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International Financial Reporting Standards:

A Closer Look

The Ohio State University

Session 1

April 1,2011

Audit.Tax.Consulting.Financial Advisory.

Topical areas

Session	Topic
1	Introduction, first time adoption and financial statement presentation
2	Revenues, inventory and taxes
3	Business combinations, discontinued operations and foreign currency
4	Intangibles and leases
5	Property and asset impairment
6	Provisions, pensions and share-based payments
7	Financial instruments
8	Consolidation, joint ventures and associates
9	Convergence and standard-setting activities
10	Final case study

IFRS Background

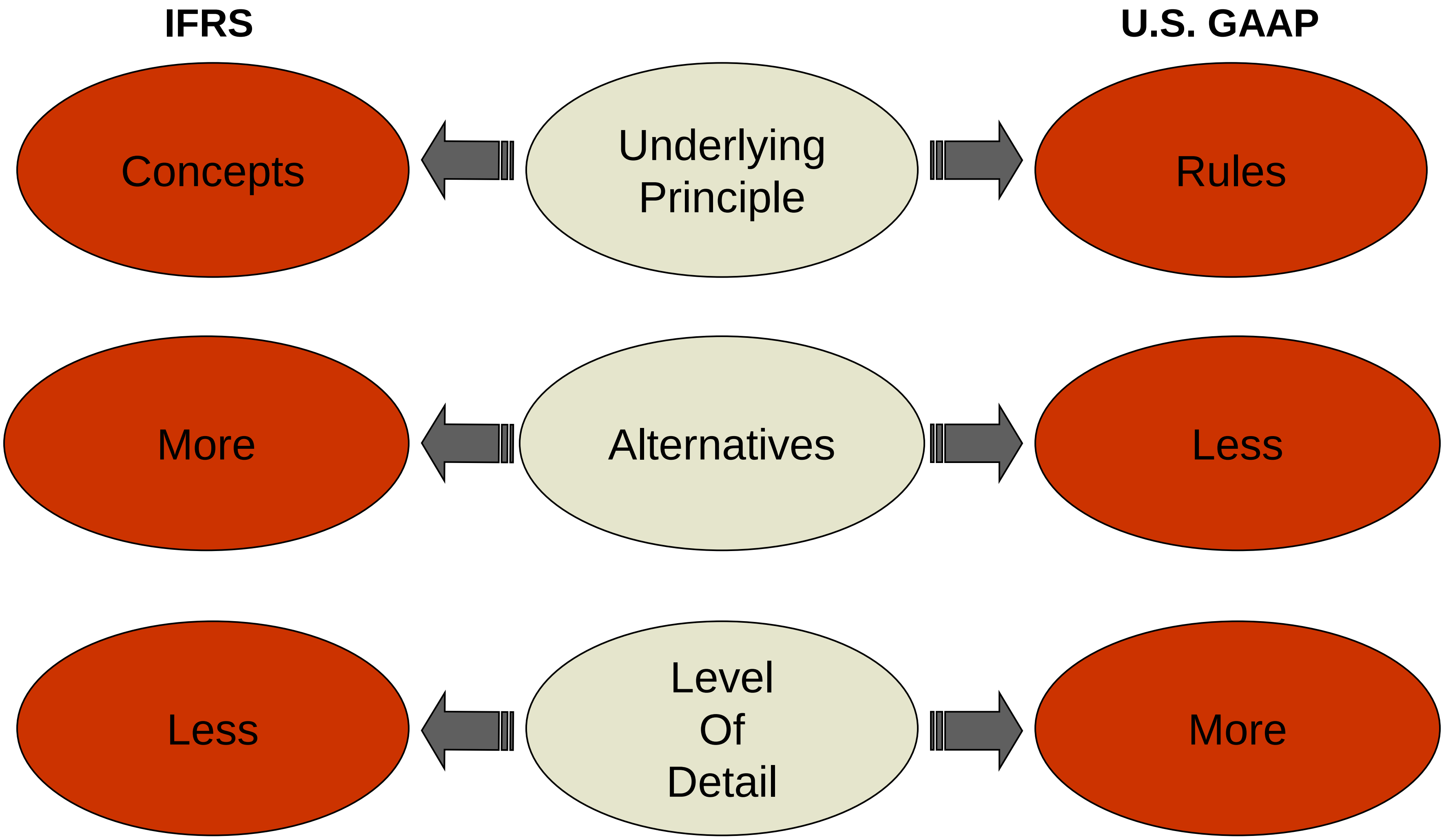
What is IFRS?

