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US GAAP to IFRS Income Conversion Case Study: An Examination of SEC Noted Accounting Differences

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Abstract

International Financial Reporting Standards (IFRS) have been implemented in every continent that has an organized stock exchange. The United States however, still requires the application of the US GAAP model in the financial reporting of its publically traded entities. Despite this, IFRS usage has made major inroads since the inception of the now expired joint SEC-IASB convergence projects approximately fifteen years ago. Many US owned companies operate directly or through its owned subsidiaries, in international markets that are IFRS compliant, while many foreign owned companies operating in the US are required to use IFRS to meet their financial reporting obligations. In response to these developments, professional licensure bodies have incorporated IFRS coverage as a major testing component of the uniform CPA examination (20 percent of the FARE part), as well as the CFA examination (20-25 percent of Level 1 and 2 exams).From an academic prospective, IFRS content has penetrated the accounting curriculum of the higher education institutions in the United States, where it is now also commonplace to find the delivery of newly developed, stand-alone, international accounting courses. Because of its extensive use in the United States, IFRS literacy has become more critical for the local accounting student, as well for the practitioner, and in a climate of continual international business integration, a necessity for the profession going forward.

This case study provides students with a rich flavor of IFRS. Students will examine and explore the most commonly encountered material differences between US GAAP and IFRS pertaining to the Statement of Income. The focus of this case is on the differences outlined in the July 13, 2012 SEC report, which relate to; Inventory (LIFO use is prohibited under IFRS), Development Costs, Measurement of Certain Asset Classes (revaluation model), Property, Plant and Equipment (use of asset componentization), Impairment losses, Certain Nonfinancial Liabilities (contingencies and exit/disposal costs), and Income Taxes (uncertain tax positions). Students are presented a US GAAP prepared Statement of Income and are required to transform it to an IRFS based statement. The case highlights the major differences, and the financial effects on the Statement of Income between the two accounting reporting regimes. Students are also asked to comment on different approaches to IFRS adoption, and the current status of IFRS adoption in the United States. This case requires students to critically read authoritative accounting literature, and apply this understanding in the satisfactory completion of the required assignments.

Keywords: July 13, 2012 SEC report, IFRS Convergence, US GAAP-IFRS Case Studies, US GAAP-IFRS differences.

The Case

Company Background

J&H Corp, a publically traded NASDAQ company (symbol JNH), based in Seattle, Washington, is a manufacturer of specialty vitamins. The primary compound in J&H's products is found exclusively in the rainforests of South America. The company sells its products solely in the United States. Its major customers are GNC and Wal-Mart. J&H is committed to expanding its business operations into neighboring countries: Canada and Mexico. Both of these countries require IFRS compliance.

J&H's Board of Directors has been discussing the impact of IFRS adoption upon J&H's financial statements. Because of its international expansion plans, they had expected that J&H would adopt IFRS in 2014. However, a change in the SEC's position towards IFRS has caused the Board to delay such implementation. The Board is forward looking and would like to see the financial effects of using IFRS on the Statement of Income. Management would also like an understanding of the various approaches of IFRS adoption, and an update on the status of IFRS reporting in the United States. They have hired you as their consultant to undertake this assignment.

Selected US GAAP prepared financial information for J&H Corp. is presented below.

Balance Sheet (US GAAP Prepared)

J&H Corp.

As of December 31,2017

(In 000's)

Assets		**Liabilities and Shareholders' Equity**	
Current Assets		**Current Liabilities**	
Cash	$ 50,000	Accounts payable	$ 20,667
Marketable Securities	20,000	Accrued expenses	15,000
Accounts Receivable	72,500	Taxes payable –current	5,000
Inventory (LIFO Basis)	55,000	Total current liabilities	$ 40,667
Prepaid Expenses	2,500		
Total current assets	$ 200,000		
Property, Plant and Equipment		**Noncurrent Liabilities**	
Assets (Historical Cost)	120,000	Bonds payable-6% Coupon	$ 33,333
Less: Accumulated Depreciation	(40,000)	Deferred Income Taxes	6,000
		Total Noncurrent liabilities	$ 39,333
Property, Plant and Equipment(net)	$80,000	Total Liabilities	$ 80,000
		Shareholders' Equity	
Intangible Assets		Common stock ($10 par)	$ 59,900
		Paid in Capital	33,000
Patent	6,000	Retained Earnings	124,000
(Net of $14,000 Accumulated Amortization)		Total stockholder's equity	$ 216,900
Goodwill	10,900		
Total intangible assets	$16,900		
Total assets	$ 296,900	Total liabilities and Shareholders' Equity	$296,900

Statement of Income (US GAAP Prepared)
J&H Corp.
Statement of Income
Year Ended December 31, 2017
(In 000's)

Sales	$ 550,000
Cost of goods sold	(397,000)
Gross profit	153,000
Selling and administrative expenses	
(includes $2,000 amortization expense, and $9,000 depreciation expense)	(106,000)
Operating Income	47,000
Other income (loss):	
Dividend income	1,100
Interest income	900
Loss on sale of marketable securities	(2,000)
Loss from restructuring- New York state plant	(7,500)
Earnings before interest and taxes	39,500
Interest expense	(2,000)
Income before tax	37,500
Tax expense (30 %)	(11,250)
Net Income	$ 26,250
Earnings Per Share	$ 4.38

Accounting Policies, Procedures and Other Information

- **A)** Depreciation Expense: The Company uses the straight line method, with an estimated useful life of 10 years for transportation equipment and machinery, and 40 years for the buildings. No residual value is expected**.**
- B) Intangible assets are amortized over a 10 year period using the straight line method. No residual value is expected on these assets. Assume the company follows the half-year convention for any intangible asset placed in service during the year.
- C) The depreciation/amortization effects resulting from the revaluation and/or impairment, and/or changes in accounting estimates of long- term assets are accounted for in subsequent periods only.
- D) There were 5,990 common shares outstanding throughout the 2017 calendar year.
- E) It has been determined that the pre-tax, market-determined discount rate for the patent is 9 percent.
- F) There were cash dividends of $5,990 paid to the common shareholders during the 2017 calendar year.
- G) J&H's tax rate is 30 percent.

Other Information (All in 000's)

1- J&H Corp. uses the Last in First out (LIFO) method to account for its inventory. The beginning of the year inventory is $50,000, and the cost of goods manufactured during 2017 was $402,000. As of year-end , the inventory balance is $55,000.Additionally, the notes to the financial statements disclose the LIFO reserve balances as follows:
LIFO Reserve- January 1, 2017= $4,295
LIFO Reserve- December 31, 2017=$7,295.

For simplicity purposes, assume that the inventory balances as of December 31, 2017 and 2016 are comprised of finished goods only, and that the inventory amounts for raw materials and work in process (WIP) are negligible.

2- There are lawsuits pending against J&H for $7,370 resulting from a customer class action litigation case. Expert legal consultants consider the likelihood of payout at 52 percent. It is expected that these contingencies will be settled in the next 3 to 5 years.

3- The three asset classes for Property, Plant and Equipment as of 12/31/2017 are as follows:

	Transportation Equipment	Machinery	Buildings	Total
Cost	20,000	60,000	40,000	120,000
Less: Accumulated depreciation	5,000	20,000	15,000	40,000
Book Value	15,000	40,000	25,000	80,000

Independent expert appraisers have established the following fair values as of 12/31/2017:

Transportation Equipment	$16,000
Machinery	41,000
Buildings	35,000

Management has elected to use the Revaluation Model to report the asset class- Buildings. They will continue to utilize the cost model for Transportation Equipment and Machinery.

4- Machinery can be broken down into a second major component part; the engine. The engine has an estimated useful life of 5 years, no expected residual value, and accounts for 30 percent of the machinery cost.

5- During 2017, the company was unsuccessful in defending its patent in a civil infringement case. The result prompted management to test for a potential impairment loss. This resulted in a revision of estimated future cash flows from the patent to $3,100 per annum for the next 2 years (originally $3,100 for 3 years). The estimated selling price of the patent, net of selling expenses (i.e. Net Realizable Value) on December 31, 2017 is $5,500.

6- During the year, the company's tax department noticed a questionable tax deduction claimed on the 2015 corporate tax return, which reduced the company's tax liability by $5,500. Management has assessed the chances of successfully winning the case upon an IRS audit as 60 percent. Additionally, detection of this questionable item by the tax authorities is determined to be in the 30 percent range.

7- On December 1, 2015, J&H made a public announcement that it will be closing its New York state plant. Prior to this date, the company had in existence a detailed demonstrably committed formal restructuring plan. Its HR department also met with all of the parties affected by this proposed closure to discuss their relocation and/or severance options. The exit plan will commence on January 1, 2016, and is expected to be finalized within a two year period at a projected cost of $15,000.The plant was officially closed on December 31, 2017, and the actual restructuring/exit costs incurred were: $7,500 in 2016, and $7,500 in 2017.

8- In 2017, J&H incurred $2,500 of development costs on a commercially viable product-known as The Essential Omega 3 Vitamin. Technical and economic feasibility was determined on January 1, 2017. Management intends to complete this product development, and has the financial and technical resources to do so. The company also keeps detailed cost records, and can thus trace the costs incurred to this project. Further, management expects that this vitamin will be J&H's best-selling item once this product enters the commercial market.

