Accounting Across Borders
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• IFRS on the Horizon

PLUS
Madoff Victims’ Tax Questions for 2008 Returns
International Financial Reporting Standards (IFRS) are issued by the International Accounting Standards Board (IASB), which was created in 2001. Previously, the International Accounting Standards Committee (IASC), founded in 1973, issued International Accounting Standards (IAS). When the IASB was created, it adopted the IAS and continued the work of the IASC. The IASB is working to harmonize accounting standards throughout the world to improve financial reporting for the global financial markets. The following are 20 common questions related to IFRS.

1. What Is the Current Status of IFRS Adoption in the United States?

   Since November 2007, the SEC has allowed foreign companies to file their financial statements prepared on the basis of IFRS. No reconciliation to U.S. GAAP is required to be filed by these foreign companies. More recently, on August 27, 2008, the SEC released a proposal for public comment that could require mandatory adoption of IFRS beginning in 2014 (updated on November 14, 2008). The mandatory adoption could be phased in depending on company size. The proposal allows the largest public companies to adopt IFRS for periods ending after December 15, 2009. It will be voted on in 2011 (“AICPA Supports SEC Proposed Roadmap for Transitioning to IFRS for Public Companies,” The CPA Letter, September 2008).

2. How Many Countries Have Adopted IFRS?

   To date, 85 countries have adopted IFRS. Another four require only select companies to use IFRS. Israel, for example, requires IFRS for all companies except banks. Twenty-four countries permit the use of IFRS. This means that 113 countries either require or permit the use of IFRS. Central and South America are moving toward IFRS, as well (“Use of IFRSs by Jurisdiction,” IAS Plus, Deloitte, www.iasplus.com/country/useias.htm).

3. What Is the Status of Converging U.S. GAAP with IFRS?

   The FASB is working with the IASB on the convergence of a conceptual framework for accounting standards. The conceptual framework project has identified eight phases: Phase A—Objectives and Qualitative Characteristics; Phase B—Elements and Recognition; Phase C—Measurement; Phase D—Reporting Entity; Phase E—Presentation and Disclosure, including Financial Reporting Boundaries; Phase F—Framework Purpose and Status in GAAP Hierarchy; Phase G—Applicability to the Not-for-Profit Sector; and Phase H—Remaining Issues. A final issued document of Phase A is expected in the second quarter of 2009. Discussion
papers for Phases C and B are expected in the third and fourth quarters of 2009, respectively. An exposure draft for Phase D is expected in the third quarter of 2009.

While creating a conceptual framework, the two boards are continuing their work on converging U.S. GAAP with IFRS. Several new accounting standards have been issued as a result of the project. (These are discussed under question 4.) Discussion papers have been issued for financial statement presentation, leases, and revenue recognition, with comment deadlines in the second quarter of 2009, and the expectation of a final document in 2011. In 2009, there should be final documents in the following areas: earnings per share, discontinued operations, subsequent events, hedging instruments, loan loss disclosures, disclosure of loss contingencies, and assets and liabilities arising from contingencies in a business combination (FASB, www.fasb.org).

4. What Standards Have Been Issued as a Result of the Convergence Project?

The FASB and IASB agreed in 2002 to conduct a convergence project to more closely align U.S. GAAP with IFRS. The accounting standards shown in the Exhibit have been issued by the FASB to move U.S. GAAP closer to IFRS. The corresponding international standard is also listed. Although there may still be some differences in certain areas, these standards did move U.S. GAAP and IFRS closer together.

5. Have All the Differences Between U.S. GAAP and IFRS Been Eliminated for the Converged Topics?

No—the joint projects that have occurred thus far have not eliminated all differences between U.S. GAAP and IFRS for the topics that have been addressed. In the area of business combinations, for example, although the boards largely achieved their goal of convergence, differences still exist. (These differences are detailed in question 10.)