- IFRS is a set of accounting standards comprising:
  - International Financial Reporting Standards (IFRS)
    - Example IFRS 9, Financial Instruments
  - International Accounting Standards (IAS)
    - Example IAS 7, Statement of Cash Flows
  - IFRIC Interpretations (IFRIC)
    - Example IFRIC 12, Service Concession Arrangements
  - SIC Interpretations (SIC)
    - Example SIC 15, Operating Leases - Incentives
- Generally more focused on objectives and principles and less reliant on detailed rules and interpretations than U.S. GAAP

Drivers of interest in IFRS

Company demographics	Proactive leadership	Cross-border activity	Current reporting
▪ Significant portion of operations outside the U.S. ▪ Capital market listings outside the U.S. ▪ Operates in industries with extensive international competitors	▪ Planning for the “inevitable” ▪ Building efficiencies in global reporting processes, including statutory reporting ▪ Embedding IFRS into larger finance transformation strategy ▪ Timely and thoughtful implementation	▪ Active in cross-border M&A transactions ▪ Investments in joint ventures	▪ Subsidiaries may already file IFRS financials ▪ More subsidiaries will be subject to IFRS reporting ▪ Lack of central visibility and control over statutory reporting ▪ IFRS financials at a country level may be required for a proposal

Why differences exist?



Where we are today

- Ongoing convergence efforts between FASB and the IASB — Recent examples of joint projects include issuance of exposure draft on Revenue recognition and leases
- More than 140 countries have adopted IFRS
- Japan might adopt its own version of IFRS
- U.S. still undecided on whether, when or how to incorporate IFRS – Focus on convergence and endorsement

SEC Final Report: Summary of Findings

- Lack of guidance within IFRSs (insurance, extractive, rate-regulated industries)
- A need for improvement in the IASB's interpretive process
- The IASB to rely more on national standard setters
- Cooperation with regulators in various jurisdictions to address diversity in practice
- Mechanism needed to protect U.S. Capital markets (e.g. endorsement mechanism)
- Concerns about funding sources
- Staff to further explore how investor education can be improved

IFRSs versus U.S. GAAP

- **Substantially converged:**
  - Business combinations
  - Debt liabilities
  - Share-based compensation
  - Other compensation
  - EPS
  - Fair value
- **Fundamental differences**
  - Nonfinancial liabilities: "probable"
  - Measurement of certain assets: revaluation vs. cost
  - Inventory – LIFO not permitted
  - R&D: Development costs may be capitalized
  - Income taxes
  - PP&E: Separately depreciated
- **Industry guidance in U.S. GAAP not in IFRSs**
  - Utilities that engage in rate-regulated activities
  - Oil and gas
  - Investment companies
  - Broker-dealers

Joint projects (as of June 2013)

	Expected date	
Projects	2013	2014
Leases (comment period ends 13 Sept. 2013)	Redeliberations	F
Revenue recognition	F	
Financial instruments:		
• Impairment (comment period ended 5 July 2013)	Redeliberations	
• Classification and measurement	Redeliberations	
• Hedge accounting — General (IASB)	F	
• Hedge accounting — Macro (IASB)	DP	F
Other joint projects		
Insurance contracts (comment period ends 25 Oct. 2013)	Redeliberations	F
Rate regulation	DP	
Interim IFRS on rate-regulated activities (comment period ends 4 Sept. 2013)	Redeliberations	F

E — Exposure Draft F — Final Standard DP — Discussion Paper

First-time adoption of IFRS

Terminology — All in a word

IFRS	U.S. GAAP
Shares	Stock
Stock	Inventory
Reserves	Equity
Associate	Investee
Provision	Accrual
Scheme	Plan
True and fair	Presents fairly

