PEYTON, INC: AN IFRS PROJECT FOR THE FIRST INTERMEDIATE ACCOUNTING COURSE

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March 5, 2012

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INTRODUCTION

In 2008, the Securities and Exchange Commission (SEC) proposed a roadmap to issuing new rules that would require US domestic listed companies to adopt International Financial Reporting Standards (IFRS) by as early as 2014. Last year, the SEC suggested a slight variation on the path that could lead to US Generally Accepted Accounting Principles (GAAP) continuing for the foreseeable future and only gradually, over time, changing in the direction of IFRS. Given the situation, accounting educators who teach financial accounting courses face a major challenge in determining whether, and how, to integrate IFRS content into their courses. This paper offers a project that instructors teaching the first intermediate accounting course can use to give students exposure to IFRS and some of the major differences with US GAAP.

LEARNING OUTCOMES

Through completing this project, students should gain:

(1) A better understanding of the financial accounting and reporting issues covered in the first intermediate course;

(2) A knowledge of the major differences between US GAAP and IFRS requirements for the topics covered in the course; and

(3) Some experience researching issues in the IFRS standards.

STATUS OF IFRS ADOPTION IN THE US

Foreign Registrants

In 2006, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) signed a Memorandum of Understanding (MoU) outlining an agenda of 21 issues for which the two Boards planned to pursue convergence of their standards over the next few years (FASB and IASB 2006). For some issues, the Boards agreed to choose either one side's existing treatment or the other's. For other issues, labeled joint projects, the Boards committed to working together to develop new, highly converged guidance. Seeing significant progress, the SEC moved in late 2007 to eliminate a requirement that foreign registrants using IFRS also supply a US GAAP reconciliation (SEC 2007). With the US GAAP requirement eliminated, such familiar names as BP p.l.c. and Siemens AG now trade in US markets based solely upon IFRS information.

Domestic Registrants

US domestic listed companies hoped for the same opportunity. In late 2008, the SEC proposed a rule that, if implemented, would require domestic registrants to adopt IFRS starting in 2014 and permit a few of the largest ones to elect IFRS reporting even sooner (SEC 2008). In the proposal, the SEC stated a timeframe for making a decision on IFRS adoption of 2011, which corresponded closely to a target date the FASB and IASB had set for completing several of their joint projects.

FASB/IASB Convergence

In 2008, the Boards updated their 2006 MoU (FASB and IASB 2008). With a few agenda items completed, they aimed to finish most of the rest by 2011. This plan proved a bit too ambitious. In a June 2010 progress report, the Boards noted they were on track to finish about half of their agenda by 2011 (FASB and IASB 2010). They settled on a strategy of prioritizing certain of the remaining projects, with the goal of completing them by midyear 2011. These projects included leases, revenue recognition and financial instruments. The IASB Chairman, Sir David Tweedie, hoped he could secure a commitment from the SEC to adopting IFRS prior to leaving his position on June 30, 2011 (Tweedie 2011).

The Boards have struggled to achieve convergence on the priority projects. In addition, stakeholders have expressed concerns with aspects of the exposure documents, particularly those on leases and revenue recognition. The Boards concluded they needed to address these concerns, which meant they would not be able to meet their target date. In November 2011, they issued a revised joint exposure draft on revenue recognition (FASB and IASB 2011). They plan to issue a new exposure draft on leases in the second quarter of 2012. Thus, completion of the priority projects likely has been pushed back to the end of 2012, or even into 2013.

SEC's "Condorsement" Idea

In 2010, the SEC announced a work plan that it intends to follow in forming a decision on IFRS adoption (SEC 2010). The SEC cited as one of two primary decision factors that IFRS exhibit sufficient comprehensiveness, enforceability and comparability to serve as a suitable replacement for US GAAP. It also stated that it wanted to see the priority convergence projects completed.

The SEC has not yet announced a decision on adopting IFRS, but it did offer some insight into its thinking through release of a staff paper in May 2011 (SEC 2011). In the staff paper, the SEC described an approach it is calling "condorsement" and asked interested parties to share their views. Basically, condorsement would combine two approaches that countries have taken to integrating IFRS into their reporting systems, convergence and endorsement.

