OBJECTIVES OF THIS COURSE

❖ To ensure that all attendees have a good understanding of the core principles of US GAAP and can apply them to the preparation of financial statements

❖ To ensure that all attendees understand how to apply GAAP in a number of key areas and can apply key concepts in real life

❖ To understand the differences between GAAP and IFRS in key areas
COURSE OUTLINE

SESSION 1: Intro
   Core principles
   Overarching standards

SESSION 2: Statement of Financial Position
   Property, Plant and Equipment
   Other Assets
   Contingencies and liabilities

SESSION 3: Income statement
   Other comprehensive income
   Specific types of income and cost

SESSION 4: Taxation
   Leases and special asset situations
   Special reporting and disclosures

SESSION 5: Consolidations and equity accounting
   Fair value accounting

SESSION 6: Accounting for financial instruments
   Final wrap-up
INTRODUCTION TO GAAP, UNDERPINNING PRINCIPLES AND HIGH-LEVEL CONSIDERATIONS
SESSION 1: AN INTRODUCTION TO GAAP, ITS UNDERPINNING PRINCIPLES AND HIGH-LEVEL CONSIDERATIONS

❖ Introduction to GAAP and how it works
❖ Core pervasive principles of GAAP
❖ Core financial statements
❖ Accounting policies, errors and estimates
❖ Events after the reporting date
❖ Fair value measurement
❖ Foreign currency translation
❖ Consolidation and business combinations
GAAP – WHAT IS IT?

❖ Generally accepted accounting principles

❖ Accounting Standards Codification (ASC) is ‘the source of authoritative GAAP recognised by the FASB to be applied by non-governmental entities’

❖ "To increase the utility of the Codification for public companies, relevant portions of authoritative content issued by the SEC and selected SEC staff interpretations and administrative guidance have been included for reference in the Codification" - About the Codification (v 4.10) published by the FASB

❖ Rules and interpretative releases of the Securities and Exchange Commission …. are also sources of authoritative GAAP for SEC registrants
THE AIM OF GAAP

❖ The basis for the measurement of economic activity
❖ The time when such measurements are to be made and recorded
❖ The disclosures surrounding this activity
❖ The preparation and presentation of summarised economic information in the form of financial statements
❖ Authoritative guidance (along with guidance issued by SEC). All other guidance is termed ‘non-authoritative’
CATEGORIES OF ACCOUNTING PRINCIPLES

RECOGNITION AND MEASUREMENT

Determining the timing and measurement of items that enter the accounting cycle and impact on financial statements

DISCLOSURE

Dealing with both qualitative and quantitative information. They give additional information helping inform decision-making needs of the reader

Expand on quantitative data, explain assumptions underlying the numbers, provide additional information on accounting policies, uncertainties, contingencies etc.
OTHER SOURCES OF GUIDANCE

If no specific guidance....

- Similar transactions covered by authoritative GAAP
- Other widely used practices recognised and prevalent in the industry
- FASB Concept Statements
- AICPA Issues Papers
### HISTORY OF GAAP

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
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</thead>
<tbody>
<tr>
<td>1929</td>
<td>Committee on Accounting Procedure (AICPA) *</td>
</tr>
<tr>
<td>1959</td>
<td>Accounting Principles Board (AICPA)</td>
</tr>
<tr>
<td>1973</td>
<td>Financial Accounting Standards Board (FASB) – note that AICPA now plays a greatly reduced role</td>
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</table>

* The Public Company Accounting Oversight Board (PCAOB) is a private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002 to oversee auditors of public companies in order to protect investors and the public interest by promoting the preparation of informative, fair, and independent audit reports.

* Note references to PCAOB in Apple accounts.

* American Institute of Certified Public Accountants
THE CONVERGENCE DEBATE

- IASB and FASB have announced that current attempts at convergence will come to an end when the partially-converged leasing standards are issued.

- Probably not practical to completely converge standards in the foreseeable future.

- Difference sometimes seen as that between ‘principles’ (IFRS) and ‘rules’ (SEC).

- Also seen in the use of different practical approaches to auditing. Could potentially impact on the nature of audited financial statements of listed companies released to the outside world. The relevance of this is that if divergence is evident in both standards of accounting AND auditing then it is likely to be more difficult to reverse.