Overview of IFRS 1

- IFRS 1 provides guidance on first-time application of IFRS (ongoing accounting policy elections and prospective accounting addressed under other standards}
- Applicable when an entity makes its first explicit and unreserved reference to IFRS
- Generally apply retrospectively all IFRS effective at reporting date
  - Certain exemptions can be elected
  - Some exceptions that must be followed
- Requires one year of comparative financial information
- Transition adjustments recognized in retained earnings
  - Disclosures and reconciliation to prior GAAP to explain effect of transition to IFRS

Primary objectives:

- Consistent starting point for IFRS
- Specific requirements and detailed disclosures
- Clearly convey to financial statement users the impact of converting to IFRS

Terms to remember

- First IFRS financial statements
  - First annual financial statements in which an “explicit and unreserved” reference to compliance with IFRS
- Date of transition to IFRS
  - Beginning of the earliest comparable period presented in an entity’s first IFRS financial statements
- Reporting date
  - The end of the latest period covered by financial statements or by an interim financial report

IFRS 1 considerations

Overall	Opening Balance Sheet	Disclosures
▪ Identify key dates ▪ Identify differences between existing accounting policies and IFRS and determine IFRS policies ▪ Determination of estimates under IFRS ▪ Elect and apply optional exemptions ▪ Apply mandatory exceptions	▪ Recognize all assets and liabilities required under IFRS (internal development costs) ▪ Derecognize all assets and liabilities not permitted under IFRS (post acquisition restructuring) ▪ Measure assets, liabilities and equity (impairment of assets) ▪ Reclassify items (deferred tax items)	▪ Identify areas where extensive disclosures will be required ▪ Reconciliation of equity and income ▪ Distinguish between policy changes, estimate changes and error corrections ▪ Narrative discussion adjustments ▪ Asset impairment ▪ Fair value as deemed cost

Voluntary exemptions from IFRS

- May elect some or all
- Doesn't impact future "accounting policy" choice
- Exemptions

▪ Business combinations ▪ Fair value or revaluation as deemed cost (PP&E, investment property intangibles) ▪ Employee benefits (defined benefit obligations) ▪ Cumulative translation differences ▪ Compound financial instruments ▪ Assets and liabilities of subsidiaries, associates and joint ventures ▪ Designation of previously recognized financial instruments	▪ Share-based payment transactions ▪ Insurance contracts ▪ Decommissioning liabilities ▪ Leases ▪ Fair value measurement of financial assets or financial liabilities at initial recognition ▪ Service concession arrangements ▪ Borrowing costs ▪ Cost of subsidiary in parent F/S

Mandatory exceptions from IFRS

- Derecognition of financial assets and financial liabilities
  - Generally, a first-time adopter shall apply the derecognition requirements of IAS 39 prospectively and would therefore not recognize items previously derecognized under local GAAP prior to January 1, 2004
  - Recognize derivatives
  - Consolidate special-purpose entities if controlled
- Follow transition provisions in IAS 39 for hedging
- Use of estimates
- Some aspects of accounting for non-controlling interests
- Classification and measurement of financial assets

Disclosure example — Reconciliation

	Notes	December 31, 2009 U.S.$	January 1, 2010 U.S.$
Total equity under U.S. GAAP		**XXX**	**XXX**
Adjustments to equity to conform with IFRS:			
Employee benefits	a	XXX	XXX
Share-based payments	b	XXX	XXX
Goodwill and other intangibles	c	XXX	XXX
Leases	d	XXX	XXX
Deferred tax	e	XXX	XXX
Total reduction in equity		XXX	XXX
Total equity under IFRS		XXX	XXX

	Notes	2009 U.S.$
Net income for the year under U.S. GAAP		XXX
Adjustments to net income to conform with IFRS:		
Employee benefits	a	XXX
Share-based payments	b	XXX
Goodwill and other intangibles	c	XXX
Leases	d	XXX
Deferred tax	e	XXX
Total adjustment to net income for the year		XXX
Net income for the year under IFRS		XXX

