The need to be “financially bilingual” US GAAP vs IFRS

XV. DEBTS

This presentation contains information, in addition to the material prepared and provided by the professor, from:

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SUMMARY

- Classification when Refinancing
- Provision (IFRS) vs Contingencies (US GAAP)
- Others

Liability: Definition

1. obligation always arises from past events
2. probably requires future sacrifice of resources
3. present obligation

CLASSIFICATION OF LIABILITIES TO BE REFINANCED

US GAAP FASB: 410, 420 , 450

1. Liabilities payable within the coming year are classified as long-term liabilities if refinancing is completed before the date of issuance of the financial statements.

2. The firm must intend to refinance on a long-term basis.
3. The firm must actually have demonstrated the ability to refinance on a long-term basis.

IAS 37

1. To be classified as long-term, liabilities must be refinanced before the balance sheet date.

CLASSIFICATION OF LIABILITIES TO BE REFINANCED

ABC Co. had $50,000,000 of XYZ Bonds Payable due in 2019. Prior to 12/31/2018, ABC Co. refinanced $4,000,000 of the XYZ Bonds with other bonds that mature in 2030. On January 6, 2019, ABC Co. refinanced another $3,000,000 of the XYZ Bonds with others that mature in 2025. ABC issued its financial statements on February 1, 2019. On February 14, 2019, ABC refinanced another $10,000,000 of the XYZ bonds with others that mature in 2028.

In its 2018 financial statements, ABC should show noncurrent bonds payable of:

Note: adapted from Spiclenad (McGraw Hill 9ed)

CLASSIFICATION OF LIABILITIES TO BE REFINANCED

Hints: Separate the information per date

Proposition: ABC Co. had $50,000,000 of XYZ Bonds Payable due in 2019.

Question: In its 2018 financial statements, ABC should show noncurrent bonds payable of:

CLASSIFICATION OF LIABILITIES TO BE REFINANCED

2018

Prior to 12/31/2018, ABC Co. refinanced $4,000,000 of the XYZ Bonds with other bonds that mature in 2030.

Closing Books Date: 12/31/2018

2019

On January 6, 2019, ABC Co. refinanced another $3,000,000 of the XYZ Bonds with others that mature in 2025.

Issue date

ABC issued its financial statements on February 1, 2019.

On February 14, 2019, ABC refinanced another $10,000,000 of the XYZ bonds with others that mature in 2028.

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CLASSIFICATION OF LIABILITIES TO BE REFINANCED

US GAAP FASB: 410, 420 , 450

1. refinancing is completed before the date of issuance of the financial statements.

Answer

$4,000,000 refinanced prior to year-end (12/31/2018)

+

$3,000,000 refinanced prior to issuance of B/S (02/01/2019)

=

$7,000,000 classified as Noncurrent

IAS 37

1. refinanced before the balance sheet date.

Answer

$4,000,000 refinanced before (12/31/2018) the balance sheet date classified as Noncurrent.

CLASSIFICATION OF LIABILITIES TO BE REFINANCED

US GAAP FASB: 410, 420 , 450	IAS 37
FINACIAL STATEMENT IMPACT: 12/31/2018	**FINACIAL STATEMENT IMPACT: 12/31/2018**
$7,000,000 classified as Noncurrent	**$4,000,000** classified as Noncurrent

CONSTRUCTIVE OBLIGATION

US GAAP FASB: 410, 420 , 450	IAS 37
No concept of constructive obligation.	Arise from past actions or current statements indicating that a company will accept certain responsibilities.

RESTRUCTURING OBLIGATION

A program planned and controlled by management that changes either:

- Scope of business
- Manner in which business is conducted

US GAAP FASB: 410, 420 , 450

Does not allow recognition until liability has been incurred.

