IFRS Study Guide for CPA Examination - 2013

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Frankly, I think many people are starting to get tired of convergence, on both sides of the ocean. The past 10 years shows this is an exceedingly difficult & slow process.

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Instructions for Use

A set of accounting standards is a system of rules designed to govern production of financial statements.

US GAAP and IFRS are two different sets of accounting standards. They are very similar, and the bodies that write the standards are striving to converge them further. However, there remain some significant differences.

The US CPA examination section on Financial Reporting is primarily a test of US GAAP rules governing financial reporting. In fact, if you were to study US GAAP until you "knew it cold," you should pass this section of the CPA examination. The question arises, then, as to how much, if any, effort should a student invest in knowing IFRS for the US CPA examination?

In my opinion, a student should strive to do the following when studying IFRS for the CPA exam:

1) Invest only enough time required to maximize their knowledge of likely tested topics.
2) Do the studying in a manner that reduces the chance of becoming confused as between US GAAP vs. IFRS rules.

To aid you in accomplishing these two goals, I have prepared this summary of what appear to be the most distinct differences remaining between US GAAP and IFRS, and have developed a method of approaching the material.

What this packet is not: It is NOT a comprehensive summary of all differences remaining between US GAAP and IFRS. It is a condensed outline of what, in my opinion, are the most likely items to be tested on the US CPA exam at this time.

Study Plan for CPA Exam Financial Section:

- Study US GAAP thoroughly, using whatever prep materials you have determined work best for you. Ignore IFRS and focus on perfecting your US GAAP knowledge. Study, study, study. Have patience with yourself and keep plugging away. Time invested pays back in knowledge.
- Take practice tests, answering only the non-IFRS questions. Use the results of these tests to go back and further improve your US GAAP knowledge.
- Once you have done Nos. 1 & 2, use this guide to hit the highlights of the main differences between US GAAP and IFRS. Strive to keep the IFRS knowledge separate in your mind from your US GAAP knowledge. See my recommendations below that will help you keep the two bodies of knowledge separate in your mind.
- Take full practice tests, answering all questions. For questions you get wrong, work first on the US GAAP questions. Segregate the IFRS questions and work on only after you have worked on the US GAAP errors.

It is detrimental to try to learn both US GAAP and IFRS at the same time. Your mind will not be able to keep the two sets of rules distinct from one another if you study them concurrently, and you are at risk for diminishing your ability to pass the CPA examination. Therefore, I recommend that you review IFRS only when you feel confident in your US GAAP knowledge, using this system:

1. Read through this entire packet once.
2. There are three broad sections – these are easy to remember. Memorize the subsection titles below the section using a mnemonic. (e.g., For the Overview section, the mnemonic is AEF Firps). A is for Authoritative Literature, E is for Elements of Financial Statements, etc. Mnemonics are amazing devices for helping you recall information.
3. Once you have the subsection titles all memorized, make up a large index card for each title (e.g., "Authoritative Literature") – the index card will be used to summarize the information below the title headings. Some are easy to remember, like Personal Financial Statements. Others are somewhat easy to remember and understand, like Inventory. For ones that are more difficult, just MEMORIZE.
4. Do your best to memorize the information in this packet, using mnemonics to prompt your memory. Perhaps it may seem like a lot to memorize 8 pages of material. It is actually not that much to memorize, and well within your ability to do so, if you use memory-enhancing techniques such as mnemonics.
5. For the index cards, use a color or type of card that does is visually different from your US GAAP study materials. While you are studying and memorizing, always visualize the IFRS information as appearing on the

color of index card that you have chosen. This will aid you in distinguishing it from the US GAAP information in your mind.

I am advocating mostly memorization because that is the quickest way to cover the material. If you have time, you might review class notes on areas that are more computational – such as PP&E.

Whenever you are studying a large amount of material, there will always be some areas that you gain better command over than others. For example, the topic of Inventory is pretty straightforward and easy to remember, but the Business Combinations area is more difficult. It is normal to feel this way. However, you should also recognize it as a sign as to where you need to spend additional time reading and studying. Try not to overspend time on an area that you are able to grasp quickly – just master it, and then practice it now and then to make sure you don't lose it, while you invest your time expanding and perfecting your knowledge of other areas. The more difficult areas are not impossible, they just require more time to conquer.

Again, these materials are for your personal study use only, and are not to be sold or used to give advice in a professional capacity.

Best of luck in your studies!

I Overview Topics

Authoritative Literature

US GAAP has one source of authoritative literature – the Accounting Standards Codification (ASC). IFRS does NOT have only one source, there is a hierarchy of sources, as follows:

1. IASB Standard, Interpretation & Implementation Guidance, if specifically applies
2. If no guidance specific to the situation exists in the above, then look to 1) guidance on similar issues and 2) the Framework.

Elements of Financial Statements

IFRS has only 5 Elements. The other elements shown in US GAAP still exist; however, they fall under one of the 5 elements of IFRS. Ex.: Transactions with owners affect equity and, therefore, are classified as an equity element under IFRS.