Required

1- For each of the items above, #1 to #8, refer to professional pronouncements and identify the differences between US GAAP and IFRS and their effect on the Statement of Income. Then prepare the required compliant journal entries to adjust the Statement of Income to an IFRS basis.

2-Using the template below, prepare a US GAAP to IFRS Net Income Reconciliation based on your findings in 1 above:

Income before Tax –US GAAP	$37,500
Adjustments: Addition (subtraction)	
(1)	
(2)	
Etc.	
Total Adjustments	
Income before Tax-IFRS	
-Income Tax Expense (30%)	
Net Income – IFRS Basis	

3- Based on your answer in #2 above, prepare an IFRS based Statement of Income (Profit and Loss Statement) for the 2017 calendar year.

4- Prepare an IFRS based Statement of Comprehensive Income for the 2017 calendar year. (This statement should be presented as a stand-alone statement).

5- Describe the difference in these terms associated with IFRS - Adoption, Convergence, Endorsement, Condorsement and Conformity.

6- Prepare a written report on the outlook of IFRS adoption in the USA, referencing at a minimum, the most current SEC position, and its communication made to the business community.

Case Learning Objectives and Implementation Guidance

Introduction

International Financial Reporting Standards (IFRS) have become the gold standard for worldwide financial reporting, having been adopted by over 100 countries. This case study provides the student with a rich flavor of IFRS. Students will examine and explore the most commonly encountered material differences between US GAAP and IFRS as outlined by the SEC, and the resulting financial reporting implications as they relate to the Statement of Income.

The United States continues to use US GAAP as its financial accounting reporting model. Despite this, IFRS use is quite prevalent in the United States. Many companies with US operations are headquartered in countries that have adopted IFRS, while many US headquartered companies which are foreign owned, are required to use IFRS to meet their global reporting obligations. Because of its extensive use, IFRS literacy has in effect become more critical and arguably mandatory for the accounting practitioner. Not surprisingly, IFRS reporting issues appear with increasing regularity on the Uniform CPA and CFA examinations.

This case study requires the student to take a US GAAP prepared Statement of Income, and based on the given facts of the case, reconcile it to an IRFS Statement of Income. The student needs to identify the accounting differences between the two regimes, and then prepare compliant IFRS complaint journal entries in the transformation process to an IFRS Statement of Income. The seven material differences between the two accounting bodies as outlined in the July 2012 SEC report are highlighted and reviewed in this case study, and include the following: Inventory (LIFO use is prohibited under IFRS), Development Costs, Measurement of Certain Asset Classes (revaluation model), Property, Plant and Equipment (use of asset componentization), Impairment, Certain Nonfinancial Liabilities (Contingencies and Exit/Disposal Costs), and Income Taxes (uncertain tax positions).The report further notes “the resolution of these differences will be individually challenging, and any attempt by the SEC or others to resolve these differences in a period even as long as five to seven years may prove to be difficult”. Continued

deviations of the accounting treatment for these seven items will arguably defer any attempt on the part of the SEC to explore the possibility of any future IFRS convergence effort.

Other major differences between the two regimes are: financing (capital) lease are more common under IFRS due to its more stringent principals based requirements (this will change in 2018 when the new codification pronouncements will take effect which will require all long-term non-cancellable leases to be capitalized); for financial instruments (i.e. convertible debt securities), IFRS requires that the option value imbedded in such instruments be re--classified as stock securities. Additionally, IFRS does not allow the completed contract method for revenue recognition, has an easier threshold to recognize impairment losses for marketable securities, and is principles based rather than US GAAP rules based. More subtle differences exist in the accounting for: pensions, consolidations, foreign currency, the cash flow statement, earnings per share, and income taxes. It is important to point out however that the similarities between the two regimes are much more prevalent, making it feasible to introduce IFRS topics in a broad range of accounting courses.

Case Description

This case is designed to have students research US GAAP and IFRS pronouncements. They must first identify the proper accounting treatment of prominent differences under the two frameworks, and then prepare IFRS compliant journal entries. Next, they must reconcile US GAAP income to IFRS income, and prepare an IFRS Statement of Income (Profit and Loss and Other Comprehensible Income Statements).Finally; they will discuss the most current status of IFRS adoption, and the impact of its potential adoption in the United States.

This case focuses on fundamental issues US companies will face prior to preparing IFRS based financial statements. Challenging topics such as deferred income taxes and other comprehensive income are included in the case. In order to successfully complete the case, students must have a solid grasp of US GAAP accounting, and the ability to research IFRS pronouncements.

The case exposes students to FASB pronouncements and standards, and IFRS in a meaningful way. Students will gain an appreciation for the relevance and timeliness of the case, and after completing the case, will have a better sense of the major differences between US GAAP and IRFS. They will also develop a sense of currency by researching and discussing the latest status of IFRS use/adoption in the United States.

Case Learning Objectives

The specific learning objectives are for the student to:

a) Prepare compliant journal entries for conversions of US GAAP income to IFRS income for the following issues:
   - LIFO Inventory
   - Loss Contingencies
   - Asset Revaluation
   - Asset Componentization
   - Impairment Losses
   - Uncertain Tax Positions
   - Restructuring/Exit Costs
   - Capitalization of Development Costs

b) Prepare an IFRS based Profit and Loss Statement of Income for the 2017 calendar year.

c) Prepare an IFRS based Statement of Other Comprehensive Income for the 2017 calendar year.

d) Describe the difference in these terms associated with IFRS - Adoption, Convergence, Endorsement, Condorsement and Conformity.

e) Prepare a report discussing the present outlook of IFRS adoption in the USA; and,

f) Apply critical thinking and problem solving skills throughout the satisfactory completion of the case study requirements.

Suitable Classes for This Case

Since this case requires research into US GAAP and IFRS pronouncements, it is most appropriate for students who have completed intermediate accounting 1, or are currently enrolled in intermediate financial accounting II. It can be used at the graduate or undergraduate levels in a variety of financial accounting related courses, including; intermediate financial accounting II, accounting theory, international accounting, an accounting capstone course, and financial statement analysis.

Implementation

This case should be assigned after the coverage of chapter 4, Income Statement and Related Information of Kieso, Weygandt, Warfield's**, Intermediate Accounting t**extbook (Wiley, 13th edition). The case should then be completed concurrently with the chapter coverage in the following recommended sequence:
Chapter 4: Income Statement and Related Information
Chapter 8: Valuation of Inventories
Chapter 10: Acquisition and Disposition of Property, Plant and Equipment
Chapter 11: Depreciation, Impairments, and Depletion
Chapter 12: Intangible Assets
Chapter 13: Current Liabilities and Contingencies

Need for the Case

Many US educators are questioning how to incorporate IFRS into their curriculum. Most educators show confidence that the US will eventually adopt IFRS at some point in time (Jackling). There has been plentiful discussion in the literature about the strategy for teaching IFRS. There are fewer instances of what to teach.
IFRS teaching resources appear to remain an issue for educators regardless of whether the country is an earlier adopter or has more recently transitioned to IFRS. It has been reported that 79% of US academics found development of IFRS materials highly challenging. (Munter).Issues in Accounting Education devoted a special section on teaching IFRS. (May 2013) It included ten articles on how to teach IFRS, but only had a single two page case reflecting what to teach.

The use of judgment is specifically woven into this case as we present a tax error issue, in addition to an IFRS option of using the revaluation model rather than the cost model. The ambiguity presented in these two instances requires students to find and justify their own solution. Two differing solutions, at a minimum, may qualify for full credit.

Using a case such as J&H Corp may come at the cost of having less time to cover technical material. Hilton suggests that less breadth and depth in exchange for skill development makes sense because the knowledge required in today's accounting profession is dynamic and ever changing. One of the main benefits of teaching through case studies is the need to explain the use of judgment through understanding the Standard Board's reasoning. (Wells) Specifically, a similar case study like the one presented here – post the July 2012 SEC report-dealing with the seven noted specific differences, has not been undertaken to date. Much of the literature in this field focuses on describing the similarities and differences between the two accounting bodies, as well as how to effectively incorporate IFRS into the US college classroom and curriculum. The Big 4 accounting firms present comprehensive on line literature, providing relevant authoritative guidance as to the reporting requirements of the encompassing range of assets, liabilities, equity, revenue and expense accounts, as well as Comprehensive income and Disclosure requirements under both regimes. Accounting similarities and differences between the two groups are outlined and discussion with reference to first time adaptor's to IFRS is explained in detail.

From a textbook viewpoint, Kieso, Weygandt, Warfield's**, Intermediate Accounting** for example, provides in appendix form an in depth analysis of IFRS, and the key differences and similarities by topic coverage when

compared to US GAAP. The CFA required textbook – International Financial Statement Analysis, consistent with its curriculum, focuses on IFRS study, with US GAAP coverage presented on a secondary basis. Additionally, no comprehensive case study is provided in these major sources to illustrate the financial effects of the differences as noted in this case study, nor is a continuation of the complete conversion process of the financial statements from US GAAP to IFRS illustrated.

In the Journal of Accounting Education 31 (2013) 53-67, Coe and Delaney present a comprehensive case study entitled –Trabeck prepares for IFRS: An IFRS case study. This case study was written prior to the July 2012 issued SEC report and its tone is one of assumed convergence. While focusing on several key differences between the two regimes, it continues with the preparation of IFRS compliant statements and examines the resulting financial effects using ratio analysis comparisons; it does not capture many of the identified SEC fundamental differences. Additionally, much of the case study focuses on the many judgments one is confronted with when dealing with IFRS compliance issues.