IAS 37

A restructuring provision is recognized when:

1. Formal restructuring plan exists.
2. There is a valid expectation of the restructuring.

Note:

Similar to Research and Development concept:

“Business Plan”

Contingency

is an existing, uncertain situation involving potential loss/gain depending on a future event

US GAAP FASB: 410, 420 , 450

Likelihood

1. Probable: *>75%
2. Reasonably possible,
3. Remote

Amount

Range: select lowest

***cited in accounting books**

IAS 37

Likelihood

1. Probable: >50%

Amount

Range: average

The need to be "financially bilingual" US GAAP vs IFRS

PROVISIONS

US GAAP FASB: 410, 420 , 450

Classification:

Contingent Liabilities

All accrued and possible obligations.

***Accrued If:**

1. Probable: (> 75%)
2. Reasonably estimated

(minimum of the range)

Diclosure

Present Value:

It's not common

Onerous contracts

No disclosure or loss recognition

unavoidable costs of meeting the obligations
>
the economic benefits expected to be received under it.

IAS 37

Classification:

Provisions

All accrued liabilities.

Contingent Liabilities

Possible obligations.

***Accrued If:**

1. Probable: more likely than not(> 50%)
2. Reasonably estimated

(average of the range)

Diclosure

Present Value:

If material

Onerous contracts

Recognizes provisions and contingencies

Remember

Warranties are other type of Contingency

is an existing, uncertain situation involving potential expense depending on a future event

PROVISIONS

In June Year 1, a costumer at ABC Corp sued the corporation. The company’s attorneys believe that it is 55% likely that ABC will lose this case. Management concludes that the 55% likelihood of incurring the loss is less than probable. The attorneys estimate that the loss will range between $200,000 and $500,000. There is no best estimate in this range of possible losses.

PROVISIONS

Is it a temporary or permanent difference, between IFRS and US GAAP?

Is it a partial o complete difference, between IFRS and US GAAP?

How this affect the Financial Statement under IFRS and US GAAP?

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How should ABC report this liability in its Financial Statements (Year 1) using IFRS?

Dr. Litigation Loss….. (200,000+500,000)/2=	350,000	
Cr. Provision Liability……		350,000

Pluss: Disclosure

What effect would this transaction have in the Financial Statements if the company uses US GAAP?

No Journal Entry

May be disclosure

PROVISIONS

In June Year 1, a costumer at ABC Corp sued the corporation. The company’s attorneys believe that it is 80% likely that ABC will lose this case. Management concludes that the 80% likelihood of incurring the loss is less than probable. The attorneys estimate that the loss will range between $200,000 and $500,000. There is no best estimate in this range of possible losses.

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Dr. Litigation Loss….. (200,000 to 500,000)	200,000	
Cr. Contingent Liability……		200,000

Pluss: Disclosure

GAIN CONTINGENCIES

US GAAP FASB: 360, 470, 605 , 952

ACCRUED

Never

DISCLOSURE

1. When gain realization is “probable”
2. Uses a higher threshold for “probable”

IAS 18

ACCRUED

If future realization is “virtually certain” to occur.

DISCLOSURE

1. When gain realization is “probable”
2. Uses a lower threshold for “probable”

ASSESSMENT ACTIVITY

10. PROVISION LIABILITY

TOPICS FOR FUTURE ACCOUNTING PROFESSIONALS

CONVERTIBLE BONDS

US GAAP FASB: 450, 470, 820 , 825	**IAS 32**
U.S. GAAP treats convertible debt the same as nonconvertible debt.	Convertible debt is divided into: Liability and Equity elements.

CONVERTIBLE DEBTS

US GAAP FASB: 450, 470, 820 , 825

Classification

- Specifically **identifies certain** instruments with characteristics of both debt and equity that must be classified as liabilities.

Convertible Bonds

- Treats convertible debt the same as nonconvertible debt.

Amortization Method: Premium & Discount

- Straight Line & Effective Interest

IAS 32

Classification

- Classification of certain instruments with characteristics of both debt and equity is largely based on the contractual obligation to deliver cash, assets or an entity's own shares.

Convertible Bonds

- divided into liability and equity elements.

