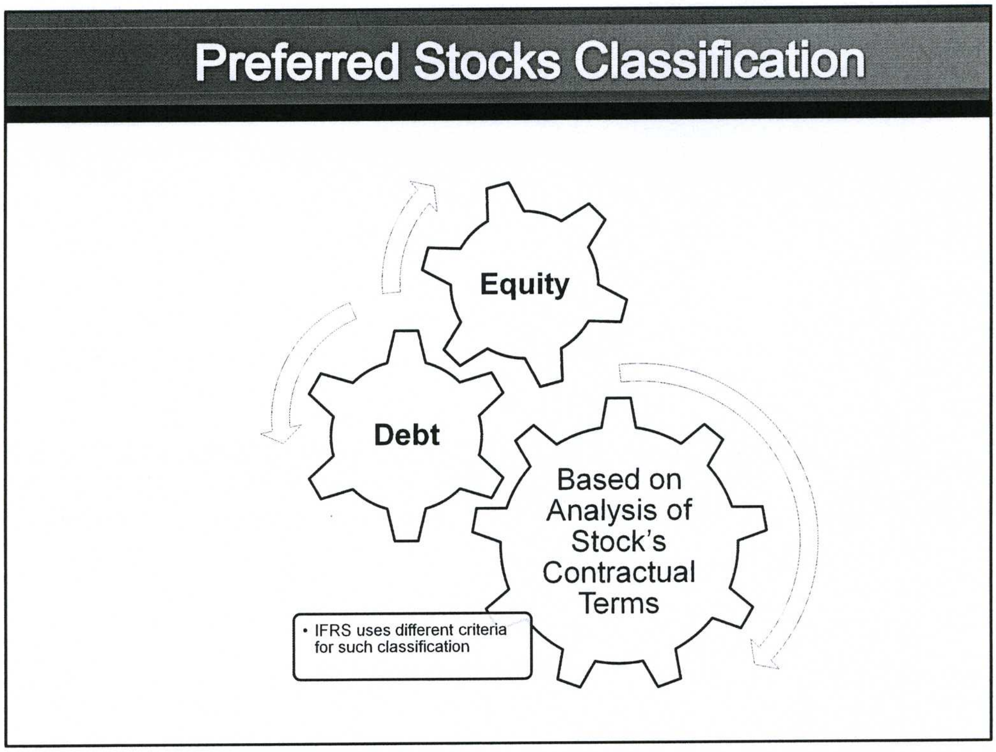


From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, p. 492:

Partnership Accounting

Partnership accounting according to US GAAP is similar, but not identical, to that under IFRS. Both US GAAP and IFRS include broad and similar guidance for partnership accounting. In addition, partnership organization is similar worldwide; however, different legal and tax systems dictate different implications and motivations for how a partnership is effectively set up.

The accounting for partnership admission, withdrawal, and liquidation is likewise similar worldwide. Specifically, procedures for admission, withdrawal, and liquidation depend on the partnership agreements constructed by all parties involved. However, different legal and tax systems impact those agreements and their implications to the parties.