- Limited appetite for IFRS in the US: may be some political resistance to the convergence in the US too.
THE STANDARD SETTING PROCESS

❖ FASB consults with constituents on issues under review

❖ Issues Accounting Standards Update (ASU) on revisions to ASC: the ASU includes a summary of the key provisions of the project that has led to the change, the specific changes to the Codification, the specific changes made to it and the Basis for Conclusions

❖ Becomes effective as US GAAP once the effective date is reached (until then described as ‘pending content’)

❖ Also Emerging Issues Task Force (established 1984) to deal with current or emerging problems and issues of implementation – often used to deal with narrow issues of immediate interest and importance
### ASC - ELEMENTS

<table>
<thead>
<tr>
<th>100</th>
<th>General principles</th>
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<tr>
<td>200</td>
<td>Presentation</td>
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<tr>
<td>300</td>
<td>Assets</td>
</tr>
<tr>
<td>400</td>
<td>Liabilities</td>
</tr>
<tr>
<td>500</td>
<td>Equity</td>
</tr>
<tr>
<td>600</td>
<td>Revenue</td>
</tr>
<tr>
<td>700</td>
<td>Expenses</td>
</tr>
<tr>
<td>800</td>
<td>Broad transactions (e.g. business combinations, derivatives, foreign currency)</td>
</tr>
<tr>
<td>900</td>
<td>Industry (e.g. entertainment, real estate, software)</td>
</tr>
</tbody>
</table>
THE CONCEPTUAL FRAMEWORK (CF)

- See ASC 105 *Generally Accepted Accounting Principles*
- 8 pronouncements (only 5 still extant) – each is called a Statement of Financial Accounting Concept (CON)
- Aim of the CF is to prescribe nature, function and limits of financial reporting and to give guidance that leads to consistent standards
- Helps guide FASB in setting standards
- Also helps the business community in understanding and applying standards and helping in their development
Chapter 1: The Objective of General Purpose Financial Statements: key objective – to provide information that is useful in making decisions.

Chapter 3: Qualitative Characteristics of Useful Financial Information – relevant, faithful presentation, neutral, comparable, verifiable, timely, understandable, cost constraint (a replacement of FASB Concepts Statements No. 1 and No. 2).
CON 5: RECOGNITION AND MEASUREMENT IN FINANCIAL STATEMENTS

- Financial statements simplify, condense, aggregate transactions
- To be included in financial statements (subject to both cost-benefit and materiality constraints) the following criteria must be met:
  1. Definition – must meet definition of an element in the statements
  2. Measurability – relevant attribute that can be measured with sufficient reliability
  3. Relevance
  4. Reliability
FULL SET OF FINANCIAL STATEMENTS INCLUDE:

- Financial position
- Net income
- Comprehensive income
- Cash flows
- Investment and distributions: owners
CON 6: ELEMENTS OF FINANCIAL STATEMENTS

1. Assets: probable future economic benefits
2. Liabilities: probable future sacrifices of economic benefits
3. Equity (net assets)
4. Revenues
5. Expenses
6. Gains
7. Losses
8. Comprehensive income
9. Increases by owners
10. Distributions to owners
CON 7: USING CASH FLOW INFORMATION AND PRESENT VALUE IN ACCOUNTING MEASUREMENTS

❖ Important in that it sets out principles for measuring future cash flows using techniques like fair value and present value

❖ At initial recognition, cost is usually deemed to be equivalent to fair value

❖ Fair value should be similar to market value or attempt to establish a suitable alternative if one is not present

❖ Present value requires:
  1. An estimate of future cash flows
  2. Expectations regarding variations in timings or amounts
  3. The value of money: risk rate of interest
  4. Risk premium
  5. Other factors including illiquidity and market imperfections
DIFFERENCES BETWEEN IFRS AND GAAP – CONCEPTUAL FRAMEWORK

❖ Both establish guidance that is used in the development of guidance
❖ Unlike IFRS, the Conceptual Framework is non-authoritative guidance
❖ In both, transactions with shareholders are measured in equity
ASC 205 – PRESENTATION OF FINANCIAL STATEMENTS

Main elements:

ASC 205-10: emphasises the value of comparative financial statements

ASC 205-20: Discontinued operations and how to deal with them e.g. when an element of an entity is disposed of or held for resale

ASC 205-30: Liquidation basis of accounting: how to account for an entity when liquidation is envisaged including disclosures

ASC 205-40: Going concern
ASC 205 – DIFFERENCES BETWEEN GAAP AND IPSAS

- Financial statements are prepared on a going concern basis unless liquidation is imminent. Under IFRS the assumption is that the reporting entity must be a going concern if it prepares financial statements or else it should disclose the facts to the contrary. Moreover, a good trading record to date and reliable access to finance would indicate that the entity is a going concern without the need for more detailed tests (per IAS 1).