6. What Is the Difference Between Principles-Based Standards and Rules-Based Standards?

IFRS is considered principles-based, whereas U.S. GAAP is considered rules-based. Principles-based standards are generally developed from a conceptual framework and provide only general guidance on how to account for particular transactions. Principles-based standards require management to apply judgment and expertise when applying accounting principles. Rules-based accounting standards, on the other hand, give strict rules that must be adhered to in order to properly account for particular transactions.

For example, lease accounting in the United States gives four criteria for determining if a lease is a capital lease. If a lease contains any of the following, then it is considered a capital lease and must be accounted for as such: 1) a bargain purchase option; 2) ownership transfers at the end of the lease; 3) minimum lease payments with a present value of at least 90% of the FMV of the asset; or 4) a lease length of at least 75% of the economic life of the asset. This is an example of very specific rules for accounting for leases. IFRS, because it is principles-based, does not list specific percentages. (Question 9 offers a more detailed discussion of leases.)

The treatment of goodwill was changed from a rules-based standard, where goodwill was amortized over 40 years, to a principles-based standard, where goodwill is merely tested for impairment and, if impaired, is written down to its current fair value (Richard G. Schroeder, Myrtle W. Clark, and Jack M. Cathey, Financial Accounting Theory and Analysis: Text and Cases, 9th edition, Wiley, 2009).

7. Has the IASB Developed a Conceptual Framework Similar to the Conceptual Framework Developed by the FASB?

Yes, the IASB has developed a conceptual framework called Framework for the Preparation and Presentation of Financial Statements, which is similar to the conceptual framework developed by the FASB. Both the FASB and the IASB have concluded that the objective of financial statements is to provide information for a wide variety of users in order to make decisions. This information should contain qualitative characteristics, such as comparability, understandability, relevance, and reliability. As discussed in question 3, the IASB and the FASB are working on a joint project to converge their conceptual frameworks (Schroeder, Clark, and Cathey 2009).

8. What Are the Major Differences Between U.S. GAAP and IFRS for Inventory?

SFAS 151, Inventory Costs, was issued to change the wording of ARB 43, Restatement and Revision of Accounting Research Bulletins, to more closely align with IAS 2, Inventories, so that U.S. GAAP and IFRS would be more consistently applied. This change, however, did not address a major difference in inventory, namely that IFRS does not allow for the last-in, first-out (LIFO) accounting for inventory. For companies operating in the United States, LIFO is used to minimize taxes. In periods of rising prices, more recent, higher costs are reported in cost of goods sold, resulting in lower profit and lower income taxes. When converting to IFRS, a company may have to plan ahead for the resulting cash outflow of additional tax liability. The IRS requires companies using LIFO for tax purposes to also use LIFO for financial reporting purposes.

Under IFRS, inventories are measured at the lower of cost or net realizable value. Under U.S. GAAP, inventories are reported at the lower of cost or market, with market value being defined as replacement cost. Replacement cost is subject to a ceiling and a floor: The ceiling is the net realizable value; the floor is the net realizable value less a normal profit margin. Another major difference in market value between U.S. GAAP and IFRS is that under IFRS, a write-down of inventory is not permanent. If the net realizable value of inventory subsequently increases, the write-down is reversed. Under U.S. GAAP, any write-down of inventory is permanent (IFRS Compared to U.S. GAAP, KPMG, 2007, www.kpmg.com.cn/en/virtual_library/Audit/IFRScompare_2007.pdf).
9. What Are the Major Differences Between U.S. GAAP and IFRS for Leases?

The major difference between U.S. GAAP and IFRS for leases is that U.S. GAAP accounting for leases is primarily rules-based, whereas IFRS is primarily principles-based. Lease accounting in the United States gives four criteria for determining if a lease is a capital lease. A lease is considered a capital lease and an appropriate asset and liability are recorded if it contains any of the following provisions: 1) a bargain purchase option; 2) ownership transfers at the end of the lease; 3) present value of the minimum lease payments of at least 90% of the FMV of the asset; or 4) a lease length of at least 75% of the economic life of the asset.