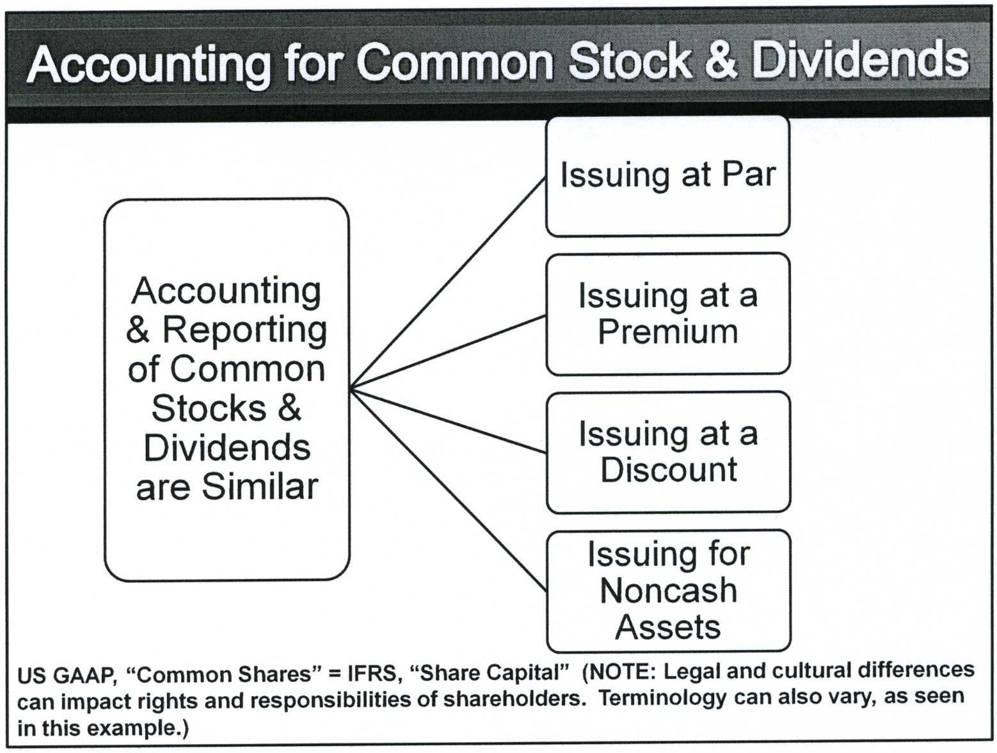


From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, pp. 521 & 526:

Accounting for Preferred Stock
Like US GAAP, IFRS requires that preferred stocks be classified as debt or equity based on analysis of the stock's contractual terms. However, IFRS uses different criteria for such classification.

Preferred stock that is redeemable at the option of the preferred stockholders is reported between liabilities and equity in US GAAP balance sheets. But, IFRS balance sheets report that same stock as a liability.

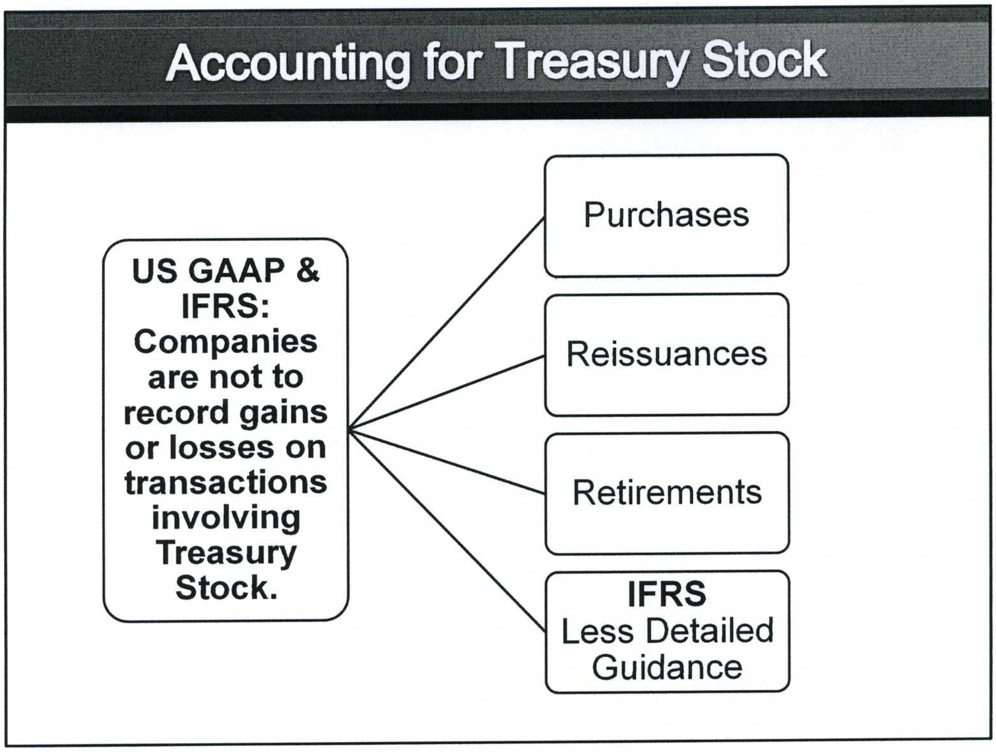
In addition, the issue price of convertible preferred stock (and bonds) is recorded entirely under preferred stock (or bonds) and none is assigned to the conversion feature under US GAAP. However, IFRS requires that a portion of the issue price be allocated to the conversion feature when it exists.