- No specific guidance on testing for going concern – though US auditing guidelines do require auditor to test for substantial doubts regarding going concern, like IFRS.

- Testing for going concern as far as it goes is not required to go beyond one year: this is only looking at disclosures and does not impact on presentation unless liquidation is imminent.

- Unlike IFRS, GAAP does not require comparative information to be included (though SEC requirements do).
ASC 210 – BALANCE SHEET

- As per IFRS, includes assets, liabilities and equity.
- Also as per IFRS, offsetting of assets and liabilities is discouraged.
- Note that current and non-current assets and liabilities are defined: this contrasts with IFRS when only current are defined – anything that does not fit within the definition of current is non-current (more than one year or the current operating cycle if this is more than one year).
Also known as ‘Statement of Income and Comprehensive Income’, ‘Statement of Operations’, ‘Statement of Earnings’

January 2015: the concept of extraordinary items removed from GAAP: but does require disclosure of ‘unusual’ or ‘infrequent’ items

The income statement remains the key measure of financial performance in the period

Presentation begins with income from continuing operations
ASC 230 – STATEMENT OF CASH FLOWS

- Required part of a set of financial statements except for certain types of pension plans.
- Similar set up as for IFRS: operating, investing and financing activities, direct and indirect method – the FASB prefers the direct method, preparers the indirect method.
- Only expenditures that result in a recognized asset eligible for classification as investing activities whereas in US GAAP the expenditure does not have to result in an asset.
- Cash and cash equivalents (the latter must be disclosed).
- In GAAP, overdrafts not included in cash/cash equivalents; changes in the balances of bank overdrafts are classified as financing cash flows, whereas in IFRS they are part of cash and cash equivalents.
- Interest received and paid plus dividends received must be under operating activities with GAAP, dividends paid must be under financing. IFRS gives a wider range of choice in these areas.
ASC 235 – NOTES TO FINANCIAL STATEMENTS

- Basis of consolidation
- Depreciation methods
- Amortisation of intangibles
- Inventory pricing
- Accounting for recognition of profit on long-term contracts
- Recognition of revenue from franchising and leasing operations
OTHER EXAMPLES OF NOTES IN APPLE FINANCIAL STATEMENTS

- Financial Instruments and derivatives
- Fair value measurements
- Foreign currency translation
- Share repurchases
- Benefit plans
- Contingencies and commitments
- Segmented information
DISCLOSURES – CURRENT ISSUES

❖ Disclosures: too few or too many?
❖ Current FASB project to review disclosures
❖ SEC reviewing specific regulations
❖ Overall objectives:
  ❖ Reduce repetition
  ❖ Focus the disclosures more
  ❖ Eliminate outdated information
ACCOUNTING POLICIES – KEY POINTS

❖ Management should adopt policies that are most appropriate to the entity’s economic circumstances

❖ Disclosures should lay out all significant accounting policies followed by the entity and the methods of applying those policies when they materially affect the financial statements

❖ With IFRS the selection and presentation of accounting policies in the disclosures is an important part of "fair presentation". With US GAAP, does that concept exist or is it more about being seen to comply with the rules?
DISCLOSURE TECHNIQUES

1. Parenthetical explanations
2. Notes to the financial statements
3. Cross-references
4. Valuation allowances (e.g. offsetting depreciation against asset values)
5. Supporting schedules
ASC 275 – RISKS AND UNCERTAINTIES

❖ This Standard (no direct equivalent in IFRS - although many of the areas discussed are covered elsewhere in the IFRS framework) looks at disclosures of risks and uncertainties.

❖ Its aim is to provide guidance to the preparers of financial statements about how to screen risks and uncertainties, thinking about those which are most useful to users of the financial statements.