Under IFRS, the four general U.S. GAAP rules are described as indicators that individually or in combination may lead to the classification of a lease as a finance lease. Instead, the terms “substantially all” and “major part” are applied. Under IFRS, the lessee can cancel the lease, and the lessor’s losses associated with the cancellation are the responsibility of the lessee. Gains or losses from the fluctuation of the fair value of the residual are the responsibility of the lessee. The lessee can extend the lease at a rent that is substantially lower than market.

Under both IFRS and U.S. GAAP, a lease not classified as a capital (finance) lease is considered an operating lease, and periodic rental expense is recorded over the life of the lease.

For U.S. GAAP, lease accounting for lessors includes further classifying capital leases into either direct financing leases, sales-type leases, or leveraged leases. Under IFRS, lease accounting for lessors has a subcategory for manufacturer or dealer lessors in which income from the lease is classified into two categories: selling profit and finance income.

Accounting for leases under IFRS applies to all leases except for leases to explore for minerals, oil, natural gas, and similar resources; licensing agreements in the entertainment industries; and intangible assets, such as patents and copyrights. Under U.S. GAAP, lease accounting applies only to property, plant, and equipment.

Lease accounting is currently a subject of the IASB–FASB convergence project. A discussion paper is expected to be issued in the first quarter of 2009, with a comment period in the second quarter of the same year (KPMG 2007).

10. What Are the Major Differences Between U.S. GAAP and IFRS for Business Combinations?

With the issuance of SFAS 141(R), Business Combinations, and SFAS 160, Noncontrolling Interests in Consolidated Financial Statements—An amendment of ARB No. 51, as well as a revised IFRS 3, Business Combinations, the majority of differences between IFRS and U.S. GAAP were resolved. The remaining discrepancies are clearly described in Appendix G of SFAS 141(R). The items outlined in Appendix G include the following:

- Definition of the acquirer
- Definition of control
- Definition of fair value
- Noncontrolling interest in an acquiree
- Contingencies
- Contingent consideration
- Goodwill disclosures

A major difference in business combinations is how the noncontrolling interest is measured. Under U.S. GAAP, the noncontrolling interest is measured at fair value on the acquisition date. Under IFRS, the company acquiring the controlling interest can measure the noncontrolling interest

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11. What Are the Major Differences Between U.S. GAAP and IFRS for Property, Plant, and Equipment?

A major distinction between U.S. GAAP and IFRS for property, plant, and equipment lies in its valuation. Under IFRS, property, plant, and equipment may be adjusted to fair value if it can be reliably measured. Under U.S. GAAP, no adjustment to fair value is allowed. Property, plant, and equipment remain on the balance sheet at depreciated cost.

Other minor differences include the timing of the review of estimates for useful life and residual value, as well as the depreciation method. Under IFRS, these must be reviewed annually. U.S. GAAP only requires review when something leads management to believe that the estimates or methodology are no longer valid. Another difference occurs with respect to component accounting, which may be used, for example, with the major overhaul of a truck. A company with a truck may decide halfway through its life to do a major overhaul. The truck and the overhaul could be depreciated with different methods or different rates. In such a situation, component accounting is required under IFRS. Under U.S. GAAP, there is no requirement to use component accounting, but there is nothing to preclude it (KPMG 2007).

12. What Are the Major Differences Between U.S. GAAP and IFRS for Equity?

The major dissimilarity between U.S. GAAP and IFRS for equity is derived from how items are classified on the right side of the balance sheet, or how liabilities and equity are categorized. IFRS has included a general principle that guides accountants in classifying liabilities. The principle is a simple one that requires items to be classified as liabilities if there is an obligation to transfer resources. U.S. GAAP does not have a general principle to guide the classification. For example, requirements to pay interest or dividends cause those instruments to be classified as liabilities under IFRS. Under U.S. GAAP, such requirements may not result in that classification because the payment of interest or dividends is just one factor in the classification decision. Under IFRS, compound financial instruments (instruments that have liability and equity components) are segregated on the balance sheet into the liability and equity components. Under U.S. GAAP, not all compound financial instruments are classified separately (KPMG 2007).