Accounting policies

Overview of key concepts — IAS 8

Concept	Discussion
Accounting policies	▪ Specific principles, bases, conventions, rules and practices
Estimates	▪ Adjustments in the carrying amount of assets or liabilities ▪ Result from new information or developments
Errors	▪ Material omissions or misstatements in financial statements ▪ Include clerical errors, mistakes in application, oversight or misinterpretation of facts, fraud
Material	▪ Omissions or misstatements that individually or collectively influence the economic decisions of users ▪ Consider the size and nature of the item

Retrospective vs. Prospective application

Item	Retrospective Application	Prospective Application
Changes in accounting policies	✓	
Changes in estimate		✓
Error corrections	✓	

Putting Principles Into Action – Transaction Analysis

Action	Management Considerations	Audit Considerations

Transaction analysis	• Understanding economic substance is paramount, and often involves considerations beyond accounting
	• Will need to engage non-accounting personnel in the process, particularly in understanding the substance
	• Considerations include understanding:
	  • The “business purpose”
	  • The parties to the transaction and whether they are related
	  • Any related transactions that should be considered in concert with the transaction being assessed
	  • What “rights and obligations” exist
	  • Whether there are any similar transactions that the company has undertaken
	  • Whether there are any similar transactions that have been undertaken by competitors or other companies more generally
		• Focus on the process used in assessing the substance of the transaction
		• Understand and ensure that the appropriate individuals were involved in the process
		• Bring in the appropriate level of expertise within the firm
		• Leverage any knowledge of similar transactions that have been dealt with at other companies
		• Understand and challenge the considerations made in analyzing the transaction

Putting Principles Into Action – Accounting Research

Action	Management Considerations	Audit Considerations

Research what items should be recognized, how they should be measured and presented	• Where the literature is not clear there should be increased sensitivity to diversity in practices
	• There may be a greater need to understand what competitors are doing, which may result in having a greater dialog with companies in the same industry
	• For each right and/or obligation identified, understand whether an asset or liability should be recognized
	    • In doing so, identify whether any specific literature exists and follow
	    • If not, look to the accounting framework and any similar literature that may be relevant and understand alternatives
	• For assets and liabilities to be recognized understand measurement and presentation requirements and any alternatives
	• Where alternatives exist, consider past practices for any similar transactions undertaken by the company or others
		• Understand the literature used in researching the recognition, measurement, and presentation requirements or alternatives
		• Understand any past practices used by the company and related firm views
		• Understand any relevant industry practices and discussions with competitors
		• Understand any biases that may exists and the variability of inputs/assumptions used
		• Understand the impact of alternatives on various metrics and materiality considerations

Putting Principles Into Action – Conclude and Disclosure

Action	Management Considerations	Audit Considerations

Conclude on final accounting treatments and determine appropriate disclosures	• There should be increased emphasis on the appropriateness of assumptions used and alternatives considered
	• Determine accounting entries to be recorded based on final conclusions
	• Determine the appropriate level of financial statement disclosure
	  • In doing so, understand any required disclosures that should be made under the applicable literature used in determining the recognition, measurement, and presentation treatments
	  • Also consider any additional items that contribute to the overall transparency of the accounting treatments concluded
	  • Assess the need for any sensitivity analysis related to key assumptions used in determining final treatments
		• Focus on process used in making final judgments
		• Ensure that the analysis was documented, and those involved followed the internal process
		• Understand the alternatives considered and reasons for ultimate treatment used
		• Understand any dissenting views
		• Ensure consistency across similar transactions undertaken by the company
		• Understand the subjectivity of judgments made
		• Focus on whether the financial statements are transparent and that sufficient disclosure has been made