❖ It does not cover risks and uncertainties around management or key personnel, proposed changes in accounting principles, deficiencies in the internal control structure or acts of God, war, or sudden catastrophes (ASC 275-10).
WHAT MUST BE DISCLOSED

❖ Primary focus is on risks and uncertainties affecting the near term [a period not more than one year from the date of the financial statements]

❖ Key areas to be covered in terms of disclosures of risks and uncertainties:
  1. The nature of the entity’s operations and activities
  2. Use of estimates in the preparation of financial statements
  3. Vulnerability due to certain concentrations
ASC 250 – ACCOUNTING CHANGES AND ERROR CORRECTIONS

❖ Provides guidance on accounting for/reporting on accounting changes and error corrections

❖ Requires, unless impractical, retrospective application of a change in accounting principle

❖ Gives guidance on what is meant by ‘impractical’ and how an impracticability should be reported

❖ The accounting and reporting is similar between GAAP and IFRS but there are a few detailed differences
As in IFRS, GAAP allows a range of policies to be used for accounting for different areas, e.g. inventory, depreciation, the identification of segments in segment reporting. Those chosen should best reflect economic substance over form.

Changes can take place because of changing economic situations, new pronouncements by standard setters etc.

The primary consideration for management must be to think about the impact on comparability of financial statements from different years – but this should not stop a change if it is warranted: it is all about management justification.
WHY CHANGE?

- A change in accounting policy is needed if it improves the quality of the information to decision makers
- A new principle has been issued
- Further experience makes a refinement of existing policies desirable
- There has been an error in previously issued financial statements
- The key consideration is for management to explain to users why changes have been made and to explain their impact to the users in a way that separates the effect from the impact of results from ongoing activities.
- Note that if the auditors do not believe management have justified the change, then a qualified or adverse opinion should be given (AU-C 708.07)
RETROSPECTIVE APPLICATION - PROCESS

1. Adjust carrying amounts for opening assets and liabilities for cumulative effect of changes
2. Offset the adjustment for Step 1 in opening balance for retained earnings – or other components of equity or net assets as applicable
3. Adjust the financial statements for the effects of applying the new accounting principle to the specific period
4. Explain clearly in disclosures the reasons for and impact of the changes
An IT company has previously written off expenses on development of new products as a cost in the year in which they are incurred. However that practice is now felt to result in a situation where the company does not match its expenditure with its revenues. The practice will now change to one where such expenditure is capitalised and written off against revenues.

Costs of development of affected items were:

2014  25m USD (none in previous years)
2015  40m USD

Tax rates were 15% of profit. Assuming that no revenues have yet been earned from these development costs, what would be the impact of these changes on the financial statements for 2015 assuming that prior-year comparative information is included?
All prior year figures should be adjusted in less it is impracticable to do so

On the following conditions (at least one):

1. Management has made a reasonable effort to do so
2. To do so management would have to make estimates that cannot be substantiated
3. Management would be forced to rely on estimates when there is no reliable objective information on which to do so.

Must make changes from the earliest period in which it is practicable to apply them.
CHANGES IN ACCOUNTING ESTIMATE

❖ Frequently used in e.g. considering asset service lives, salvage values, lease residuals, collectability of accounts receivable, warranty costs, pension costs

❖ These costs cannot be estimated with certainty

❖ New information is regarded as updating the estimate – this does not mean that the original information was wrong

❖ Such changes must be recognised currently and prospectively
MISSTATEMENTS FROM PREVIOUS YEARS

❖ Management may assess the impact on previous years as not being material. Two methods of assessing this: the rollover method and the iron curtain method

❖ Rollover method: quantifies a misstatement as its originating or reversing effect on the current period’s statement of income regardless of the effect on statement of financial position

❖ Iron curtain method: misstatement quantified on basis of impact on statement of financial position at end of current period

❖ SEC guidance is that both must be considered (SAB – Staff Accounting Bulletin – 108).
DIFFERENCES BETWEEN GAAP AND IFRS

❖ IFRS requires accounting policies within a group to be consistent: GAAP makes no such statement.

❖ There is no impracticability exemption for errors in GAAP: opening balances and comparatives must be adjusted.

❖ Under IFRS there is greater prominence of critical accounting policies than GAAP. Management required to disclose the judgements they have made regarding the adoption.
When foreign currency transactions and balances are involved, there must be some policy guidance on how to translate them into a common currency.

The main aim is to provide some guidance on how to deal with information relative to the economic effects of rate changes on the entity’s cash flows and equity AND

Information on consolidated statements vis-à-vis each consolidated individual foreign entity.