The J&H case study is ideal in a university curriculum, for a variety of undergraduate and graduate courses. It is the only case study on record that examines the most significant accounting differences between US GAAP and IFRS from the SEC's viewpoint, thereby making it relevant. Additionally, it has been prepared for the university curriculum in terms of complexity, thereby making it efficient in terms of student time spent on this assignment. Further, it requires students to research both; US GAAP and IFRS literature, and then prepare a written report based on their research results. Research and written communication skills are necessary for the prospective accounting practitioner. This case study also helps students in the preparation of the CPA examination, as much of the tested materials relating to IFRS are sufficiently addressed in this case study. Equally important, going forward, the differences discussed in this case study will undoubtly be reviewed in the future when the potentiality of convergence comes into play again. As a result, absent complete IFRS convergence, this case study will continue to be current and relevant in the university curriculum.

Grading the Case

We recommend the case be completed as a group project. Students will be challenged to prepare the IFRS compliance entries. The case could have a weight of 20-25% of the final course grade.
We recommend the lower amount for undergraduate classes and the higher amount for graduate classes, as there are more required assignments for the latter, as discussed below.

When offered as a collaborative group project, it could be covered in two parts. The first session would include a review of the conversion adjustments prepared and submitted by the students prior to class. Instructors should highlight the salient points. Students may have difficulty in determining whether adjustments are reflected on the balance sheet or the income statement (includes comprehensive income). After the adjusting reconciliation entry review, preparation of the reconciliation of GAAP to IFRS and the IFRS income statement could then be required. A review of the results would likely be very brief, but this would be an opportune time to discuss the status of IFRS implementation in the US and the impact IFRS had on J&H Corp.

Alternatively, after the group papers are submitted to the instructor, portions of the solution could be assigned to each group for presentation to the entire class based on the quality of their submitted solution.
In grading the case write-ups, instructors need to address the issues of identification of relevant issues, proper accounting for the IFRS conversion process; including the computational accuracy of amounts, quality and depth of research as evidenced by proper citations of the literature.

For the undergraduate curriculum, we recommend assignments 1-4, and recommend the entire assignment 1-6 for the graduate curriculum.

***Below is the grading criterion for this case study*.** We suggest that the instructor explain the basis for grading at the beginning of the semester.

Undergraduate Class Grading:

Assignments 1, 2, 3 and 4 are the requirements for the case study, and the points assigned to each part respectively are: 80,10,4 and 6, which equal 100.]

Graduate Class Grading:

Assignments 1, 2, 3, 4, 5 and 6 are the requirements for the case study, and the points assigned to each part respectively are: 64,10,4, 6, 12 and 4, which equal 100.

Requirement 1: For each scenario 1 to 8, refer to professional pronouncements and identify the differences between US GAAP and IFRS and their effect on the Statement of Income. Prepare the required IFRS compliant journal entries to record the Statement of Income differences.
32 answers:
2.5 points each for Undergraduate courses=80 Points
2 points each for Graduate courses = 64 Points.

A) Inventory:
1) IFRS disallows the LIFO Inventory method.
2) correct IFRS compliant journal entry:
Dr. Inventory
Cr. Cost of goods sold
3) Correct amount of $3,000=change in LIFO Reserve in 2017 (7,295-4,295).

B) Contingency Losses:
4) US GAAP threshold for contingency loss is probable; defined as "likely"
6) Correct IFRS compliant journal entry: Dr. Contingency loss Cr. Contingency liability payable.
7) Correct amount of $7,370.

C) Asset revaluation
8) US GAAP requires the cost model.
9) IFRS allows either the cost model or the revaluation model.
10) The choice of revaluation by IFRS is by asset class.
11) If revaluation model is used-the need for regular revaluation is required.
12) Correct IFRs compliant journal entry;
A) Assuming the use of the Proportionate Restatement Method:
Dr. PP&E 16,000 Cr. Accumulated Depreciation 6,000 Cr. OCI-Revaluation Surplus 10,000.
Or
B) Assuming the use of the Depreciation Elimination Method:
Dr. Accumulated depreciation 15,000 Cr. PP&E 5,000 Cr. OCI-Revaluation Surplus 10,000.
13) Correct amounts –included above in 12.

D) Componentization depreciation:
14) IFRS requires componentization depreciation.
15) Correct IFRS compliant journal entry: Dr. Depreciation Expense Cr. Accumulated Depreciation.
16) Correct calculation of the additional $1,800 depreciation expense created by the use of componentization.

E) Impairment Losses:
17) Correctly specify US GAAP has a two-step process to test impairment loss.
18) Correctly specify that IFRS has a single step process.
19) Correctly define the recoverable amount definition under IFRS=higher of: recoverable value or the asset's value in use (Present Value of asset's future cash flows).
20) Correct calculation of value in use= $5,453.
21) State that IFRS allows for the reversal of impairment losses (excluding Goodwill), while this treatment is prohibited under US GAAP,
22) Correct IFRS compliant journal entry: Dr. Impairment loss Cr. Patent or Accumulated Amortization-Patent.
23) Correct amount of impairment loss of $500 = 6,000 less recoverable amount of 5,500.

F) Uncertain Tax Position:

24) State that IFRS does not specifically address the accounting treatment for uncertain tax positions.
25) A correct, acceptable amount for tax expense/tax liability under IFRS of: $0, $2,200 or $660.
If 660 or 2,200 is the answer then compliant journal entry required to get full credit:
Dr. Income tax expense   Cr. Income tax payable

G) Restructuring/Exit Costs
26) Correctly state that under IFRS, restructuring/exit costs is recognized in the year of announcement to all affected parties (plan also has to be committed), or in the year of commencing the exit strategy (i.e. $15,000 restructuring/exit costs recorded in 2015 or in 2016); whereas US GAAP requires expense recognition in the year incurred (i.e. $7,500 in 2016 and $7,500 in 2017).
27) Correct IFRS compliant journal entry:
Dr. Retained Earnings   Dr. Income tax payable-current   Cr. Restructuring expense-loss from restructuring
28) Correct amount of 7,500.(Due to its extreme complexity a 7,500 debit amount to retained earnings will be an acceptable answer, in addition to the recommended answer of a 2,250 debit to income tax payable-current and a debit for 5,250 to retained earnings. The restructuring expense amount however has to be 7,500 to receive credit.

H) Development Costs
29) State that IFRS requires capitalization of development costs when technical and economic feasibility of the project has been established. A listing of the 6 criteria required for the capitalization of development costs will also receive full credit.
30) Correctly identify IFRS compliant entries by Capitalizing Development costs of 2,500 by;
Dr. Development Costs 2,500   Cr. Selling and administrative expenses 2,500
31) Correct journal entry to amortize Development Costs in 2017:
Dr. Amortization Expense   Cr. Accumulated Amortization -Development Costs
32) Correctly provide the amount of amortization expense of $125.

Requirement 2: Using the template below, prepare a US GAAP to IFRS Net Income Reconciliation based on your findings in 1 above**:**
10 Answers- 1 point each. Correct amounts are listed below for the 10 answers-(1-10).

US GAAP to IFRS Income Reconciliation

Income before Tax –US GAAP		37,500	
Adjustments:			
	(1)	3,000	Cost of Goods Sold
	(2)	(7,370)	Contingent Liability Loss
	(3)	(1,800)	Added depreciation expense relating to Asset Componentization
	(4)	(500)	Impairment Loss to Patent
	*(5)	(660)	Uncertain Tax Position Loss
	(6)	7,500	Reversal of Restructuring/Exit or Disposal Costs
	(7)	2,500	Capitalization of Development Costs
	(8)	(125)	Amortization Expense relating to Capitalized Development Costs
Total Adjustments		2,545	
Income before Tax-IFRS		40,045	
Income Tax Expense (30%)		12,014 (9)	
Net Income – IFRS Basis		28,031 (10)	

*(5) The uncertain tax position loss has three correct, different answers, depending on the IFRS position taken. The correct answers are; $2,200, $660 and $0. Each of these acceptable, correct answers will lead to a different adjustment total, and will result in a different Net Income-IFRS Basis amount.

***Requirement 3*:** Based on your answer in #2 above, prepare an IFRS based Statement of Income (Profit and Loss Statement) for the 2017 calendar year.
2 Answers-- 2 point each.

Answer 1: Consistent with the answers in requirements 1 and 2, correctly present in proper form an IFRS Statement of Income (Profit and Loss Statement)for 2017. (Presented below- 2 points).

Answer 2: Correctly calculate and present Earnings per Share= Net Income Available to Common Shareholders/common shares outstanding (28,031/5,990= $4.68). (2 points).

IFRS prepared Profit and Loss Statement

J&H Corp.
Statement of income-IFRS Basis
For the Year Ended December 31, 2017
(In 000's)

Sales	$ 550,000
Cost of goods sold	(394,000)
Gross Profit	156,000
Operating expenses	(92,500)
(Excludes depreciation and amortization)	
Depreciation and amortization expense	(12,925)
Other Income/ (Losses):	
Dividend income	1,100
Interest income	900
Loss on sale of marketable securities	(2,000)
Contingency loss	(7,370)
Accrued income tax expense	(660)
Impairment loss-patent	(500)
Earnings before interest and tax	42,045
Interest expense	, (2,000)
Earnings before tax	40,045
Income tax expense	(12,014)
Net Income	28,031
Earnings per Share	$ 4.68

Requirement 4: Prepare an IFRS based Statement of Comprehensive Income for the 2017 calendar year. (This statement should be presented as a stand-alone statement).
3 Answers- 2 point each.