Regarding the *convergence* aspect, US GAAP would remain for a transition period, and the FASB would continue to function and pursue improvement and convergence of US standards with IFRS. The SEC suggested the transition period could last five to seven years. Regarding the *endorsement* aspect, the US would establish an endorsement process, perhaps managed by the FASB, to review, propose for adoption and adopt any new standards issued by the IASB. The success of an endorsement process would rely, in large part, upon the FASB participating fully in the IASB's due process to ensure that US concerns are considered in the development of new international standards.

If the SEC settles on a path that includes a convergence aspect, the convergence activity likely would shift to being mostly one-sided. Recent comments by IASB officials suggest the IASB will cease working solely with the US once the priority joint projects have been completed (Tweedie 2011; Orlik 2011). By the end of the transition period, US GAAP should be very similar to IFRS. The SEC staff paper points out some differences could remain due to retaining US GAAP for issues where IFRS is silent and to the potential for carve-outs arising through the endorsement process. When the transition period is completed, the SEC could require adoption of IFRS, or simply proceed with the functioning endorsement protocol.

Stakeholder Views on IFRS Adoption

The AICPA surveyed its members in 2011 and found that 53% of the respondents believed the SEC should proceed with requiring adoption of IFRS (AICPA 2011). An additional 23% believed the SEC should permit, though not require, domestic listed companies to use IFRS. A majority of those who favored an SEC decision to adopt IFRS supported a condorsement approach, where further convergence would be achieved before adoption is imposed.

A recent survey of company executives indicates strong support among them as well. A 2011 Grant Thornton survey of CFOs found that 76% believed the US should move to IFRS within the next five to seven years (Grant Thornton 2011). As with the AICPA survey, most of the respondents favoring adoption within five to seven years wanted to see further convergence over that period before adoption is mandated.

Private Companies

For US private companies, the most significant development in relation to IFRS occurred in 2008, when the AICPA recognized the IASB as an approved standard setting body. For private companies, this decision opened the door for them to choose IFRS and have an AICPA member audit, review or compile their financial statements. According to a Deloitte survey of private companies in 2009, 11% of respondents were either using IFRS already or planning to adopt the standards shortly (Deloitte 2009).

In 2009, the IASB released a version of IFRS for small- and medium-sized entities (SMEs), giving US private companies a choice of two IFRS versions to consider. The SME standards are shorter in length, and for many issues, simpler than the full IFRS. Some private companies may object to certain aspects of these standards, such as requirements to immediately recognize actuarial gains and losses and to apply a fair value reporting model to most investments. According to a 2011 Grant Thornton survey of CFOs, just 22% of private company respondents supported replacing US GAAP with the SME standards (Grant Thornton 2011).

IMPLICATIONS FOR ACCOUNTING EDUCATORS

So, how should accounting faculty proceed? The SEC has proposed that US public companies be required to adopt IFRS by mid-decade. It appears to be backpedalling slightly from the proposal by raising the condorsement idea, which would produce a more gradual adopting of specific IFRS requirements within an ongoing US GAAP framework. Add to these developments for public companies that US private companies already have options to use either full IFRS or a streamlined SME version. Accounting faculty have long struggled with how to teach the ever-expanding volume of US GAAP requirements in the intermediate sequence. Now, they have the added challenges of determining whether to integrate IFRS content, and if so, how.

Most intermediate accounting textbooks have taken the approach of adding some IFRS coverage to supplement a continued emphasis on US GAAP. *Intermediate Accounting* (14th edition), by Kieso, Weygandt and Warfield, provides a good example. The authors have added a section at the end of most chapters that they call IFRS Insights. In these sections, they discuss key US GAAP/IFRS differences and offer some questions and problems for students to work. In a textbook of 1,581 pages, the IFRS Insights sections account for 164 pages, or 10% of the total. The AICPA is taking a similar approach with the CPA exam. It began testing IFRS on a limited basis in 2011, while continuing to give primary attention to US GAAP requirements.

How do accounting faculty view IFRS? KPMG and the American Accounting Association (AAA) have surveyed faculty annually the last few years for their thoughts on IFRS (KPMG and AAA 2011). The 2011 survey shows that most respondents believed the SEC will opt for a condorsement approach that will reshape US GAAP gradually over a period of years in the direction of IFRS. Yet, the majority believed that accounting programs should be teaching IFRS now. Many said that their schools already are teaching IFRS, with the most common setting being in the intermediate courses. The respondents cited two main challenges to expanding coverage of IFRS in their curricula. One is finding time in the existing intermediate courses to add IFRS coverage. The other is developing meaningful problems and case studies that help students to see the differences between US GAAP and IFRS.