From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, p. 526:

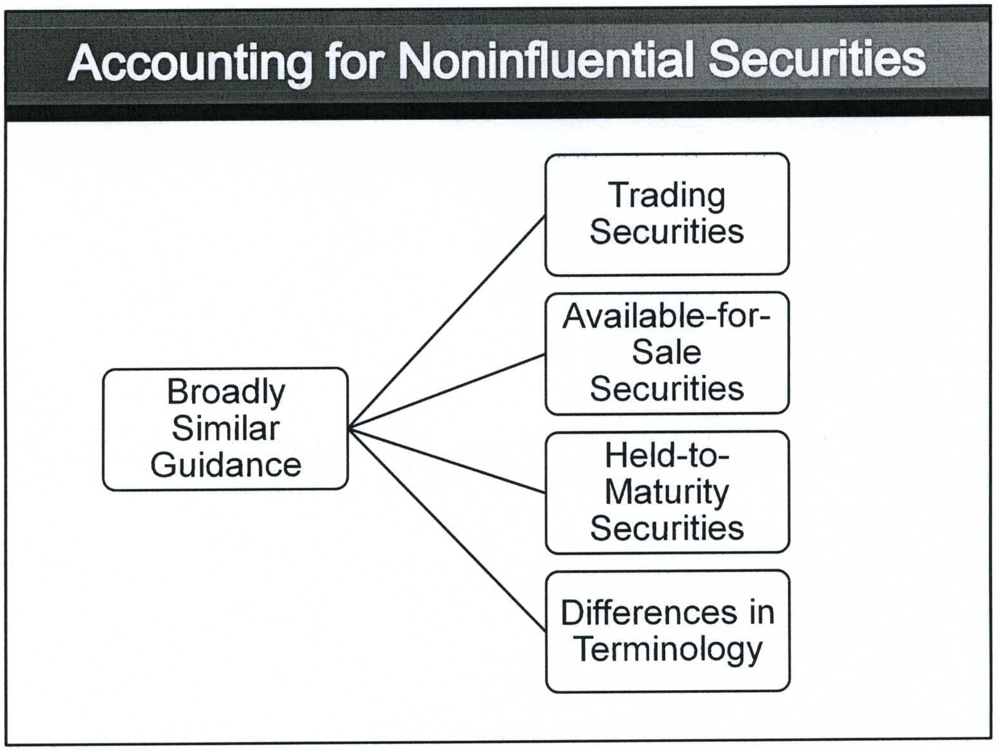
Accounting for Common Stock
Accounting and reporting of common stock is similar for both US GAAP and IFRS. Specifically, procedures for issuing common stock at par, at a premium, at a discount, and for noncash assets are similar across both systems. It is important to note, however, that there are legal and cultural differences worldwide which can impact the rights and responsibilities of common shareholders. Some companies will use somewhat different terminology such as "share capital" when referencing what US GAAP would call "common shares."

Accounting for Dividends
Accounting for and reporting of dividends is also comparable for both US GAAP and IFRS. This applies to cash dividends, stock dividends, and stock splits.