Putting Principles Into Action – Document

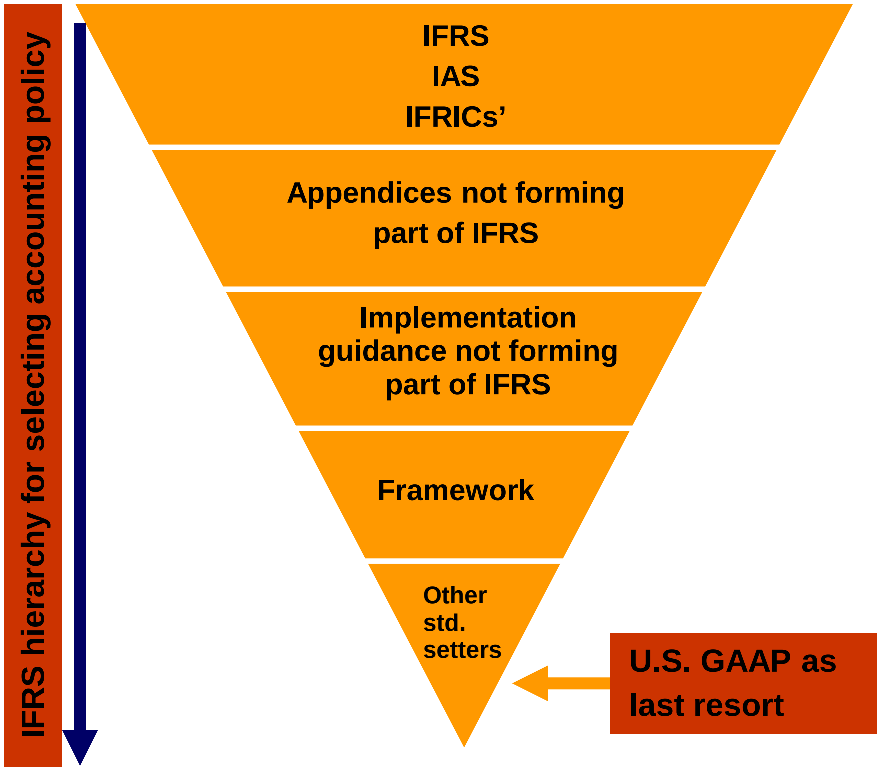
Action	Management Considerations	Audit Considerations

Document	• The development of position papers is critical in documenting managements' assessment of the proper accounting and reporting
	• Documentation should be contemporaneous with when the final conclusion is reached
	• Items to be documented include:
	  • Applicable facts and related evidence
	  • Relevant literature and guidance
	  • Individuals consulted
	  • Alternatives considered
	  • Analysis performed
	  • Basis for final conclusion
	• All individuals consulted should have an opportunity to review and comment on the final document
		• Ensure that the analysis was documented, and those involved followed the internal process
		• Ensure that the rationale for the final treatment is clear
		• Assess whether the effort undertaken and level of documentation are consistent with the significance and complexity of the issue

Accounting policies: IFRS Hierarchy

- Apply consistently once selected
- Without "bright-lines", a need to justify "benchmarks"
- Transitional provisions in U.S. standards and interpretations may not be applicable under IFRS

- In considering the applicability of U.S. GAAP, consider IFRS hierarchy and consistency with the appropriate IFRS "principle"



Financial statement presentation

Applicable standards

Financial statement presentation

IFRS	U.S. GAAP
• IAS 1(R) • IAS 7 • IAS 8 • IAS 10 • IAS 24 • IAS 33 • IFRS 5 • IFRS 7 • IFRS 8	• ASC 205 (ARB 43) • ASC 810 (ARB 51) • ASC 275 (SOP 94-6) • ASC 255 (SOP 93-3), etc. • ASC 310 (APB 12) • ASC 225 (APB 9) • ASC 235 (APB 22), etc. • ASC 255 (SFAS 89) • ASC 230 (SFAS 95 and SFAS 102) • ASC 220 (SFAS 130) • ASC 250 (SFAS 154) • ASC 855 (SFAS 165), etc. • Others

Components of financial statements

- Statement of financial position
- Statement of comprehensive income
- Statement of changes in equity
- Statement of cash flows
- Notes
  - Significant accounting policies
  - Other explanatory information
- Statement of financial position as of the beginning of the earliest comparative period when an entity:
    - Applies an accounting policy retrospectively or
    - Makes a retrospective restatement
    - Reclassifies items

Financial statement — Considerations

Statement of comprehensive income	Statement of financial position	Others
• Individual line items • Performance measures – Operating income • Expense classification	• Current/non-current distinction • Individual line items • Option to disclose certain information either on the face of the statement of financial position or in the notes	• Critical accounting judgments • Risk disclosures, including key assumptions, estimates and sensitivity analysis

Expense classification by function

Revenue	X
Cost of sales	X
Gross Profit	X
Other income	X
Selling costs	X
Administrative expenses	X
Other expenses	X
Profit	X

Entities classifying expenses by function shall disclose additional information on the nature of expenses, including: depreciation, amortization, and employee benefits.