This paper describes an IFRS project that faculty can use in teaching the first intermediate accounting course. The project addresses both of the concerns raised by faculty in the KPMG/AAA survey. It aims to give students meaningful exposure to significant differences between US GAAP and IFRS for the set of issues that arise in the first intermediate course. Furthermore, given the design, an instructor could choose to use it as a standalone outside-of-class assignment. The project easily could be integrated into the first intermediate course, even one that continues to give primary emphasis to US GAAP treatments.

THE PROJECT: PEYTON, INC.

<u>**Peyton, Inc.**</u>

Peyton, Inc. is a private company based in Charlotte, NC. The company operates retail sporting goods stores in most of the larger cities in the eastern US. It has issued common shares and bonds to a small group of investors and secured additional financing through bank loans. The company has no plans at this time to seek capital in public markets.

Peyton currently reports on a US GAAP basis. In February 2012, Peyton sent copies of its 2011 financial statements, for the calendar year 2011, to its investors and bank lenders. The company's controller, Dana Elliott, has been learning about IFRS, and she is giving more and more thought to Peyton possibly switching to these standards. As a private company, Peyton could elect to use IFRS as long as its stakeholders would be willing to accept IFRS basis financial statements. Dana is aware that two versions of IFRS exist, the full version and a shorter and slightly simpler SME version. From preliminary conversations with the company's investors and lenders, she has determined that they would be more willing to receive IFRS financial statements if prepared according to the full version of the standards.

Dana has discussed the idea with other members of the company's management team, and they have encouraged her to investigate further. As an initial step, Dana wants to see how IFRS adoption would affect the company's 2011 financial statements. In early March 2012, she meets with the members of her accounting staff and asks them to begin working on converting the recently released 2011 financial statements to an IFRS basis. Peyton's 2011 US GAAP basis financial statements are shown in Exhibit 1.

Primer on First-time Adoption of IFRS

As stated in IFRS 1, *First-time Adoption of International Financial Reporting Standards*, companies making a first-time adoption must apply the new standards on a retrospective basis (see ¶¶ 10-11). IFRS 1 provides certain exceptions to a full retrospective approach, but none pertain to Peyton's case (see ¶¶ 13-19 and Appendices B, C and D). IFRS 1 requires adopting companies to prepare an opening IFRS balance sheet as of the beginning of the earliest period to be presented in the first set of IFRS basis comparative financial statements (see ¶ 6 and Appendix A). International Accounting Standard (IAS) 1 specifies that companies must present at least one comparative period, which has been Peyton's practice for many years (see ¶ 38).

Dana thinks the company could adopt IFRS as quickly as its 2012 financial statements. If Peyton were to adopt IFRS for 2012, technically, Dana and her staff would need to begin with preparing an opening IFRS balance sheet as of January 1, 2011. For now, in this initial step, she simply wants to gain an understanding of how the company's financial statements would look on an IFRS basis. So, she asks her staff to focus on recasting the 2011 financial statements. The process of recasting the 2011 financial statements will reveal any adjustments that would be needed to prepare the opening IFRS balance sheet (as of January 1, 2011).

IFRS 1 states that adopting companies must use the IFRS in effect as of the end of the year in which IFRS reporting is adopted. Dana and her staff plan to proceed with using the IFRS expected to be in effect as of December 31, 2012. She has gathered some information she believes will be relevant to converting Peyton's 2011 financial statements and organized it into a list of 10 items, given in Exhibit 2.

Instructions for Students

Assume you are a valued member of Dana's staff. She has asked you to assist with recasting Peyton's 2011 financial statements to an IFRS basis. In part, she hopes this project will help you develop a better understanding of how IFRS differs from US GAAP.

Specifically, you must research the 10 items given in Exhibit 2, determine any changes that are needed and prepare a set of IFRS compliant financial statements for 2011. Dana tells you she suspects the 10 items will necessitate changes in the recognition, measurement and presentation of information. For the researching step, she directs you to the IASB's website, which offers free access to the standards (see http://www.ifrs.org/IFRSs/IFRS.htm). You must register to establish an account, but the process is a simple one.