US GAAP	**IFRS**
Assets	Assets
Liabilities	Liabilities
Equity	Equity
Investments by owners	
Distributions to owners	
Revenues	Income (incl. revenues + gains)
Gains	
Expenses	Expenses (incl. expenses + losses)
Losses	
Comprehensive income	

Fair Value Definition

The definitions of Fair Value have been effectively converged with the issuance of IFRS 13, effective January 1, 2013. The definition used in IFRS 13 is:

> **Fair value** is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (i.e., an exit price)

First-Time Adoption of IFRS (IFRS 1)

This topic refers to what an entity must include in its financial statements when it issues its first set of IFRS statements. This topic refers to transition to IFRS from **any** other financial system, not just US GAAP. Note that US GAAP does not contain guidance regarding First-Time Adoption of US GAAP.

IFRS 1:

Must include an "*explicit and unreserved statement of compliance with IFRS.*"

Date of Transition is the opening date for first **income statement** presented. Must prepare a Statement of Position (SOP = balance sheet) as of the Date of Transition (in order to be able to compute the first income statement), but the Date of Transition SOP may or may not be included in the first IFRS financial statements.

Date of Reporting – ending date for the latest income statement presented. Also date of latest Statement of Position.

Comparative information required: 3 SOPs and at least 2 of each other statement.

Use IFRS in effect as of Date of Reporting

Disclosure: Extensive disclosure regarding transition is required.

Exemptions from certain IFRS rules are granted to a First Time preparer. There are 6 Mandatory exemptions and 18 Optional Exemptions. These exemptions are designed to alleviate some of the more difficult aspects of the transition to IFRS statements. Here are the three most important of the mandatory exemptions:

1) Previous business combinations need not be restated
2) PP&E – use fair value or revaluation as deemed cost
3) Employee benefits – unrecognized gains & losses at date of transition need not be recognized

Interim Financial Reporting:

An interim financial report must include, at a minimum, condensed financial statements (financial position, comprehensive income, changes in equity, and cash flows) and notes. The condensed statements must include at least all the headings and subtotals included in the most recent annual statements.

If the interim report contains a complete set of statements, their form and content must conform to those required for annual statements.

Significant events & transactions must be explained.

For Inventory – LCNRV applies even if impairment is expected to reverse by year end.

Reporting Income:

Under IFRS, expenses may be classified either by nature or function.

Extraordinary items DO NOT EXIST under IFRS. Anything "unusual and infrequent in nature" would be included as a component of income from continuing operations.

Personal Financial Statements are covered under US GAAP; there is no guidance under IFRS regarding personal financial statements

Statement of Cash Flows:

Cash flows from interest and dividends must be separately disclosed. Financial institutions consider interest & dividends from investments to be anoperating item. A nonfinancial entity classifies interest and dividends as follows:

	Operating	**Financing**	**Investing**
Interest paid	Yes	Yes	No
Interest received	Yes	No	Yes
Dividends paid	Yes	Yes	No
Interest received	Yes	No	Yes

Reporting cash flow per share is not prohibited.

Operating, investing & financing cash flows of a discontinued operation must be disclosed (in notes is acceptable)

Noncash investing & financing activities must be disclosed, but not in the statement of cash flows.

Bank overdrafts resulting from the entity's cash management program are netted against cash and cash equivalents (therefore, changes therein are not operating, financing or investing cash flows).

II. Balance Sheet Accounts

Inventory:

Inventory is valued at "Lower of Cost or Net Realizable Value," referred to as LCNRV

LIFO is not allowed

Impairments go to P&L and those that have been taken must be reversed through P&L on subsequent financial statements if the situation causing the impairment has been alleviated. Don't write up above original cost.

Biological Assets (living animals and plants) are a separate line item on the balance sheet and are measured at Fair Value less costs to sell (with changes going through P&L). Measure at LCNRV if fair value cannot be reliably determined

Agricultural produce is the harvested product from biological assets. These are measured at Fair Value less costs to sell at point of harvest.

Property, Plant & Equipment

Two methods of measurement are allowed: Cost method and Revaluation method.

Revaluation Method may be elected for a class of assets – **if the fair value can be reliably measured**. Depreciation is recomputed for the remaining life of the asset based on the revalued amount. The asset must be revalued whenever its fair value deviates materially from its carrying amount.

When using Revaluation Method, write-ups above original cost minus original depreciation are credited directly to an Equity account called Revaluation Surplus. Write-downs are then taken first against Revaluation Surplus until it zeros out, and then to P&L.

Under Cost Method, an impairment exists when as asset's recoverable amount has fallen below its carrying amount. Impairments that have been taken must be reversed on subsequent financial statements if the situation causing the impairment has been alleviated. Impairment losses and subsequent reversals go to P&L. Don't write up above original cost less originally planned depreciation.