Expense classification by nature

Revenue		X
Other income		X
Changes in inventories of finished good and work in progress	X	
Raw material and consumables used	X	
Employee benefits costs	X	
Depreciation and amortization	X	
Other expenses	X	
Total expenses		**X**
Profit/loss		X

Events after the reporting period

Concept	Discussion	Examples
Adjusting event	▪ Events after the reporting period that provide evidence of conditions that existed as of the end of the reporting period ▪ Adjust the financial statements	▪ Settlement of litigation ▪ Information indicating an asset was impaired as of the end of the reporting period – Subsequent inventory sales – Customer files for bankruptcy
Non-adjusting event	▪ Events after the reporting period that are indicative of conditions that arose after the end of the reporting period ▪ Do not adjust the financial statements	▪ Announcing or implementing a restructuring ▪ Business combinations ▪ Discontinued operations ▪ Change in tax rates enacted after the end of the reporting period ▪ Destruction of assets

Overview of key potential differences

Item	U.S. GAAP	IFRS
Post balance sheet debt refinancing	Non-current	Current
Post balance sheet cure of a covenant violation	Non-current	Current

Overview of key concepts — IAS 7

Concept	Discussion
Operating activities	▪ Principle revenue producing activities and other activities not considered investing or financing
Investing activities	▪ Acquisition and disposal of long-term assets and other assets not included in cash equivalents
Financing activities	▪ Activities that result in changes in the size and composition of equity and borrowings
Cash equivalent	▪ Short-term, highly liquid investments that are readily convertible to known amounts of cash **and** are subject to an insignificant risk of changes in value

Cash flow activities — Examples

Operating	Investing	Financing
▪ May use either direct or indirect approach ▪ Principal revenue-producing activities of the entity ▪ Generally relate to current assets and liabilities ▪ Pensions	▪ Generally relate to long term assets ▪ Investments in financial assets ▪ Property, plant and equipment ▪ Finance leases ▪ Intangibles ▪ Investments in associates ▪ Investments in joint ventures	▪ Generally relate to long term liabilities and equity items ▪ Long term debt ▪ Shares

Cash flow considerations

- Offsetting
- Foreign currency
- Interest and dividends
- Income taxes
- Business combinations
- Disclosure of non-cash transactions
- Components of cash and cash equivalents

Overview of key potential differences

Item	U.S. GAAP	IFRS
Interest /Dividends received	• Operating activity	• Either operating or investing activity
Interest/Dividends paid	• Dividends - financing activity • Interest - operating activity	• Either operating or financing activity
Taxes paid/refunded	• Operating activity	• Operating activity unless specific identification with financing or investing activities
Bank overdrafts	• Financing activity	• Generally a financing activity unless it's part of the entity's cash management
Components of cash and cash equivalents	• No specific requirement	• Disclosure and reconciliation with the equivalent items reported in the statement of financial position required

Overview of key concepts — IAS 24

Concept	Discussion
Related party	▪ Controlled parties (subsidiaries) ▪ Parties under common control ▪ Parties with significant influence (associates) ▪ Joint venture parties ▪ Key management personnel ▪ Certain family members of the above
Key management personnel	▪ Persons having authority and responsibility for planning, directing, and controlling the activities of the entity, directly or indirectly ▪ Includes directors
Additional IFRS disclosure requirements	▪ There are different disclosure requirements under IFRS regarding the quantification of related party transactions and the compensation of key management personnel

Overview of key concepts — IAS 33

Concept	Discussion
Ordinary share	▪ Equity instrument subordinate to all other classes of equity instruments
Potential ordinary share	▪ Financial instrument or contract that may entitle its holder to ordinary shares ▪ Examples: convertibles, options and warrants
Contingently issuable share	▪ Ordinary shares issuable for little or no cash or other consideration ▪ Dependent on the satisfaction of specified conditions
Dilution	▪ Reduction in EPS or an increase in loss per share ▪ Assume conversion of convertibles and issuance of potential ordinary shares