From <u>*Fundamental Accounting Principles*</u>*, by John J. Wild, et. al., 20th edition, 2011, p. 526:*

Accounting for Treasury Stock
Both US GAAP and IFRS apply the principle that companies will not record gains or losses on transactions involving their own stock. This applies to purchases, reissuances, and retirements of treasury stock. IFRS, however, is less detailed than US GAAP in this area.



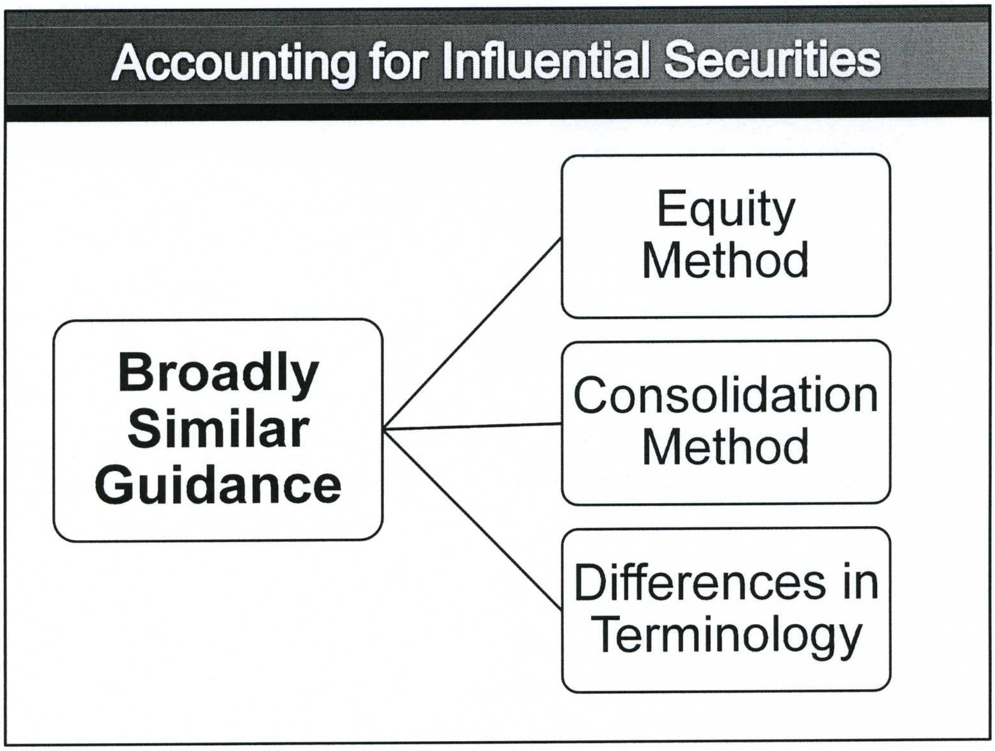
From *__Fundamental Accounting Principles__*, *by John J. Wild, et. al., 20th edition, 2011, p. 605:*

Accounting for Noninfluential Securities
US GAAP and IFRS provide broadly similar guidance involving accounting for noninfluential securities.

> **Trading securities** are accounted for using fair values with unrealized gains and losses reported in net income as fair values change.
> **Available-for-sale securities** are accounted for using fair values with unrealized gains and losses reported in other comprehensive income as fair values change (and later in net income when realized).
> **Held-to-maturity securities** are accounted for using amortized cost. Likewise, companies have the option under both systems to apply the fair value option for available-for-sale and held-to-maturity securities. In addition, both systems review held-to-maturity securities for impairment.