A foreign currency transaction is a transaction that is denominated in a currency other than the functional currency of the entity.
FOREX – ISSUES TO ADDRESS FOR FOREIGN ENTITIES

❖ Select the functional currency: issues at the entity level
❖ Is the foreign entity’s sales market the same as the parent company?
❖ Are the foreign entity’s expenses primarily in the same company as the parent?
❖ Is the foreign company reliant on the parent for financing?
❖ Is there a high volume of inter-company transactions between the foreign entity and the parent?
❖ If the answers to the above are predominantly ‘yes’ then there is an indication that the foreign entity’s functional currency is the same as that of the parent
CURRENT RATE METHOD

❖ Mandated when the functional currency is the foreign currency (e.g. the currency in use for an Irish company that is a US subsidiary is euro and this is used by the subsidiary for its reporting but the functional currency of the parent is USD)

❖ All assets and liabilities are translated at current rates whilst equity accounts are at the appropriate historical rate. Revenues and expenses are translated at rates that applied when the transaction took place – weighted average can be used if there is no significant variation in exchange rates over the course of the reporting period

❖ Under US GAAP Equity is required to be translated at historical rates. Under IFRS Management can use either historical rate or closing rate for equity items. The chosen policy should be applied consistently. If the closing rate is used, the resulting exchange differences are recognized in equity and thus the policy choice has no impact on the amount of total equity
**RE-MEASUREMENT METHOD**

- Used when accounting records are not kept in the functional currency (e.g. when the records are kept in USD but the subsidiary is an Irish subsidiary)

- Monetary assets and liabilities (cash + other assets and liabilities that will be settled in cash) are translated at current rate

- Non-monetary assets and liabilities should be translated at the appropriate historical rates – the exchange rate that was relevant at the date of the transaction from which the asset/liability originated

- In the latter case, the amounts relating to the assets and liabilities in the income statement (e.g. depreciation/amortisation on an asset, costs of sales inventory) should be translated at the same rate that applies to the equivalent entry on the statement of...
ACCUMULATED OTHER COMPREHENSIVE INCOME (AOCI)

❖ **Accumulated other comprehensive income** is a general ledger account that is classified within the equity section of the balance sheet.

❖ It is used to accumulate unrealized gains and unrealized losses on those line items in the income statement that are classified within the other comprehensive income category.
### SUMMARY OF TREATMENTS – CURRENT RATE

<table>
<thead>
<tr>
<th>Functional currency</th>
<th>Determinants</th>
<th>Translation method</th>
<th>Reporting and presentation</th>
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</thead>
<tbody>
<tr>
<td>Local currency of foreign entity</td>
<td>Operations not integrated with parent</td>
<td>Current rate (all assets/liabilities translated at current rate; equity accounts are at the appropriate historical rates; all revenue/expenses at weighted-average)</td>
<td>All accumulated adjustments in equity of parent as part of AOCI</td>
</tr>
<tr>
<td></td>
<td>Buying/selling mainly in local currency</td>
<td></td>
<td>Changes in accumulated translation reported as part of AOCI</td>
</tr>
<tr>
<td></td>
<td>Cash flows not immediately remitted to parent</td>
<td></td>
<td>Effect of exchange rate changes included in reconciliation of opening and closing balances in statement of cash flows</td>
</tr>
<tr>
<td></td>
<td>Financing in local currency</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Determinants**
- Operations not integrated with parent
- Buying/selling mainly in local currency
- Cash flows not immediately remitted to parent
- Financing in local currency

**Translation method**
- Current rate (all assets/liabilities translated at current rate; equity accounts are at the appropriate historical rates; all revenue/expenses at weighted-average)

**Reporting and presentation**
- All accumulated adjustments in equity of parent as part of AOCI
- Changes in accumulated translation reported as part of AOCI
- Effect of exchange rate changes included in reconciliation of opening and closing balances in statement of cash flows
<table>
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<th>Reporting and presentation</th>
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<tr>
<td>US Dollar</td>
<td>Operations integrated with parent</td>
<td>Re-measurement (monetary assets/liabilities translated at current rate; non-monetary using historical rates, revenue/expenses at weighted-average if related to monetary items, non-monetary at relevant historical rates); equity is translated at historical rates</td>
<td>Re-measurement gains/losses form part of the entity’s consolidated statements</td>
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<tr>
<td></td>
<td>Buying/selling mainly in USD</td>
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<tr>
<td></td>
<td>Cash flows immediately available for remittance to parent</td>
<td></td>
<td>Re-measurement gains/losses reconciling item between net income and cash flows from operations in statement of cash flows</td>
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<tr>
<td></td>
<td>Financing in USD</td>
<td></td>
<td>Re-measurement gains/losses included in reconciliation of opening and closing balances in statement of cash flows</td>
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