Amortization Method: Premium & Discount

- Effective Interest
- Do not use premium or discount accounts, the bond is presented at its net amount.

LEASES

US GAAP FASB ASC: 840	IAS 16
Two Model Approach	**One Model Approach**
Lessee Classification : (Capital and Operating)	**Lessee Classification** : (Finance)
Lessor Classification : (Sales type and Operating)	**Lessor Classification** : (Finance and Operating)

SHORT-TERM LEASES: SHORTCUT METHOD

US GAAP	IFRS
Defines a short-term lease as a lease that has a lease term of 12 months or less and does not include a purchase option that the lessee is reasonably certain to exercise.	IFRS precludes a lease from being considered short term if the lease includes a purchase option regardless of whether the lessee is reasonably certain to exercise it.
Does not allow the shortcut method for “small ticket leases” ($5,000 or less).	IFRS allows “small ticket leases” ($5,000 or less) also to apply this shortcut method.

LEASES

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Two Model Approach **Lessee Classification** : (Capital and Operating) **Lessor Classification** : (Sales type and Operating)	**One Model Approach** **Lessee Classification** : (Finance) **Lessor Classification** : (Finance and Operating)

RATE

US GAAP	IFRS
Requires use of the incremental rate unless the implicit rate is known by the lessee and the implicit rate is lower than the incremental rate.	Requires that lessees use the implicit rate to record a lease unless it is impractical to determine the lessor's implicit rat

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ACCOUNTING FOR INCOME TAXES

The need to be "financially bilingual" US GAAP vs IFRS

Deferred tax assets

Items that may be used for tax relief purposes in the future.
Usually, it means that your business has overpaid tax or has paid tax in advance, so it can expect to recoup that money later.

Deferred tax liability

Taxes owed but not due until a future date.
The liability is deferred due to a difference in timing between when the tax was accrued and when it is due to be paid.

tax vs accrual basis

The need to be “financially bilingual” US GAAP vs IFRS

DEFERRED TAX ASSET

US GAAP FASB ASC: 740	IAS 12
An impairment approach. In this approach, the deferred tax asset is recognized in full.	An affirmative judgment approach is used, by which a deferred tax asset is recognized up to the amount that is probable to be realized.
Enacted tax rate must be used.	Uses the enacted tax rate or substantially enacted tax rate. (“Substantially enacted” means virtually certain.)
Charges or credits the tax effects to income.	The tax effects related to certain items are reported in equity.
Deferred tax assets and liabilities ➢ Current ➢ Non-current ➢ Based on underlying asset or liability	Deferred tax assets and liabilities ➢ Only classified as noncurrent

The need to be "financially bilingual" US GAAP vs IFRS

DEFERRED TAX ASSET

US GAAP FASB ASC: 740	IAS 12
Requires companies to assess the likelihood of uncertain tax positions being sustainable upon audit.	All potential liabilities must be recognized.
Potential liabilities must be accrued and disclosed. (materiality and probability must apply)	Uses an expected-value approach to measure the tax liability.

PENSIONS AND OTHER POSTRETIREMENT BENEFITS

The need to be “financially bilingual” US GAAP vs IFRS

ACCOUNTING FOR LOSSES AND GAINS IN DEFINED BENEFIT PLANS

US GAAP FASB ASC: 715	IAS 19
Different rates for the interest cost on the defined benefit obligation and the interest revenue on the plan assets.	Same rate for both the interest cost on the defined benefit obligation and the interest revenue on the plan assets.
OCI items in the statement of comprehensive income are gradually amortized or move to expense, when the accumulated net gain or net loss exceeds the 10% threshold.	OCI items in the statement of comprehensive income are not subsequently amortized out of OCI and into expense, instead, those amounts remain in the balance sheet as accumulated other comprehensive income.

The need to be "financially bilingual" US GAAP vs IFRS

PRIOR SERVICE COST

US GAAP FASB ASC: 715

OCI items in the statement of comprehensive income are gradually amortized or move to expense, when the accumulated net gain or net loss exceeds the 10% threshold.