13. What Are the Major Differences Between U.S. GAAP and IFRS for Contingent Liabilities?

Contingent liabilities can be classified as recognized or unrecognized. The definition of contingent liabilities differs, however, between U.S. GAAP and IFRS. Under U.S. GAAP, contingent liabilities refer to uncertain liabilities, whether recognized or not. Under IFRS, they are limited to the ones that are not recognized.

Recognized liabilities are generally treated the same way under U.S. GAAP and IFRS, with a few minor differences. Liabilities are recognized under both IFRS and U.S. GAAP if it is probable that a liability has been incurred and a reasonable estimate can be made; however, “probable” is defined as “more likely than not” under IFRS and as “likely to occur” under U.S. GAAP. Measurement differs between the two reporting systems. If there is a range of outcomes that are equal, IFRS requires the use of the mid point of the range, and U.S. GAAP requires that the obligation be measured at the low end of the range. Under IFRS, certain provisions are discounted if they are material to the total. Under U.S. GAAP, discounting only takes place in certain circumstances. Discount rates differ under U.S. GAAP and IFRS. U.S. GAAP uses the risk-free rate, and IFRS generally uses the pre-tax rate that reflects time-value and risk.
There are differences in unrecognized contingent liabilities between U.S. GAAP and IFRS. Under IFRS, no disclosures are made if the uncertainty is classified as remote. Under U.S. GAAP, a loan guarantee must be disclosed, even if it is remotely possible that a company will have to make good on the guarantee (KPMG 2007).

14. What Are the Major Differences Between U.S. GAAP and IFRS for Gain Contingencies?
Under U.S. GAAP, gain contingencies are not recognized. Such items are recorded only when the contingencies are removed and the cash is collected (realized). Under IFRS, the gain contingencies and the related contingent asset can be recorded if it is determined that the realization is “virtually certain” (KPMG 2007).

15. Are There Any Differences Between U.S. GAAP and IFRS on Long-Term Construction Contracts?
Yes, under U.S. GAAP, long-term construction contracts are accounted for under either the percentage-of-completion methodology or the completed-contract methodology. The completed-contract method is used when reasonable estimates cannot be made as to costs, profits, or time of completion; when the contract is not clear; collection is doubtful; or when the company may not be able to satisfy the contract. The percentage-of-completion method recognizes profit over the life of the contract, whereas the completed-contract only recognizes profit when the contract is complete. IFRS does not allow use of the completed-contract method.

The percentage-of-completion method differs slightly under the two reporting standards. Under IFRS, revenues and costs are recognized on the basis of the stage of completion of the contract. Under U.S. GAAP, the IFRS methodology may be followed, but it is also permissible to recognize the costs incurred on the project and recognize revenue by using the gross margin earned on the contract during the period (KPMG 2007).

16. Are There Any Differences in the Basic Financial Statements Between U.S. GAAP and IFRS?
Yes, there are some distinctions in the basic financial statements. IFRS requires a balance sheet, income statement, statement of recognized income and expense (or a statement of changes in equity), statement of cash flows, and footnotes. Under U.S. GAAP, the statement of recognized income and expense is referred to as comprehensive income. U.S. GAAP allows the income statement and statement of comprehensive income to be presented as one statement. IFRS does not allow this presentation for the two similar IFRS statements. Under IFRS, comparative information is required for the prior accounting period. Under U.S. GAAP, there is not a comparative information requirement. The SEC, however, requires current- and prior-year balance sheets and a current- and two prior years’ income statements.

The SEC also requires more financial statement disclosure items than IFRS. The statement of cash flows has some minor differences between IFRS and U.S. GAAP. Under IFRS, cash can include bank overdrafts; under U.S. GAAP, these overdrafts are reclassified as liabilities. Sometimes, a single transaction could be classified as operating, investing, or financing. Under IFRS, the components of the transaction are segregated and reported separately in the statement of cash flows. Under U.S. GAAP, the predominant source of the cash flow is used to classify the transaction, unless the transaction is accounted for using the separate components of the transaction (KPMG 2007).