Answers 1, 2 and 3: Correctly present: 1-the gain on revaluation of $10,000, 2-the income tax expense of $3,000 related to this revaluation gain, and 3- the Total Other Comprehensive Income of $7,000 on the Statement of Comprehensive Income for the calendar year 2017.

J&H Corp.
Statement of Comprehensive Income -IFRS Basis
For the Year Ended December 31, 2017
(In 000's)

Net Income	28,031	
Other Comprehensive Income:		
Gain on revaluation of assets	10,000	(2 points)
Income tax expense relating to revaluation gain	(3,000)	(2 points)
Other Comprehensive Income	7,000	(2 points)
Comprehensive Income	35,031	

Requirements 5 and 6 are for Graduate courses only.

Requirement 5: Describe the difference in these terms associated with IFRS - Adoption, Convergence, Endorsement and Condorsement.
4 answers**-**3 points each.

Answers:
1-a correct description/definition of Adoption; (3 points).
2-a correct description/definition of Convergence; (3 points).
3-a correct description/definition of endorsement; and, (3 points)
4-a correct description/definition of Condorsement. (3 points)

Please see the answer key for the recommended answers.

***Requirement 6**: Prepare* a written report on the outlook of IFRS adoption in the USA, referencing at a minimum, the most current SEC position.
1 Answer- 4 points.

Answer: Reference should be made to the July 13, 2012 SEC report and its implications of IFRS adoption in the USA going forward.

The SEC has given no timetable for further review of IFRS and noted that there were "significant gaps" between IFRS and US GAAP. The report further notes "the resolution of these differences will be individually challenging, and any attempt by the SEC or others to resolve these differences in a period even as long as five to seven years may prove to be difficult". (1) (Page 14, July 2012, SEC report). (4 points).

Student Feedback and Classroom Validation

Students in two graduate accounting courses; Financial Statement Analysis and Financial Accounting Theory completed the case and the following survey. The results appear below.

A. Graduate Student Experience Questionnaire: J&H Corp Case.
On a 1- to 5-point scale, with I being Strongly Disagree with the statement and 5 being Strongly Agree with the statement.

Survey Questions

	Weighted Mean
This case greatly increased my knowledge of IFRS treatment of:	
LIFO Inventory	4.27
Capitalization of Development Costs	4.27
Asset Revaluation	4.64
Asset Componentization	4.45
Impairment Losses	4.09
Reversal of Impairment Losses	4.36
Loss Contingencies/Uncertain Tax Positions	4.25
Restructuring Costs	4.64
I found this case interesting.	4.36
This case was a positive learning experience.	4.44
I would recommend the use of this case in future offerings of this class.	4.45
The level of difficulty present in the case was appropriate for the course.	3.72
Overall, I felt the case was helpful.	4.64
Overall, the case helped me to gain a better understanding of the differences between IFRS and U.S. GAAP.	4.55

What was the benefit of this case assignment?

"This case study was a true learning experience as I found the differences between US GAAP and IFRS. It really made me do tons of research to learn the accounting practices of the future. That being said, I heartily recommend this case study."

“The case was a little difficult for me but it was helpful.”

“I currently work as an accountant and am currently studying for my CPA exams while I finish my MBA. This case has been helpful as we are forced to explore IAS/IFRS and the CPA exam is incorporating more and more IAS/IFRS every year. I honestly do not believe this will help me in my current job but this case certainly related to what I have been studying for the CPA exam and helped to put some things in perspective as I just study the same Becker over and over”.

Student reaction to the case was very positive, as 91% found the case to be a good learning experience. They did find the case challenging and this prompted the authors to make some revisions to the case. Specifically, we eliminated coverage of an impairment loss for actively traded intangible assets. Given the uniqueness of such a situation, we eliminated it from the case study with the goal of having the student spend time studying on more common situations where IFRS and US GAAP differ. Specifically this was eliminated from the case study: 8-In 2015, there was impairment loss on the New York Stock Exchange seat for $100.This was the only impairment

realized since its purchase in 2013 for $4,000. As of 12/31/2017, the fair value of the NYSE seat is $4,200. Furthermore, there is an active, traded market for this intangible asset.

2. Students in one undergraduate accounting course- Intermediate Accounting 11 completed the case and the following survey. The results appear below.

B. ***Undergraduate Student Experience Questionnaire: J&H Corp Case.***
On a 1- to 5-point scale, with I being Strongly Disagree with the statement and 5 being Strongly Agree with the statement.

Survey Questions

	Weighted Mean
This case greatly increased my knowledge of IFRS treatment of:	
LIFO Inventory	4.50
Capitalization of Development Costs	4.62
Asset Revaluation	4.50
Asset Componentization	4.38
Impairment Losses	4.50
Reversal of Impairment Losses	4.37
Loss Contingencies/Uncertain Tax Positions	4.50
Restructuring Costs	4.50
I found this case interesting.	4.75
This case was a positive learning experience.	4.37
I would recommend the use of this case in future offerings of this class.	4.63
The level of difficulty present in the case was appropriate for the course.	4.38
Overall, I felt the case was helpful.	4.50
Overall, the case helped me to gain a better understanding of the differences between IFRS and U.S. GAAP.	4.68

What was the benefit of this case assignment?

"The experience the J&H case delivered was beneficial in many ways. This case allowed for a much better understanding of GAAP and IFRS. The topic is growing in importance, as well as complexity. As I prepare for the CPA exam, this case couldn't have come at a better time. Being able to allocate the proper time to such a complex subject has given me a major advantage moving forward. The one aspect that stands out for me was the structure. The professor provided us with detailed relevant information that kept the case challenging, but also provided us with some support. Having the proper resources available and how well the information related to each is really what made this such a valuable learning experience for me".

"The case helps to clearly distinguish the differences in the accounting practices between US GAAP and IFRS. It enhanced my knowledge on adjustments to be made in the accounting statements when converting from US GAAP to IFRS".

"This case helped me to know more about IFRS. I came to know about the impairment loss, Loss Contingencies, Reversal of Impairment Losses, Restructuring Costs, it is a good learning process".

"This case study was well written and challenging. As accounting students, it gave us the ability to research additional information on GAAP vs IFRS rules and principles. The case was helpful due to the fact that it gave us a better understanding on what to expect on the CPA exam. The case had real life simulations, which we will face in the future due to the rapid globalization of international business".

"This case had many benefits however the greatest benefit was the ability to get a better understanding of U.S. GAAP versus IFRS. The case taught me that there are several differences with handling simple accounting procedures. It also demonstrated that there are different thresholds for different items and different constraints for the two different accounting styles. I do believe this case was beneficial and it helped me gain greater knowledge regarding the proper ways to handle IFRS and the IAS".

All of the students found the case study helpful and stated that this case study increased their knowledge of IFRS, and many students stated that this case study will help them in their future.

Student reaction to the case was completely positive, as 100% found the case to be a positive learning experience. They did find the case challenging and this prompted the authors to make some revisions to the case. Specifically, the requirements for the case were reduced at the undergraduate level to include assignments 1 to 4 only, and requirements 5 and 6 were eliminated. We believe that requirements 1 to 4 are essential for students to obtain adequate IFRS literacy, while requirements 5 and 6 can be eliminated without adversely affecting this understanding. It is important to also point out that requirements 1-4 require much in the way of written communication; a necessary skill for the accounting practitioner.

Conclusion

Presently, over 100 countries worldwide have adopted IFRS, or a close variation of its financial reporting framework. Yet others (i.e. China, India) have committed to IFRS convergence in future periods. Much of this momentum towards mandatory IFRS use has been manifested in the last five to seven years.

Today, all financial professionals can expect the utilization of IFRS at some point in their career. It is beneficial therefore for every student in the US to obtain IFRS literacy during her college career.

Although not on the SEC's current radar screen, the debate and continued possibility of US convergence to IFRS will remain an important topic in the business literature. It will continue to draw attention from its many constituents. Going forward, the possibility of complete or partial adoption of IFRS in the US, or the continuation of further convergence projects aimed to reduce major differences between the two groups, remain as available and viable options for our policymakers.

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ASC Numbers: 220, 330, 350, 360, 420, 450, 730, 740, 985.

IAS Numbers**:** 1, 2, 12, 16, 36, 37, 38.

ASC Numbers: 220, 330, 350, 360, 420, 450, 730, 740, 985.

	ASC Numbers:	IAS Numbers:
1-Inventory	330	2
2- R and D (computer software)	730,985	38
3-Property, Plant and Equipment	360	16
4-Intangible assets	350	38
5-Asset Impairments	350	36
6-Liability Contingencies	450	37
7-Exit/Disposal Restructuring costs	420	37
8-Component Depreciation	360	16
9-Income Taxes	740	12
10- Statement of Comprehensive Income	220	1

Biography

Peter Harris is a Professor and Chair of the Accounting and Finance department at the New York Institute of Technology. Previously, he has worked for Ernst and Young LLP. He is an author of over 100 refereed journal articles and has over 200 intellectual contributions. He serves on six editorial boards and is an ad hoc reviewer for several Cabell listed journals. He has presented and continues to present seminars on topics relating to financial

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Bill Stahlin is an Affiliate Associate Professor at Stevens Institute of Technology. He has over 30 years of teaching experience and 10 years in public accounting. He is both a CPA and CGMA. He is the mid -Atlantic regional coordinator for the American Accounting Association's teaching, learning and curriculum section. He's made numerous presentations on teaching pedagogy and co-authored an instructor training course while at Coopers & Lybrand. He can be reached at the Howe School of Management, Stevens Institute of Technology, Hoboken, NJ 07030 or wstahlin@stevens.edu.