As the meeting is ending, Dana asks you to provide her with the following two things:

(1) A table that lists the 10 items, and for each one, shows the specific standard, and paragraph within the standard, that provides the relevant guidance; and

(2) A set of IFRS basis financial statements for the calendar year 2011. Omit the statement of cash flows.

IMPLEMENTATION

This project has been used the last three years in the author's Intermediate Accounting I classes. This course covers through the topic of acquisition and disposal of fixed assets. The project has been given as an individual assignment, and a total of 133 students have completed it during the last three years. The course focuses mainly on US GAAP requirements. The IFRS project is given as a standalone assignment both to reinforce issues covered earlier in the term and to expose students to some of the ways in which IFRS requirements differ.

Students are given three to four weeks to complete the project. Approximately 60 minutes of class time are needed to support it. Half of that time is used to explain the requirements, and the other half to discuss the graded papers. Students generally have performed as well on the IFRS project as they do on the exams and other assignments.

This project asks students to work with the full version of IFRS. The main reason is that the intermediate accounting textbooks, to the extend they address IFRS, address the full version. Also, the students seem more interested in starting with the full version.

The students are provided a project handout that includes Exhibits 1 and 2. No surprise, many students have questions as they work to complete the project. Exhibit 3 shows some optional additional guidance that an instructor might want to consider giving to students. The information in this exhibit reflects the students' most frequently asked questions.

Based upon the experience to date, the aspect of the project students find most challenging is determining the deferred income taxes under IFRS. The first intermediate course introduces students to income tax effects and the presentation of them in financial statements. In the balance sheet chapter, students learn that deferred income taxes must be presented separately in the current and noncurrent sections. In contrast, IFRS requires that all deferred income taxes be classified as noncurrent (see IAS 1 ¶ 56). The instructor may want to consider simply giving students the IFRS figure for net deferred income taxes. The students still would need to determine how the amount should be shown in the balance sheet.

As an alternative to asking students to research the issues in the IASB standards, some instructors might prefer pointing students to information provided in the textbook. For those who prefer this option, the Suggested Solution includes citations from two leading textbooks.

Students likely would need to supplement the textbook information with an outside source. The larger CPA firms have produced some excellent guides on US GAAP/IFRS differences. See, for example, the one prepared by Grant Thornton (available at http://www.grantthornton.com/portal/site/gtcom/menuitem.91c078ed5c0ef4ca80cd8710033841ca/?vgnextoid=bb444cfadd5d3110VgnVCM1000003a8314acRCRD)

Finally, because adjustments are needed to convert Peyton's balances to an IFRS basis, some instructors might want to ask students to prepare and submit a conversion worksheet. The Suggested Solution also includes a completed conversion worksheet.

CONCLUSION

This paper offers a project that addresses concerns expressed by accounting faculty regarding IFRS coverage in their courses. In a recent survey, faculty cited concerns about not having enough time in intermediate courses to spend on IFRS issues and not having enough meaningful assignments that help students to see the differences between US GAAP and IFRS. The project described in this paper can be used as a standalone assignment that does not require significant class time. In addition, it gives faculty who are looking for IFRS assignments another option that they easily can implement in their courses.

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EXHIBIT 1: PEYTON, INC.'S US GAAP FINANCIAL STATEMENTS

Peyton, Inc.
Statement of Earnings
For the Year Ended December 31, 2011
(*all amounts in 000s*)

Net sales		$731,600
Cost of goods sold		405,800
Gross margin		325,800
Operating expenses:		
Salaries expense	$98,300	
Utilities expense	27,400	
Advertising expense	23,700	
Repairs & maintenance expense	21,200	
Depreciation expense	16,900	
Bad debts expense	9,800	
Amortization expense	4,300	201,600
Income from operations		124,200
Other revenues and gains:		
Dividend revenue	7,400	
Gain on sale of investments	27,100	34,500
Other expenses & losses:		
Interest expense	(9,600)	
Loss on inventory write-down	(7,100)	
Loss on retirement of debt	(11,800)	(28,500)
Income from continuing operations before taxes		130,200
Income tax expense		45,570
Income from continuing operations		84,630
Discontinued operations:		
Income from operations (net of taxes of $5,922)	10,998	
Loss on disposal (net of taxes of $15,750)	(29,250)	(18,252)
Extraordinary loss from earthquake damage (net of taxes of $8,015)		(14,885)
Net income		$ 51,493