17. What Is the Impact of the Adoption of IFRS on FASB’s Codification Project?
At the moment, this remains unclear. The Codification project is essentially taking current U.S. GAAP, which is generally organized chronologically by issuance of the standard, and organizing the accounting literature into topics. Because the literature has been tagged, users can search the accounting rules by topic. The Codification project includes SEC guidance, as well, and is now in the verification stage. The Codification is scheduled to become U.S. GAAP on July 1, 2009. Future standards will be updated directly to the Codification when issued. If the United States adopts IFRS, the Codification will mostly be unnecessary for public companies, but may still be helpful for U.S. nonpublic companies (“FASB Launches Verification Phase for the FASB Accounting Standards Codification,” FASB News Release, January 15, 2008, www.fasb.org/news/nt011508.shtml).

18. What Actions Must Be Taken to Convert Financial Statements from U.S. GAAP to IFRS?
Europe has already converted from local GAAP to IFRS. It is hard to estimate the time to convert financial statements from U.S. GAAP to IFRS because each company will encounter different sets of issues. Accountants and auditors will need to be trained in IFRS, and much data and information will need to be gathered to make the appropriate adjustments. IFRS represents a significant change to the way U.S. accountants think. Because U.S. GAAP is rules-based, management may spend its time trying to use the loopholes in the rules to its advantage. Under IFRS, guiding principles replace the rules. Disclosures under IFRS will most likely be much longer because IFRS requires a great deal of judgment, which will need to be explained in the financial statements.

19. What Resources Are Available Regarding IFRS?
IFRS resources are growing in number as the implementation of IFRS continues to gain speed. Unlike U.S. accounting stan-

### IFRS Online Resources

- **www.ifrs.com/ The AICPA**
- **www.iasb.org/Home.htm International Accounting Standards Board**
- **www.ey.com/global/content.nsf/International/Assurance_-_**
  - IFRS - Overview
    - Ernst & Young
- **www.kpmgifsarinstitute.com/ KPMG**
- **pwc.blogs.com/ifrs/ PwC’s IFRS blog**
- **www.iasplus.com/index.htm Deloitte & Touche**
- **www.nysscpa.org/ifrs/main.htm New York State Society of CPAs**
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20. What Resources Are Available to Educators?

In addition to the resources already noted, textbooks and academic conferences are widely available. New textbooks are being written that cover IFRS. Some are devoted solely to international standards, such as Applying International Accounting Standards by Keith Alfredson, Ken Leo, Ruth Picker, Paul Pacter, and Jennie Radford (Wiley); International Accounting: A User Perspective, 2nd Edition, by Shahrokh M. Saudagaran (South-Western College Publishing); and International Accounting, 2nd Edition, by Timothy Doupnik and Hector Perera (McGraw-Hill). Some textbooks have incorporated a discussion or comparison of U.S. GAAP to IFRS. Financial Accounting Theory by Schroeder, Clark, and Cathey (Wiley) includes a discussion of IFRS in most chapters.

Big Four firms have committed to assisting colleges and universities with infusing IFRS into their curriculum because they recognize the need to have future staff trained in IFRS. Deloitte has developed the IFRS University Consortium, which incorporates numerous resources, such as cases, presentations, research materials, and other course materials. Deloitte’s IFRS University Consortium is located online at www.deloitte.com/dtt/article/0,1002, cid%253D206187,00.html. PwC has a program called “IFRS Ready.” This program has instructional and assignment materials for both faculty and students, as well as a grant program to assist faculty in implementing IFRS into the classroom. For more information, see www.pwc.com/extweb/aboutus.nsf/docid/70CCD8B601397905852574910075A03D.

There are numerous upcoming conferences that will be offered through the AICPA, the NYSSCPA, and the American Accounting Association (AAA). IFRS is certain to appear on their agendas.

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