Teaching Notes and Suggested Solutions

This suggested answer key is a recommended solution. As with all case studies, differing solutions may earn full credit based on assumptions and interpretations. This is especially true when dealing with IFRS, where making judgments rather than following prescribed rules are essential.

Requirement 1:
For each of the items above, #1 to #8, refer to professional pronouncements and identify the differences between US GAAP and IFRS and their effect on the Statement of Income. Then prepare the required compliant journal entries to adjust the Statement of Income to an IFRS basis.

1) LIFO Inventory

As LIFO is not permitted under IFRS (IAS 2), the FIFO or weighted average method must be used. We will use the FIFO method because of the information available. The difference between the LIFO and FIFO cost of goods sold for 2017 will equal the change in the LIFO Reserve during the year (end of year less beginning of year LIFO reserve).

In this case, the difference will result in a decrease in cost of goods sold of $3,000 as a result of the increased change in the LIFO Reserve ($7,295 less $4,295).This can be illustrated by the following inventory formula which clearly illustrates a decrease in cost of goods sold from LIFO reporting of $297,000, to FIFO reporting of $294,000, resulting in an increase to gross profit (income before tax) of $3,000.

	LIFO	LIFO Reserve Adjustment	FIF0
Beginning Inventory	50,000	4,295	54,295
+Cost of Goods Manufactured	402,000		402,000
Total Inventory Available for sale	452,000	4,295	456,295
Less: Ending Inventory	(55,000)	7,295 (4,295 +3,000)	(62,295)
Cost of Goods Sold	397,000	(3,000)	394,000

The IFRS compliant journal entry is:

A) Dr. Inventory 3,000
  Cr. Cost of goods sold 3,000

Additionally, there is another compliant journal entry (not required for this case) that affects several balance sheet accounts. There will be another increase in FIFO inventory to reflect the beginning of year LIFO reserve of $4,295, bringing a total increase in inventory to $7,295. An increase in Retained Earnings of $3,006.5 will result, which will equal the net of tax effect of the beginning of year LIFO Reserve ($4,295 times the after tax rate of 70 percent; 100 less 30 percent tax rate). Finally, a corresponding increase in the Deferred Tax Liability account is also created for $1,288.5, which will equal the $4,295 beginning of year LIFO Reserve times the tax rate of 30 percent.

The compliant Balance Sheet journal entry is (not required for this question):

B) Dr. Inventory	4,295	
Cr. Deferred income taxes payable		1,288.50
Cr. Retained earnings		3,006.50

Notes for Instructor:
There is an inverse relationship between ending inventory and cost of goods. When ending inventory increases (decreases), cost of goods sold decreases (increases). This is an important relationship to emphasize, as students may have difficulty in reporting the $7,295 FIFO increase.

It may also be helpful to point out that LIFO Reserve increases this year will be reported on the income statement, while increases from prior periods (i.e. the Beginning LIFO reserve), will be reported on the balance sheet as an increase in retained earnings. With the increase in retained earnings, a deferred income tax must be recognized.

IFRS (IAS 12) requires that all deferred taxes be reflected as non-current; whereas under US GAAP (ASC 740), the classification is dependent on the account creating the deferral (i.e. a non-current (current) account creates a non-current (current) deferred tax asset/liability).

2) Loss Contingencies
Both, US GAAP and IFRS record a contingency loss when the liability is deemed to be "probable". The definition of probable however differs between the two regimes. Per IAS 37, IFRS defines probable as "more likely than not to occur" (i.e. greater than a 50 percent probability of occurrence), whereas under ASC 450, US GAAP defines probable as "the future event or events are likely to occur." "Likely" is considered a higher threshold than "more likely than not," meaning US GAAP has a higher recognition threshold than does IFRS. The effect of this difference is that, under IFRS, a liability often will be recognized earlier than under US GAAP". (3) (Page 15, July 2012 SEC report). In this situation, the loss is recorded for IFRS purposes only.

In this case, expert legal consultants consider the likelihood of the liability payout at 52 percent, which makes it "likely" for IFRS purposes, but not for US GAAP purposes. As such this contingency is recognized under IFRS.

The IFRS compliant journal entry is:

C) Dr. Contingency Loss	7,370	
Cr. Contingency Liability Payable		7,370

3) Asset Revaluation
US GAAP-ASC 360 requires the cost model in the valuation of Property, Plant and Equipment (cost less accumulated depreciation)**.** Per IAS 16, IFRS requires the use of the cost model in the year of asset acquisition, but permits the choice of the cost model or an alternative, called the revaluation model in subsequent periods. Under the revaluation model, a company may opt to value Property, Plant and Equipment within an asset class at its fair value (less accumulated Depreciation/Amortization), through comprehensive income (i.e. Dr. PP&E-carrying value and Cr. Other Comprehensive Income- Revaluation Surplus).

A requirement for the use of the revaluation model is the ability to obtain a reliable measure of fair value .This essentially disqualifies intangible assets from the use of this method (discussed later in detail). Regular revaluation of assets to fair value within each elected class is required once the revaluation model is chosen. In no circumstance may Property, Plant and Equipment be written above its carrying value under US GAAP. The results of the revaluation model will be increased future asset carrying values.

Intangible Assets

Although IFRS allows for the revaluation of intangible assets (excluding Goodwill), such revaluations are rare, and only permitted in very restricted circumstances-namely if there is a quoted market price for the intangible asset (such as a stock exchange seat, taxi medallion or milk quota). In the rare case of intangible asset revaluation, such revaluation must be made for a class of intangible assets, and subsequent revaluations to fair value must be made on a regular basis.US GAAP prohibits intangible asset revaluation, and in no case may intangible assets be written above their carrying value.

In this case study, the company has elected to re-value the Buildings asset class only. The fair value of the Buildings is $35,000; a $10,000 increase above its carrying value. This revaluation gain will be reflected as: Other Comprehensive Income on the Income Statement, and reported as: Accumulated Other Comprehensive income-Revaluation Surplus (part Shareholders' Equity account) on the Balance Sheet.

There are two acceptable revaluation methods under IFRS.
The first method is the proportionate restatement method**.** Using this method, the write-up to fair value includes a pro-rata increase of both; the gross value and accumulated depreciation of the asset. The accumulated depreciation is restated proportionately with the change in the gross carrying value of the asset, so that the net carrying value of the asset after revaluation will equal its revalued amount. It should be noted that the gross value of the assets may or may not be the same as its historical cost. They will be the same only if; 1- a company utilizes the cost model to report the assets, and, 2- there has not been any impairment on the assets. If both of these conditions are not met, these amounts will differ.

The IFRS compliance journal entry will pro-rate the revaluation gain for the buildings of $10,000, between the gross asset and accumulated depreciation accounts by the following sequence: Step 1-calculate the ratios of the carrying amount and the accumulated depreciation of the asset with respect to the gross amount of the asset; the sum of the carrying value asset ratio plus accumulated depreciation ratio will equal 100 percent;
Step 2- divide the carrying amount ratio calculated above into the revaluation gain; this represents the pro-rata increase in the gross asset , and is Debited (Dr.) to the asset account; a credit (Cr.) is also recorded to Other Comprehensive Income-Revaluation Surplus for the revaluation gain; and, 3-take the dollar addition to the gross asset amount calculated in step 2 , and multiply this by the accumulated depreciation ratio calculated in step 1; this represents the pro-rata increase in the accumulated depreciation amount ,and is credited (Cr.) to the accumulated depreciation-asset account.

In this case: the buildings and accumulated depreciation accounts have the following ratios; $25,000/40,000, or 62.5% for buildings, and $15,000/40,000=37.5% for accumulated depreciation; 62.5% divided into $10,000 = $16,000, this represents the pro-rata increase to –Buildings (gross amount); and, 37.5 % X 16,000=$6, 000, represents the pro-rata increase to accumulated depreciation-buildings.
The IFRS compliant journal entry is:

D.1)	Dr. Property, Plant and Equipment -Building,	16,000	
	Cr. Accumulated Depreciation-Building		6,000
	Cr. Other Comprehensive Income –Revaluation Surplus		10,000

The second method presents the new gross and carrying value of the asset in an amount equal to its revaluation amount-the Depreciation elimination method. Under this method, the accumulated depreciation will first be eliminated against the gross carrying amount of the asset itself, followed by the restatement of the gross and carrying value of the asset to its revalued amount.

This is done by 1: zeroing out/eliminating the accumulation depreciation account –this will result in a debit entry (Dr,) to Accumulated Depreciation; 2-making the gross amount of the asset equal to its revaluation amount-this will

result in either a debit (Dr.) or credit (Cr.) entry to the Asset; and 3-record the revaluation gain to Other Comprehensive Income-Revaluation Surplus-this will result in a credit (Cr.).