Peyton, Inc.
Statement of Comprehensive Income
For the Year Ended December 31, 2011
(*all amounts in 000s*)

Net income	$ 51,493
Other comprehensive income:	
Unrealized gain on available-for-sale securities (net of taxes of $5,110)	9,490
Comprehensive income	$ 60,983

Peyton, Inc.
Statement of Changes in Equity
For the Year Ended December 31, 2011
(*all amounts in 000s*)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
January 1, 2011 balance	$75,000	$138,400	$175,647	$20,810	$409,857
2011 net income			51,493		51,493
2011 other comprehensive income				9,490	9,490
2011 dividends declared			(22,000)		(22,000)
December 31, 2011 balance	$75,000	$138,400	$205,140	$30,300	$448,840

Peyton, Inc.
Statement of Financial Position
As of December 31, 2011
(*all amounts in 000s*)

Assets

Current assets:			
Cash and equivalents		$ 55,240	
Accounts receivable	$164,700		
Less: Allowance for bad debts	9,900	154,800	
Inventories	181,400		
Less: Allowance to reduce to market	7,100	174,300	
Deferred income taxes		21,600	
Prepaid expenses		10,900	
Total current assets			$416,840
Long-term investments			132,700
Property, plant & equipment:			
Land		32,000	
Buildings	319,400		
Less: Accumulated depreciation	126,300	193,100	
Equipment	171,900		
Less: Accumulated depreciation	108,200	63,700	288,800
Intangible assets:			
Goodwill		52,000	
Licenses		34,600	86,600
Other assets:			
Long-term notes receivable			61,300
Total assets			$986,240

Liabilities & Stockholders' Equity

Current liabilities:			
Accounts payable		$ 87,100	
Accrued expenses		35,400	
Customer deposits		26,900	
Bank overdraft		8,500	
Total current liabilities			$157,900
Noncurrent liabilities:			
Bonds payable		120,000	
Long-term notes payable		113,200	
Long-term lease obligations		91,600	
Deferred income taxes		54,700	379,500
Total liabilities			537,400
Stockholders' equity:			
Common stock	$ 75,000		
Additional paid-in capital	138,400	213,400	
Retained earnings		205,140	
Accumulated other comprehensive income		30,300	
Total stockholders' equity			448,840
Total liabilities and stockholders' equity			$986,240

EXHIBIT 2: INFORMATION FOR CONVERSION TO IFRS BASIS

(*all amounts in 000s*)

1. Peyton plans to use the fair value measurement model option for reporting its land under IFRS. The company has obtained independent real estate appraisals as follows:

January 1, 2011	$55,000
December 31, 2011	$70,000

2. The discontinued operation presented in Peyton's 2011 US GAAP financial statements relates to a disposal in 2011 of the company's stores in Florida. Peyton continues to operate retail stores in other parts of the eastern US. The Florida operations that were sold qualify as an asset group, but not as a separate major line of business or geographical area of operations.

   The income from operations of the Florida stores of $16,920 (before taxes) from the beginning of the year to the sale date was determined as follows:

Net sales	$49,670
Cost of goods sold	22,500
Salaries expense	6,600
Utilities expense	1,800
Advertising expense	1,100
Depreciation expense	750
Income from operations	$16,920

   The cost of goods sold figure of $22,500 is computed on a LIFO basis. The figure would be the same under the average cost method

3. Peyton has gathered the following information related to its cost of inventories and cost of goods sold:

	2011	Prior Years
Inventories (LIFO)	$181,400	–
Inventories (Average Cost)	$265,900	–
Cost of goods sold (LIFO)	$405,800	$2,160,000
Cost of goods sold (Average Cost)	$347,100	$2,134,200

4. If permitted by IFRS, Peyton would like to present its other comprehensive income in the same way it has chosen for its US GAAP financial statements.

5. The bank overdraft of $8,500 exists on a checking account at Citigroup. This particular account sometimes is overdrawn, and when that happens, the overdraft automatically converts to a loan balance. Peyton does not have any other cash accounts at Citigroup.