Overview of IAS 33

	Basic EPS	Diluted EPS
Earnings (the numerator)	▪ Profit or loss attributable to ordinary equity holders	▪ Adjust for the effects of potential ordinary shares ▪ May include dividends, interest or other changes in income or expense
Shares (the denominator)	▪ Weighted average number of ordinary shares	▪ Assume conversion of all dilutive potential ordinary shares ▪ Assume conversion as of the beginning of the period, or issue date, if later

EPS example

Facts:	
Profit attributable to ordinary equity holders of the parent entity for 2011	$1,200,000
Weighted average number of ordinary shares outstanding during 2011	500,000 shares
Average market price of one ordinary share during 2011	$20.00
Weighted average number of shares under option during year 2011	100,000 shares
Exercise price for shares under option during 2011	$15.00

EPS example (cont.)

Calculation of earnings per share			
	Earnings	**Shares**	**Per share**
Profit attributable to ordinary equity holders of the parent entity for 2011	$1,200,000		
Weighted average shares outstanding during 2011		500,000	
Basic earnings per share			$2.40
Weighted average number of shares under option		100,000	
Weighted average number of shares that would have been issued at average market price: (100,000 x $15.00)/$20.00	**(a)**	(75,000)	
Diluted earnings per share	$1,200,000	525,000	$2.29

(a) Earnings have not increased because the total number of shares has increased only by the number of shares (25,000) deemed to have been issued for no consideration.

Overview of key potential differences

Item	U.S. GAAP	IFRS
Contracts settled in cash or shares	• Inclusion of the shares in diluted EPS is based on a rebuttable presumption that the contracts will be settled in shares if the effect is more dilutive. This presumption may be overcome if the entity has an existing practice or a stated policy that provides a reasonable basis to conclude that the contract will be settled partially or wholly in cash.	• Inclusion of the shares in diluted EPS is based on a presumption that the contract will be settled in ordinary shares if the effect is dilutive. The presumption of share settlement may not be overcome.

Overview of key concepts — IFRS 8

Concept	Discussion
Core principle (management approach)	▪ An entity should disclose information to enable the users of its financial statements to evaluate the nature and financial effects of the types of business activities in which it engages and the economic environments in which it operates
Operating segment	▪ Component that earns revenues and incurs expenses ▪ Reviewed by chief operating decision maker ▪ Discrete information is available
Reportable segment	▪ Revenue or assets greater than 10% of total

Basis of segmentation

- Generally will be either related to products and services sold or geography
- May also have a mixed model or matrix approach
- Measurement basis used for segment disclosures is what is used by CODM
  - May not be consistent with accepted IFRS measurement basis of items in the financial statements

Reportable segments — Considerations

- Aggregation of operating segments
- Quantitative thresholds
- Reconciliations
- Entity-wide disclosures
  - Information about products and services
  - Information about geographical areas
  - Major customers

Types of items disclosed by segment

General	Balance Sheet	Income Statement
▪ Factors used to identify reportable segments ▪ Types of products and services from which reportable segment derives revenue	▪ Assets ▪ Liabilities ▪ Additional disclosure (if provided to CODM) – Amount of investment in associates and JVs accounted for by the equity method – Additions to non-current assets	▪ Profit or loss ▪ Additional disclosure (if provided to CODM) – Revenue from external customers – Inter-segment revenues – Interest revenue – Interest expense – Depreciation and amortization – Interest in profit or loss of associates or JVs accounted for by the equity method – Income taxes – Other non-cash items

Overview of key potential differences

Item	U.S. GAAP	IFRS
Use of a matrix organization	• Segments are identified based on products and services	• Segments are identified on the basis of "core principle"
Non-current assets	• Long-lived assets in segment disclosure do not include intangible assets	• Non-current assets include intangible assets
Segment liabilities	• No disclosure required	• Disclosure required if regularly provided to CODM

Case study

Overview of case study

- Consists of excerpts from actual financial statements
- Objective of the cases
  - Summarize the company's accounting policy
  - Identify relevant differences from U.S. GAAP

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