Differences in terminology that exist under IFRS:

1. Trading securities are often called *financial assets at fair value through profit and loss.*
2. Available-for-sale securities are often called *available-for-sale financial assets.*



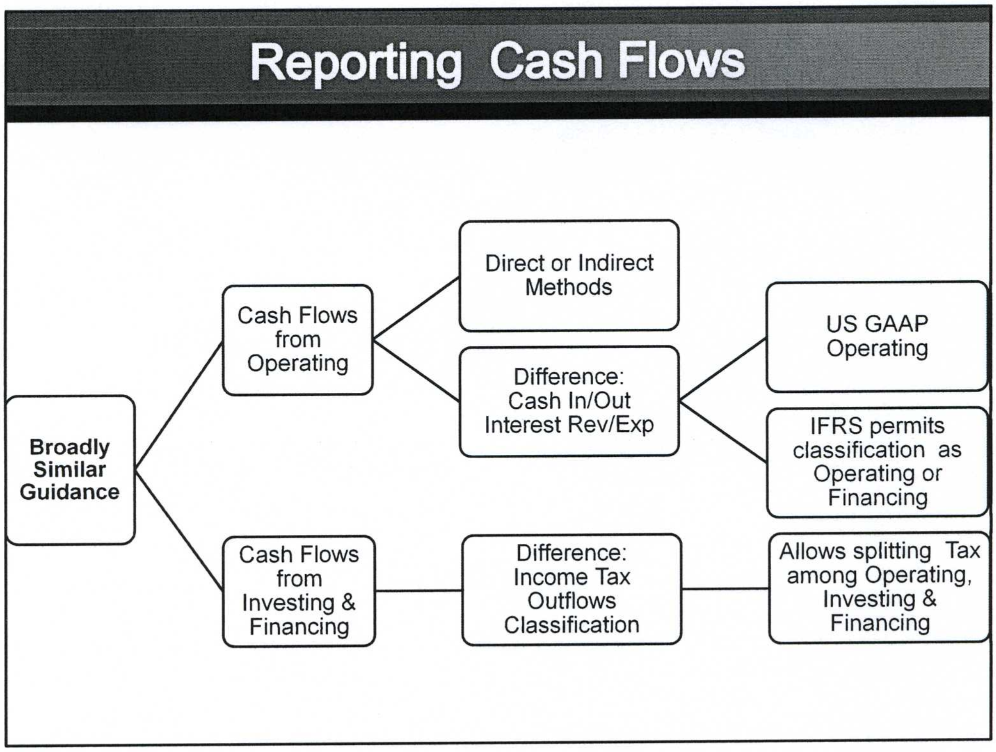
From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, p. 605:

Accounting for Influential Securities
US GAAP and IFRS provide broadly similar guidance involving accounting for influential securities.

> **Under the equity method** the share of investee's net income is reported in the investor's income in the same period the investee earns that income, and the investment equals the acquisition cost plus the share of investee income less the share of investee dividends (minus amortization of excess on purchase price above fair value of identifiable, limited-life assets).
> **Under the consolidation method** investee and investor revenues and expenses are combined, absent intercompany transactions, and subtracting noncontrolling interests. In addition, nonintercompany assets and liabilities are similarly combined (eliminating the need for an investment account), and noncontrolling interests are subtracted from equity.

Differences in terminology that exist:

1. US GAAP companies often call earnings from long-term investments *equity in earnings of affiliates,* while IFRS companies use *equity in earnings of associated (or associate) companies.*
2. US GAAP companies often call noncontrolling interests in consolidated subsidiaries *minority interests,* while IFRS companies use *noncontrolling interests.*