The compliant IFRS entry if this method were used is as follows:

	Dr.	Cr.
D.2) Dr. Accumulated Depreciation-Property, Plant and Equipment-Building	15,000	
Cr. Other Comprehensive Income-Revaluation Surplus		10,000
Cr. Property, Plant and Equipment-Building		5,000

The carrying account for Building will be shown at its revalued amount of $35,000 on the Balance Sheet regardless of the chosen method as presented below:

Method:	1- Proportionate restatement method	2-Depreciation elimination method
Building	56,000 = (40,000 plus 16,000)	(40,000 less 5,000) = 35,000
Less: Accumulated Depreciation	(21,000) = (15,000 plus 6,000)	(15,000 less 15,000) = 0
Carrying value =revaluation amount	35,000	35,000
		(Gross value=carrying value)=Revaluation amount

4) Investment Property:

"Under IFRS-IAS 40, an entity can also make an election to adopt either the fair value model or the cost model to account for investment properties. US GAAP generally allows for the cost model, unless the entity meets certain criteria. The optionality permitted under IFRS could result in significant differences in the carrying value of assets as compared to US GAAP." SEC July 13, 2012 report, pages 15 and 16.

5) **Depreciation Expense : Asset Componentization**

"Under IFRS-IAS 16 , each part of an item of Property, Plant and Equipment with a cost that is material in relation to the total cost of the item is required to be depreciated separately (i.e., as if each part was a separate asset-"a practice commonly known as asset componentization''). SEC July 13, 2012 report, page 17. For asset componentization to apply, the parts/components have to have different life expectancies.
As an example, a home can be viewed as having multiple asset parts, each having its own estimated useful life. The doors and windows may have a 10 year estimated useful life, whereas the roof and the boiler may have a 20 year estimated useful life and the electrical and plumbing parts may have a 25 year estimated useful life. Each material component part is depreciated as if it a separate asset, and this summation will equal the home's depreciation expense for the year. "Under US GAAP, an item of PP&E that has multiple parts is generally depreciated over a useful life attributed to the item as a whole. The report further adds that "this approach is not precluded from use under US GAAP; however, the Staff understands it is not an approach commonly applied currently by US issuers. Further, the Staff notes that this approach can significantly impact issuers upon application of IFRS". SEC July 13, 2012 report, page 17.

In this case, the machinery has two components-the engine which represents 30 percent of the machinery and has a 5 year estimated useful life with no residual value, while the rest of the machine has a 10 year useful life with no residual value..

Under IFRS, the depreciation expense will equal:

1- Transportation Equipment: $20,000/10 years = 2,000
2- Machinery : 70 percent X $60,000=42,000/10 years = 4,200
   Plus 30 percent X $60,000 =18,000 /5 years = 3,600 (7,800 for machinery)
3- Buildings : $40,000/40 = 1,000
   Total depreciation expense: IFRS $10,800

Under US GAAP, depreciation expense equals $9,000, ($20,000/10=2,000 for Transportation Equipment +60,000/10=6,000 for Machinery + 40,000/40 =1,000 For Buildings); versus $10,800 under IFRS. This will exceed US GAAP calculated depreciation expense by $1,800-which is composed solely of the added depreciation in the Machinery (7,800-6,000).

The IFRS compliant journal entry is:

	Dr.	Cr.
E) Dr. Depreciation Expense-Machinery	1,800	
Cr. Accumulated Depreciation-Machinery		1,800

6) Impairment Losses

Both US GAAP (ASC 360.10) and IFRS (IAS 36) require recognition of asset impairment for Property, Plant and Equipment as well as for Intangible Assets. The initial step in the impairment process is the review requirement, which is similarly defined under both regimes. Indefinite life assets (i.e. Goodwill) must be reviewed at least annually for impairment and more frequently if impairment indicators exist. For limited life assets (i.e. PP&E, patents), the review for impairment needs to be made only when indicators of impairment exist.

IAS 36.12 provides some indicators of impairment as follows:
External sources include: market value declines; negative changes in technology, markets, economy, or laws; increase in market interest rates, and net assets of the company higher than market capitalization. Internal sources include: obsolescence or physical damage; asset is idle, part of a restructuring or held for disposal; and worse economic performance than expected. IAS 36 also states: "These lists are not intended to be exhaustive. Further, an indication that an asset may be impaired may indicate that the asset's useful life, depreciation method, or residual value may need to be reviewed and adjusted. "According to Ernst and young.com/ifrs vs US GAAP, such indicators are similarly defined under both standards.

Test for Impairment and Measurement of loss (if applicable)

Testing for impairment and the measurement of the loss (if applicable) differs between the two regimes. Under ASC 360, US GAAP uses a two-step criteria; the first step determines if there is impairment, and if so, follows with the second step which measures the loss. Specifically, the first criteria tests for impairment by comparing the asset's carrying value with the undiscounted cash flows the asset is expected to generate over its useful life. If the undiscounted cash flow is greater than or equal to the carrying value of the asset, there is no impairment, and thus no need to move to the second criteria. If this undiscounted cash flow however is less than the carrying value of the asset, impairment exists and we move to the second criteria which measures the loss. Impairment loss will equal the difference between the carrying value and the lower fair value of the asset (present value of the asset's future cash flows can be used if the fair value of the asset is not determinable; in which case a company specific discount rate is used in this calculation; such as the entity's incremental borrowing rate or its cost of capital).

Under IFRS-IAS 36, impairment loss has a one test criterion, and is calculated by comparing the carrying value with the recoverable value of the asset. If the carrying value of the asset is greater than its recoverable value, an impairment loss exists by this differential; otherwise (i.e. if recoverable value is equal to or greater than the carrying value of the asset), there is no impairment. Recoverable value is the higher of net realizable value (sales price less the cost to dispose the asset), or its value in use (present value of the asset's expected future cash flows).

In measuring value in use, the discount rate used to calculate the present value of the asset's future cash flows per IAS 36.55, is a market-determined asset-specific pre-tax rate. It should equal a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the asset (i.e. risk free interest rate plus asset specific risk premium. In cases where a market-determined asset-specific rate is not determinable, IAS 36.57 requires the use of an entity specific discount rate, including, but not limited to; the entity's own weighted cost of capital, the entity's incremental borrowing rate, or, other market interest rates (such as the yield on a corporate bond that has a similar credit rating to that of the entity) should be considered.

Recognition of impairment loss

Impairment loss is reported in the operating income section of the Profit and Loss Statement of Income, as Other Income (Loss).This is consistent between the two regimes.

Exit value

Also of importance, is that fair value measurement under both regimes is consistently applied as an "exit" value, in accordance with ASC 820.

In this case, the company has been unsuccessful in defending its patent; clearly an indicator of impairment. Under US GAAP, a two test criteria is applied as follows:

Test 1- Is there an impairment loss?

To answer this question, we measure the carrying value of the patent-in this case $6,000-with the undiscounted cash flows the patent is expected to generate in the future; which will equal $3,100 per year for 2 years, or $6,200. Since the undiscounted cash flow is greater than its carrying value, there is no impairment, and there is no need to move to the second test which measures the impairment loss.

Under IFRS, the one test criterion measures the carrying value of the patent -$6,000 versus the recoverable value; which is the higher of net realizable value (sales price less disposal costs) of $5,500, or its value in use, which equals the present value of the asset's future cash flows of $5,453 ($3,100 per year for 2 years discounted at 9 percent). The 9 percent represents the pre-tax market-determined asset-specific discount rate, and is used here to discount the cash flows to its present value. The impairment loss is the excess of carrying value of $6,000 less the recoverable value of $5,500 (higher of $5,500 net realizable value or value in use of $5,453), or $500, leading to the adjusting IFRS compliance journal entry as follows:

F) Dr. Impairment Loss-Patent 500
Cr. Patent or Accumulated Amortization-Patent 500

Finally, J&H should also change the estimate of the patent's useful life from 3 years to 2 years. This represents a change in accounting estimate which affects current and prospective financial statement reporting periods. (Per the facts and for simplicity purposes, this accounting change will affect future periods only).Thus for next year (assuming no other changes to the Patent account), the amortization expense will equal $5,500 divided by 2=$2,750.

7) Reversal of Impairment Losses

Under IAS 36, IFRS requires reversal of impairment losses for all tangible and intangible assets, but not for Goodwill. Management assesses at each reporting period whether there are indicators that the impairment loss has been decreased. If so, the reversal of the loss, up to its new recoverable amount, not to exceed what the asset would have been carried at present if the impairment had not been previously recognized, is recorded as a gain in the profit or loss segment of the Income Statement; unless it relates to a revalued asset. Any excess amount is part of Comprehensive Income.

The result of the reversal of impairment loss is an increased carrying value on the Balance Sheet, and future increases in depreciation expense amounts.US GAAP does not allow for the subsequent reversal of an impairment loss on all tangible and intangible long term assets.

The SEC report expresses concern with this reversal process-which adds to the potential of "earnings management", and states: "US issuers could experience volatility if the IFRS models were incorporated (flowing from recoveries of values previously written down)". SEC July 13, 2012 report, page 15.

8) Uncertain Tax Positions

Under ASC 740-10-25, US GAAP "rules based" ("bright-line rules") criteria require a two-step process in the recognition of uncertain tax positions. The first step tests for recognition, and if met, the second test measures the

amount. Recognition is met if it is "more likely than not" that the tax position will be sustained based on the facts and merits of the case. Detection risk is precluded from this analysis. If there is more than 50 percent likelihood that the benefit/loss will be realized, recognition will equal the largest amount of the benefit/loss expected to be realized. In this scenario, since loss recognition is gauged at less than 50 percent (40%), no recognition for this uncertain tax position is recognized.