Prior service cost is reported as a separate component of other comprehensive income.

IAS 19

OCI items in the statement of comprehensive income are not subsequently amortized out of OCI and into expense, instead, those amounts remain in the balance sheet as accumulated other comprehensive income.

Prior service cost is combined with the current service cost and reported within the income statement.

REPORTING PENSION EXPENSE

US GAAP FASB ASC: 715

1. The service cost component as part of the total *compensation costs*, separate from the other components of pension expense.
2. Net amount of the remaining components of pension expense on a separate line below income from operations.

IAS 19

1. The service cost component, including past service cost.
2. The net interest cost/income component in the income statement.
3. Remeasurement gains and losses as other comprehensive income.

ASSESSMENT ACTIVITY FOR CLASSROOM

The term "provision" as it is used in IAS 37, is most closely related to what term in U.S. GAAP?

A. Contingent liability, where the outflow of resources is "remote."

B. Contingent liability, where the outflow of resources is "probable."

C. Current liability, where the outflow is difficult to measure.

D. Reserve for bad debt, where the amount recoverable is "uncertain."

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Under IAS 37, inflows of resources that are "virtually certain" to be received should be:

A. disclosed as contingent assets in the notes to the financial statements.

B. recognized as assets.

C. undisclosed until management is absolutely certain that resources will be received.

D. reported only in the cash flow statement.

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Which of the following is a difference between IAS 37 and U.S. GAAP with respect to restructuring provisions?

A. U.S. GAAP does not allow recognition of a restructuring provision until a liability has been incurred.

B. There is no difference between IAS 37 and U.S. GAAP with respect to restructuring provisions.

C. IAS 37 does not allow recognition of a restructuring provision until a liability has been incurred.

D. A restructuring provision and related loss is more likely to occur later under IAS 37 than under US GAAP.

TRUE OR FALSE

Contingent gains are generally not recognized in the IFRS Financial Statements due to conservatism.

TRUE OR FALSE

Contingent gains are generally not recognized in the IFRS Financial Statements due to conservatism.

Answer: False

A liability for a contingent loss will be accrued and reported on the IFRS Balance Sheet if the occurrence of the obligation is at least reasonably possible.

A liability for a contingent loss will be accrued and reported on the IFRS Balance Sheet if the occurrence of the obligation is at least reasonably possible.

Answer: FALSE

More contingencies are reported on the balance sheet under U.S. GAAP than under IFRS because of different definitions of "probable."

More contingencies are reported on the balance sheet under U.S. GAAP than under IFRS because of different definitions of "probable."

Answer: FALSE

Provisions for contingent losses are accrued because the likelihood of an unfavorable outcome is ________.

A) virtually certain

B) more likely than not

C) reasonably possible

D) more than remote

Provisions for contingent losses are accrued because the likelihood of an unfavorable outcome is ________.

A) virtually certain

B) more likely than not

C) reasonably possible

D) more than remote

Answer: B

How is accounting for loss contingencies different under IFRS as compared to U.S. GAAP?

How is accounting for loss contingencies different under IFRS as compared to U.S. GAAP?
Answer: IFRS is similar to U.S. GAAP, except for the following three differences:

- Definition of probable. Where U.S. GAAP defines probable as "likely," IFRS defines probable as "more likely than not," which is greater than 50% probable. Thus, some contingencies that would not be reported on the balance sheet under U.S. GAAP will be reported under IFRS.

- Estimate in a range. When a company can estimate a range for the loss, but cannot identify a single most-likely outcome within that range, IFRS requires that it accrue the midpoint of the range rather than the minimum as under U.S. GAAP.

- Discounting. IFRS reporters take into account the time value of money when evaluating contingent liabilities and discount the liability, when material.

note
Recall that U.S. GAAP reporters can discount contingent liabilities to their present value when the amount of the liability and the timing of the payments are fixed or reliably determinable.