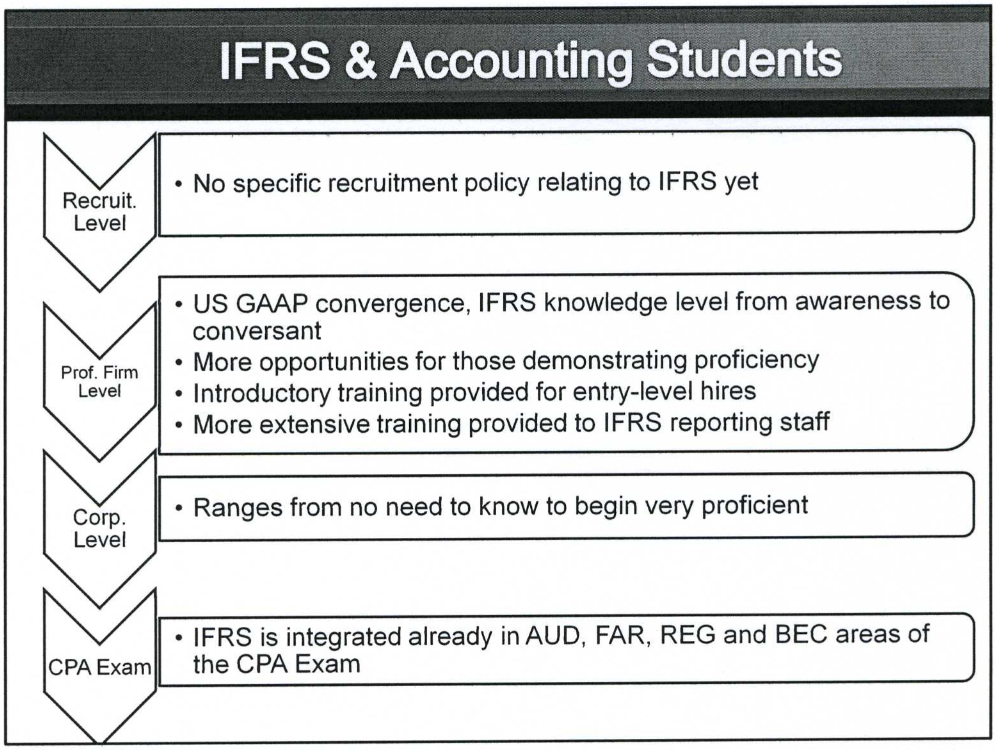


From Fundamental Accounting Principles, by John J. Wild, et. al., 20th edition, 2011, pp. 649 & 661:

Reporting Cash Flows from Operating
US GAAP and IFRS permit the reporting of cash flows from operating activities using either the direct or indirect method. The basic requirements underlying the application of both methods are fairly constant across both accounting systems. However important differences do exist.

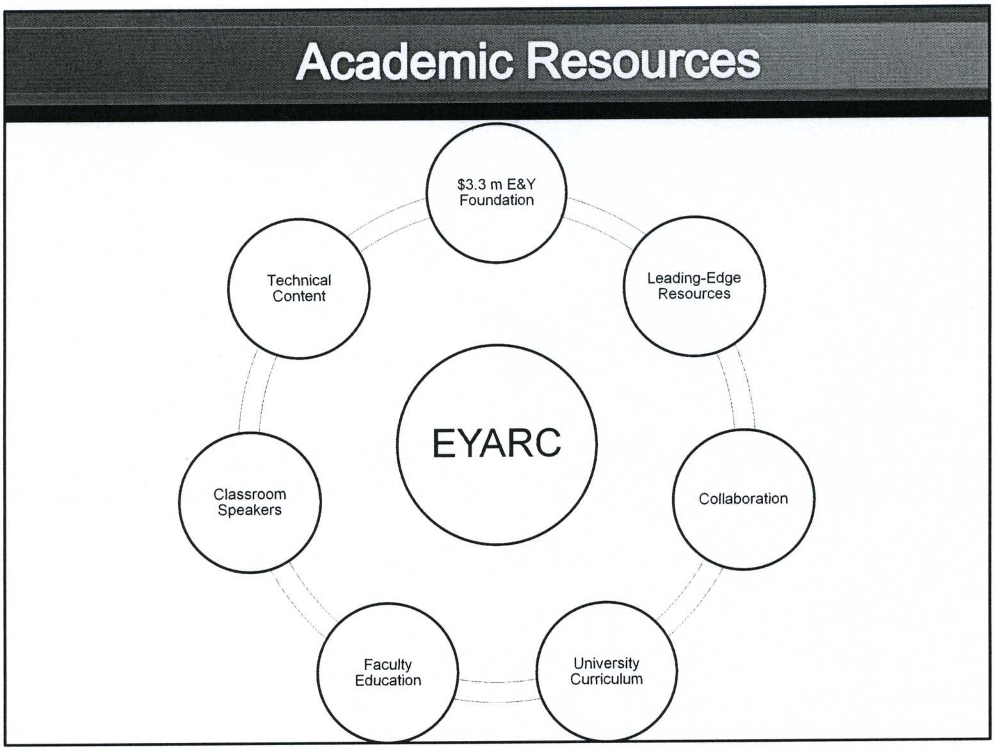
Differences:
1. US GAAP requires cash inflows from interest revenue and dividend revenue be classified as operating, while IFRS allows classification under operating or investing provided that this classification is consistently applied across periods.
2. US GAAP requires cash outflows for interest expense be classified as operating, while IFRS again allows classification under operating or financing so long as it is consistently applied across periods.