IFRS on the other hand does not provide specific guidance in many areas, and therefore lends itself on judgment calls based on the facts and circumstances of a specific scenario. This is commonly termed as a "principles based" approach. IAS 12 best exemplifies this philosophy, as IFRS does not specifically address the accounting for tax uncertainties. IAS 12 states that tax assets and tax liabilities should be measured at the amount(s) expected to be received/paid; thereby allowing for varying approaches in its measurement. In this circumstance, some IFRS registrants use a two-step approach similar to US GAAP, as discussed above, which will result in a zero expense and no liability. Others find that an uncertain tax liability falls under the umbrella of a contingent liability, thereby requiring the application of IAS 37. As previously discussed, IAS 37 recognizes a liability if it probable that an outflow of economic resources will occur. Probable is defined as "more likely than not ", meaning that the application of IA 37 would not result in a tax liability in this case. Alternatively, one may apply a single step approach in such situations. A single step approach will recognize uncertain tax positions at an expected value. In this scenario, the expected value of the uncertain tax expense/liability will equal $5,500 times 40 percent, or $2,200. Finally, one may consider detection risk in this analysis, further creating another possibility, which will equal the $2,200 times the 30 percent detection risk, or $660. In this case, the ladder amount has been chosen and recorded as the uncertain tax position expense/liability, leading to the following IFRS compliant journal entry:

G) Dr. Income tax expense	660	
Cr. Income Tax payable-current		660

The implications as discussed above are as follows:
1-Different potential answers exist under principles based IFRS, as not all accounts have clear literature guidance. IAS 12 is one example of undefined accounting guidance.
2-This leads to greater judgment under IFRS, which comes from both; internal sources (management), as well as external sources (such as from Independent Auditors).
3-Potentially, various accounting results will occur as registrants will formulate differing opinions and judgments, which will be based on the same set of facts and circumstances.
4-The result is voluminous amounts of disclosure under IFRS, which is required to corroborate the accounting treatment for many of its financial reporting assertions**.**

9) **Restructuring/Exit or Disposal Costs**

Per US GAAP, ASC section 420 Accounting for Costs Associated with Exit or Disposal Activities, requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment or announcement. Examples of costs covered by the standard include lease termination costs, retirement of assets, and employee severance costs that are associated with the restructuring, plant closing or other exit or disposal activity. Linda A. MacDonald, FASB Project Manager, stated the following in the passage of this standard: "Liabilities represent present obligations to others. Because a commitment to a plan, by itself, does not create a present obligation to others, the principal effect of applying Statement will be on the timing of recognition of costs associated with exit or disposal activities. In many cases, those costs will be recognized as liabilities in periods following a commitment to a plan, not at the date of the commitment." News Release, Norwalk, Connecticut on FASB 146, now ASC 420 on July, 30, 2002. As such, in this scenario, the restructuring costs for US GAAP presentation are recorded as an expense at the times of occurrence- $7,500 in 2016 and $7,500 in 2017.

Under IAS 37, exit costs (other than employee benefits) are recognized when a constructive obligation exists as demonstrated by (1) the existence of a detailed, formal plan and (2) implementation of the restructuring or announcement of the plan to those affected by the plan. Closure of Business Locations is covered under the broad heading of Restructuring per IAS 37.70. Specifically, IAS 37.72 states: Closure or Reorganization: recognize a

provision only after a detailed formal plan is adopted and has started being implemented, or announced to those affected. A board decision of itself is insufficient. A formal plan is one that is "demonstrably committed" (that is a legal or constructive obligation) to a detailed exit plan (Ernst and Young.com/ifrs).

As such, there is some latitude in this area under IFRS reporting, as the entire $15,000 restructuring expense can be recorded in 2015 when the existence of a detailed formal closure plan was adopted and demonstrably committed (that is a legal or constructive obligation to a detailed exit plan), and the related announcement was made to those affected; or in 2016 after the detailed closure plan was adopted and demonstrably committed, and the plan started being implemented. "The effect of this difference is that, under IFRS, a liability often will be recognized earlier than under US GAAP. July 13, 2012 SEC report, page 15.

The accounting reporting results for the respective regimes are as follows:

	Restructuring Expense		
	US GAAP	**IFRS**	
2015	0	15,000	in 2015–Committed plan and announcement date
2016	7,500		or in 2016-Implementation date and committed plan
2017	7,500	0	
Total	15,000	15,000	

One should note that as of 12/31/2017 the Retained Earnings and its related income tax account are correct under both regimes as the entire $15,000 restructuring cost has been recorded by this date. (The timing effects of recording the expense in different periods have been rectified on J&H's balance sheet as of 12/31/2017.
Since IFRS recorded this expense in full prior to 2017 a necessary compliant entry needs to be made to reflect this, which will reduce restructuring expense to $0 for 2017.This will result in a credit to Restructuring Expense for $7,500. The effect of this credit however is to increase the "correct" income tax payable-current account by $2,250 (30 percent tax rate times 7,500), and the "correct" retained earnings account by $5,250 (the net of tax amount-7,500 times 70 percent).

As a result, a reduction (Debit) in these two accounts is needed to restore the income tax payable-current, and retained earnings accounts back to their corrected balances.

The IFRS compliant journal entry as such is:

(H) Dr. Retained Earnings	5,250	
Dr. Income tax Payable-current	2,250	
Cr. Restructuring Expense –Loss from restructuring		7,500

Notes for Instructor:

Due to the difficulty and pervasiveness of the net of tax concept as to income/gains and expenses/losses, now may be a good time for its review with the class. Several examples of its application include; intraperiod tax allocation requirement for separately reported income statement items; such as discontinues operations and extraordinary gains (losses), which are reported as net of tax amounts; prior period adjustments to the retained earnings account which are reported as net of tax amounts, and interest expense (cost of debt), which is a net of tax amount (due to the income tax deductibility of interest expense).

10) Development Cost

Consistent with US GAAP, IFRS requires that all research costs are charged to expense in the period incurred (ISA38.54). However IAS 38.57 requires the capitalization of development costs (recorded as an intangible asset) only after technical and economically feasibility of the asset for sale or use has been established (i.e. a commercially viable product).

The six specific requirements for capitalization of development costs under ISA 38.57 are; 1-the reporting entity's technical ability of completing the product development ;2--the reporting entity's intention to complete the project; 3-the reporting entity's ability to use it or sell the product; 4-the reporting entity must be able to demonstrate how the asset will generate future economic benefits.;5-the reporting entity's availability of adequate technical, financial and other resources to complete the development project; and 6-the reporting entity's ability to measure the expenditure related to the intangible asset during its development.

US GAAP treatment of Development Costs:

With the exception of capitalizing development costs purchased as a result of corporate acquisitions , and for computer software products (only if specific criteria are met), US GAAP requires that development costs be expensed in the period incurred. Under US GAAP (ASC 985), the costs incurred in researching and developing a software product for sale is charged as an expense until technological feasibility has been established for the product, at which time such costs are capitalized.

In this case, all of the requirements per IAS 38.57 are satisfied; first, technical and economic feasibility was established on January 1, 2017 next, the company intends to complete the product development and has the technical feasibility and economic resources to do so. Additionally, J&H can easily demonstrate that the project will generate future economic benefits as it presently sells specialty vitamins at an available market at a 28 percent gross profit percentage, and this new product- The Essential Omega 3 Vitamin is expected to be their best-selling item after its development. Lastly, J&H can measure the expenditure related to the intangible asset during its development stage. As a result, J&H is required to capitalize the $2,500 development costs incurred in 2017

Two IFRS compliant entries are required; the first is to capitalize $2,500 of development costs as an Intangible Asset on the Balance Sheet, and the second is to amortize this asset over a 10 year period using the half year convention; straight line method ($2,500/10 = 250 Divided by 2; equals $125).

The IFRS compliance journal entries are as follows:

I) Dr. Intangible Asset-Development Costs	2,500	
Cr. Selling and Administrative Expenses		2,500
J) Dr. Amortization Expense –Development Costs	125	
Cr. Accumulated Amortization-Development Costs		125

Requirement 2:

Using the template below, prepare a US GAAP to IFRS Net Income Reconciliation based on your findings in 1 above:

Income before Tax –US GAAP	$37,500
Adjustments: Addition (subtraction)	
(1)	
(2)	
Etc.	
<u>Total Adjustments</u>	
Income before Tax-IFRS	
<u>-Income Tax Expense (30%)</u>	
Net Income – IFRS Basis	

US GAAP to IFRS Income Reconciliation

Income before Tax –US GAAP		37,500	
Adjustments:			
	(A)	3,000	Cost of Goods Sold
	(C)	(7,370)	Contingent Liability Loss
	(E)	(1,800)	Added depreciation expense relating to Asset Componentization
	(F)	(500)	Impairment Loss to Patent
	(G)	(660)	Uncertain Tax Position Loss
	(H)	7,500	Reversal of Restructuring/Exit or Disposal Costs
	(I)	2,500	Capitalization of Development Costs
	(J)	(125)	Amortization Expense relating to Capitalized Development Costa
Total Adjustments		2,545	
Income before Tax-IFRS		40,045	
Income Tax Expense (30%)		12,014	
Net Income – IFRS Basis		28,031	

Under IFRS, there is an increase in income before tax of $2,545, resulting in an increased income tax expense of $763.5 (tax rate of 30%), and net income amount of $1,781. $1,781.5 plus US GAAP reported Net Income of $26,250, equals IFRS Net Income of $28,031.