Depreciation – separate significant components of PP&E with different economic lives must be recorded and depreciated separately.

Investment Property

This is a separate line item on the balance sheet. These are land or buildings held for rental or capital appreciation. US GAAP just includes these with PP&E.

An election is made to either carry these using the Cost method (w/o depreciation) or the Fair Value method (with all changes going to P&L).

Intangible Assets & R&D

Intangible Assets:

Goodwill is allocated to Cash Generating Unit (CGU) that will benefit from the business combination. CGU is lowest level at which goodwill is monitored and must not be larger than an operating segment. The test for impairment of goodwill is whether the carrying amount of the CGU is larger than the recoverable amount. Recoverable amount is greater of fair value minus costs to sell or value in use.

An intangible asset other than goodwill must be recognized if the item fits the definition of an asset, is identifiable and lacks physical substance.

Impairments of intangible assets are tested via a one-step test: comparison of an asset's carrying amount to its recoverable amount.

The Revaluation Model may be used for intangible assets if they are traded in an active market.

R&D:

Research is always expensed

Development costs must be capitalized if the entity can demonstrate:

1) Technological feasibility
2) Intent to complete
3) Ability to use or sell
4) Ways in which it will generate future economic benefits
5) Availability of resources to bring to completion
6) Ability to measure costs reliably

Investments

There is an option similar to the US GAAP Fair Value Option. It is called designating a financial asset or liability at initial recognition as FVTPL (Fair Value Through Profit or Loss). The fair value must be able to be reliably measured. It must satisfy one of the following:

It must reduce a measurement mismatch.

Its investment strategy is evaluated on a fair value basis

An investment has an imbedded derivative and the host is not an asset.

The equity method is not required if 1) the investment is classified as held for sale and 2) the entity is not required to file a consolidated return.

A financial asset not valued FVTPL is initically measured at FV + transaction costs.

Liabilities

Provisions are liabilities of uncertain timing or amount. An example would be a warranty or a liability for future plant decommissioning costs.

A provision for restructuring is recognized only when the entity has 1) developed a detailed formal plan and 2) created valid expectation in those affected by either starting or announcing the plan.

A contingent liability is a possible obligation arising from past events. Its existence will be confirmed only by uncertain future events not wholly within the entity's control. An example of a contingent liability would be in the case of a liability that is jointly and severally payable by the entity and other parties, the amount expected to be paid by the other parties is a contingent liability. A contingent liability is not recognized, but it is disclosed unless the probability of future economic outflows is **remote**.

Note: A contingent asset has a similar definition, but is only disclosed if it is **probable**.

Pensions & Other Postretirement Benefits

An entity may recognize gains and losses when they occur.

Past service cost is recognized immediately to the extent it is **vested** upon introduction, or amendment, of a plan. Otherwise, it is expensed on the straight-line basis over the average period to vesting.

Leases:

Leases are classified as either Finance or Operating

The classification is not based on “bright line” rules (as in US GAAP), rather, it is made based on an assessment of whether substantially all risks and rewards of ownership are transferred to the lessee. Certain situations, taken individually or together, indicate that it is a Finance lease:

1) Transfer of ownership
2) Bargain purchase option
3) Term is for a major portion of the asset’s economic life
4) PV of lease payments is substantially all of FV at inception
5) Leased asset has attributes that make usable only by the lessee
6) Lessor losses on lease are borne by lessee
7) Lessee bears risk of fluctuations in fair value of the residual value
8) Lessee may renew at substantially below market rent

Accounting for Income Taxes:

Current and deferred taxes must be recognized as income or expense in the P&L. However, these amounts may result from transactions that are taken directly to equity or OCI.

Deferred tax accounts are noncurrent

Deferred tax liabilities = always recognized; Deferred tax assets = recognized only when taxable profit is **probable**.

Accounting Changes and Error Corrections:

A prior period error must be corrected by restatement unless it is impracticable to do so.

A change in accounting policy must be made only if it 1) is required by a new standard or interpretation, or 2) results in reliable and more relevant information about transactions, financial condition, financial performance, and cash flows.

Long-Term Construction-Type Contracts, Installment Sales, and Consignments:

Completed contract method prohibited. If outcome of long-term contract cannot be reliably estimated, use cost recovery method.

Business Combinations and Consolidated Financial Reporting:

A noncontrolling interest (NCI) may be measured at 1) fair value or 2) a proportionate share of the fair value of the acquiree's identifiable net assets.

An acquirer must recognize a contingent liability at the acquisition date if 1) it is a present obligation arising from past events and 2) its fair value can be measured reliably

Control is defined as "the power to govern the financial and operating policies of an entity so as to obtain benefits its activities.

An acquiree may be the lessor of certain of its assets under operating leases. The acquisition-date fair value of such assets must reflect the terms of the leases. Thus, the acquirer does not recognize a separate intangible asset or liability if the lease terms are favorable or unfavorable, respectively.