Reporting Cash Flows from Investing and Financing
US GAAP and IFRS are broadly similar in computing and classifying cash flows from investing and financing activities. **One noteworthy difference** is that US GAAP requires cash outflows for income tax be classified as operating, while IFRS allows the splitting of those cash outflows among operating, investing, and financing depending on the source of that tax.



From *<u>International Financial Reporting Standards Update and Impact on Instructors and Students</u>, by Michael Lutze, Ernst & Young, July 18, 2011, pp. 12-15:*

Current expectations of Accounting students:
At this time there is no specific recruitment policy relating to IFRS. The general expectations for professional accounting service firms is that students be knowledgeable about US GAAP convergence and range in their understanding of IFRS from an awareness level to conversant, but not necessarily proficient. However, more opportunities such as international internships, global accounts, and mobility exist for students who demonstrate proficiency levels in IFRS. Firms provide training for entry-level hires at a minimum of an awareness level. Students who have had exposure to IFRS will find this reinforces their learning. Firms provide more extensive training for those staff with IFRS reporting responsibilities. At the corporate level, IFRS knowledge requirements range from limited to being very proficient, depending on the corporation and its reporting requirements. The CPA Exam has already integrated IFRS into the assessments areas of AUD, FAR, REG and BEC. For more specific information about CPA Exam and IFRS, see pp. 13 – 15 of Mr. Lutze's presentation hand-out.



From International Financial Reporting Standards Update and Impact on Instructors and Students, by Michael Lutze, Ernst & Young, July 18, 2011, pp. 16-18:

Please note that there are many resources located throughout the Internet on professional accounting organizational, governmental, and major accounting firm web sites, as well as in more and more new editions of textbooks. This slide provides specific information concerning the IFRS resources made available to clients and educators by Ernst & Young. Michael Lutze, Partner, E&Y Financial Accounting Advisory Services, presented this summer at the "Moving Accounting Forward" summer workshop sponsored by DPI, WICPA, and WBEA. Teachers who participated enjoyed three days of guest speakers and presentations of content and curriculum materials for the classroom, wonderful networking opportunities and a field trip to tour EPIC Systems in Verona and meet with their chief accountant (ALL VERY COOL!). If you want to advance your understanding of Accounting, gather resources to use in your classroom, and network with other accounting teachers, you'll want to consider next summer's "Moving Accounting Forward" event!

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- A $3.3 million investment by the Ernst & Young Foundation
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    - Campus specific training
    - Offerings through AAA national and regional meetings
  - Classroom speakers
  - Technical content subscriptions
- EYARC Resources ONLINE relating to IFRS: www.eyonline.com (available to college-level faculty) or www.ey.com/ifrs (available to clients and HS level teachers)
- Here is a link directly to a list of Ernst & Young IFRS online learning modules: **http://tinyurl.com/E-YIFRS** To download, access, and complete a module, there is a pdf file containing downloading instructions.