Adjusting entries for the income statement (profit and loss statement) (Not required):
Closing entries for the profit and loss Statement of Income: IFRS compliant entry (K):

Dr. Income Summary	2,545	
Cr .Income Tax Payable		763.5
Cr. Retained Earnings		1,781.5

To close out the Income Summary (Profit and Loss Statement) to Retained Earnings and adjust/increase the Income Tax Payable-Current account.

Requirement 3

Based on your answer in #2 above, prepare an IFRS based Statement of Income (Profit and Loss Statement) for the 2017 calendar year.

IFRS prepared Profit and Loss Statement

J&H Corp.
Statement of income-IFRS Basis
For the Year Ended December 31, 2017
(In 000's)

Sales	$ 550,000
Cost of goods sold	(394,000)
Gross Profit	156,000
Operating expenses	(92,500)
Depreciation and amortization expense	(12,925)
Other Income/ (Losses):	
Dividend income	1,100
Interest income	900
Loss on sale of marketable securities	(2,000)
Contingency loss	(7,370)
Accrued income tax expense	(660)
Impairment loss-patent	(500)
Earnings before interest and tax	42,045
Interest expense	(2,000)
Earnings before tax	40,045
Income tax expense	(12,014)
Net Income	28,031
Earnings per Share	$ 4.68

Earnings Per Share: IFRS Basis

Earnings per share= $28,031 divided by 5,990 common shares outstanding in 2017=$4.68.

Requirement 4:
Prepare an IFRS based Statement of Comprehensive Income for the 2017calendar year. . (This statement should be presented as a stand-alone statement).

J&H Corp.
Statement of Comprehensive Income-IFRS Basis
For the Year Ended December 31, 2017
(In 000's)

Net Income	28,031
Other Comprehensive Income:	
Gain on revaluation of assets	10,000
Income tax expense relating to revaluation gain	(3,000)
Other Comprehensive Income	7,000
Comprehensive Income	35,031

IFRS compliant comprehensive income entry L (Not required):

Dr. Revaluation Surplus-Gain on Revaluation of Assets	3,000	
Cr. Deferred Income Tax Payable		3,000

To reduce comprehensive income accounts to reflect the income tax implications (30% of $10,000).

IAS 1 requires a Statement of Comprehensive Income which can be prepared as part of a combined statement of income and other comprehensive income (one statement), or, as a separate, stand-alone statement which is presented immediately after the Statement of Income (profit and loss statement); (two statements). Further, expenses can be classified by function or by nature. US GAAP-ASC 220 is consistent with these requirements, except that expenses are required to be classified by function only (not nature). The income statements prepared above under IFRS are two separate, stand-alone statements. One is a statement of income (requirement 3), using the functional approach of expense classification and the other is a statement of comprehensive income (requirement 4).

Requirement 5:
Describe the difference in these terms associated with IFRS - Adoption, Convergence, Endorsement and Condorsement.

In order to better understand the status of adoption of one set of accounting rules internationally, it is helpful to understand the terms used to indicate the various approaches to adoption of IFRS. Should it be complete adherence to IFRS with the deletion of the local standards or piecemeal adherence to IFRS is the issue to be resolved.

1- Adoption refers to a conversion from local standards to IFRS, without converging them first. Under this approach, US GAAP would no longer exist in the USA, as only IFRS criteria would be observed.

2- Under the convergence approach, jurisdictions do not adopt IFRS as issued by the IASB or incorporate IFRS into their accounting standards directly, according to the SEC staff paper. Instead, these jurisdictions maintain their local standards but make efforts to converge or closely align local standards with IFRS. This will minimize the differences between GAAP and IFRS over time. There are some accountants who believe that it is better to focus on convergence of standards rather than learning the subtleties of the US GAAP versus IFRS differences.

3- Under the endorsement approach, jurisdictions incorporate individual IFRSs into their local body of standards. Many of these jurisdictions use stated criteria for endorsement, which are designed to protect stakeholders in these jurisdictions.

4-The condorsement approach is in essence an endorsement approach that would share characteristics of the incorporation approaches with other jurisdictions that have incorporated or are incorporating IFRS into their

financial reporting systems. However, during the transitional period, the framework would employ aspects of the convergence approach to address existing differences between IFRS and US GAAP. Importantly, the framework would retain a U.S. standard setter and would facilitate the transition process by incorporating IFRSs into U.S. GAAP over some defined period of time (e.g., five to seven years). The condorsement objective would be that a U.S. issuer compliant with US GAAP should also be able to represent that it is compliant with IFRS as issued by the IASB.

The condorsement approach would allow FASB to retain control over US GAAP. It would also mitigate the effort associated with a full scale, mandated switch to IFRS. The condorsement approach moves the SEC away from its originally stated goal of convergence of GAAP and IFRS.

Requirement 6:
Prepare a written report on the outlook of IFRS adoption in the USA, referencing at a minimum, the most current SEC position and its communications made to the business community.

The SEC has given no timetable for further review of IFRS and noted that there were “significant gaps” between IFRS and US GAAP. The report further notes “the resolution of these differences will be individually challenging, and any attempt by the SEC or others to resolve these differences in a period even as long as five to seven years may prove to be difficult”. (1) (Page 14, July 2012, SEC report).

The SEC report appropriately notes that the LIFO inventory method poses a significant hurdle in the IFRS adoption process. The SEC states that LIFO is a tax policy issue; as it is an allowable tax method under the internal revenue code (tax code). The future of LIFO in the United States is dependent on the tax authorities, and will be eliminated for financial reporting purposes only upon the repeal of LIFO for federal and state tax purposes. Continued tax approval of the LIFO method is arguably the single greatest obstacle for any possibility of IFRS convergence in the United States.

Students should research the latest literature regarding adoption or convergence or other approaches to integrating the two reporting standards.

Conclusion

IFRS is the future of worldwide financial reporting and should be included as a major part of any accounting and business curriculum in the United States, as well as the rest of the world. This case illustrates the conversion of a US GAAP basis income statement to IFRS, with the goal of further advancing IFRS literacy in the university setting. In this case study, coverage of IFRS methodology is addressed, and the most likely income statement differences between US GAAP and IFRS are examined. The authors recommend a follow up case study addressing a balance sheet conversion from US GAAP to IFRS, with a critical examination of its financial reporting consequences.

(Note to Instructor)
Included for information purposes are appendices A and B as follows:
Appendix A: Statement of Comprehensive Income Reconciliation: US GAAP to IFRS.
Appendix B: An IFRS prepared Statement of Comprehensive Income (one statement).

Appendix A

Statement of Comprehensive Income Reconciliation: US GAAP to IFRS..

J&H Corp. Statement of Comprehensive Income For the Year Ended December 31, 2017 (In 000's)			
	US GAAP	**Adjustments**	**IFRS Basis**
Sales	$ 550,000		$ 550,000
Cost of goods sold	(397,000)	- (A)3,000	(394,000)
Gross profit	$ 153,000		$ 156,000
Selling and administrative expenses			
(exclusive of amortization and depreciation)	(95,000)	- (I)2,500	(92,500)
Amortization and depreciation expense	(11,000)	+ (E)(1,800)+ (J) (125)	(12,925)
Operating income	47,000	3,575	50,575
Other Income/Loss			
Dividend income	1,100		1,100
Interest income	900		900
Loss on sale of marketable securities	(2,000)		(2,000)
Loss from restructuring	(7,500)	(H) 7,500	0
Loss contingency	0	(C)(7,370)	(7,370)
Tax Expense-previous years	0	(G) (660)	(660)
Impairment loss-patent	0	(E) (500)	(500)
Earnings before interest and taxes	$ 39,500	2,545	42,045
Interest expense	(2,000)		(2,000)
Income before tax	$ 37,500	(K) 2,545	40,045
Tax expense (30 %)	(11,250)	(K) (764)	(12,014)
Net Income	26,250	(K)1,781	28,031
Other Comprehensive Income			
Gain on revaluation of assets	0	(D) 10,000	10,000
Income Tax relating to revaluation gains (30%)	0	(L) 3,000	(3,000)
Total Other Comprehensive Income	0	7,000	7,000
Total Comprehensive Income	26,250	8,781	35,031

Appendix B:

The Statement of Comprehensive Income presented below is a combined statement of income and other comprehensive income (one statement).

J&H Corp.
Statement of Comprehensive Income-IFRS Basis
Year Ended December 31, 2017
(In 000's)

Sales	$ 550,000
Cost of goods sold	(394,000)
Gross Profit	156,000
Selling and administrative expenses	(92,500)
Depreciation and amortization expense	(12,925)
Operating income	50,575
Other Income/ (Losses):	
Dividend income	1,100
Interest income	900
Loss on sale of marketable securities	(2,000)
Contingency loss	(7,370)
Accrued income tax expense	(660)
Impairment loss-patent	(500)
Earnings before interest and tax	42,045
Interest expense	(2,000)
Earnings before tax	40,045
Income tax expense	(12,014)
Net Income	28,031
Other Comprehensive Income:	
Gain on revaluation of assets (net of tax)	7,000
Comprehensive Income	35,031
Earnings per Share	$ 4.68