6. At year-end 2010, Peyton had notes receivable totaling $61,300. Peyton recognized impairment of these receivables in 2010 amounting to $15,700. The company has determined that the same write-down would have been needed in IFRS financial statements for 2010. At year-end 2011, Peyton continues to hold these notes, and the debtor's credit rating has improved dramatically. As a result, the present value of the expected future cash flows from the notes has increased to their full face value of $77,000.

7. During 2011, Peyton's operations in Virginia were hit by the biggest earthquake to occur in that area in more than a century. The company suffered losses to facilities and inventory totaling $22,900 (before taxes).

8. Peyton has gathered the following information related to the market value of its inventories at December 31, 2011:

Replacement cost	$167,600
Net realizable value	$249,100
Net realizable value, reduced by normal profit	$174,300

9. Peyton's deferred income taxes under US GAAP at year-end 2011 were as follows:

Current deferred income tax assets	$34,800
Current deferred income tax liabilities	$13,200
Noncurrent deferred income tax assets	$20,500
Noncurrent deferred income tax liabilities	$75,200

All of the above deferred income tax amounts were levied by the same taxing authority. Peyton must determine how the deferred income taxes should be presented under IFRS.

10. Assume the company's income tax rate for all years and income items is 35%. For any adjustments that create a change in Peyton's income taxes, recognize the effect of the change in income taxes through the company's Deferred Income Taxes account.

EXHIBIT 3: OPTIONAL ADDITIONAL GUIDANCE FOR STUDENTS

The instructor could elect to give the student some or all of the following additional guidance:

○ To help you get started with the research task, refer to the specific IAS and IFRS standards indicated below:

Information Item	**IAS or IFRS**
1	IAS 16 – *Property, Plant and Equipment*
2	IFRS 5 – *Noncurrent Assets Held for Sale and Discontinued Operations*
3	IAS 2 – *Inventories*
4	IAS 1 – *Presentation of Financial Statements*
5	IAS 7 – *Statement of Cash Flows*
6	IAS 39 – *Financial Instruments: Recognition and Measurement*
7	IAS 1 – *Presentation of Financial Statements*
8	IAS 2 – *Inventories*
9	IAS 1 – *Presentation of Financial Statements*
10	–

○ Information items 1 (relating to land) and 3 (relating to inventory costs) require retrospective treatments.

○ For information item 6 (relating to notes receivable), see IAS 39, ¶ 65.

○ For information item 9 (relating to presentation of deferred income taxes), see IAS 12, ¶ 74.

○ For information item 10 (relating to calculation of deferred income taxes), the correct figure for the <u>net</u> deferred income taxes at December 31, 2011 is $78,075 (credit).

SUGGESTED SOLUTION: (1) IFRS CITATIONS

The table below gives the IAS or IFRS citation for each of the 10 information items. It also shows citations for many of the items from the following two intermediate accounting textbooks:

Nikolai, L. A., J. D. Bazely and J. P. Jones. 2010. *Intermediate Accounting* (11th edition). Mason, OH: South-Western Cengage Learning.

Kieso, D. E., J. J. Weygandt and T. D. Warfield. 2012. *Intermediate Accounting* (14th edition). Hoboken, NJ: John Wiley & Sons, Inc.

Citations for IFRS Guidance			
Information Item	**IAS or IFRS**	**Nikolai, Bazley & Jones (11th ed.)**	**Kieso, Weygandt & Warfield (14th ed.)**
1	IAS 16 ¶¶ 29 & 39 IFRS 1 ¶ 11	Page 489	Pages 657-659
2	IFRS 5 ¶ 32	Page 214	Page 204
3	IAS 2 ¶ 25 IFRS 1 ¶ 11	Page 398	Page 545
4	IAS 1 ¶¶ 7,12 & 81	Page 214	Page 204
5	IAS 7 ¶ 8	Page 1171	Page 428
6	IAS 39 ¶ 65	Page 740	Page 430
7	IAS 1 ¶ 87	Pages 214-215	Page 204
8	IAS 2 ¶ 28	Page 433	Pages 545-548
9	IAS 1 ¶ 56 IAS 12 ¶ 74	Page 991	Pages 1200 & 1202
10	–	–	–

SUGGESTED SOLUTION: (2) US GAAP-TO-IFRS CONVERSION WORKSHEET

Peyton, Inc.
December 31, 2011 (all amounts in 000s)

	US GAAP Balances			Adjustments			IFRS Balances	
Line Items	**Dr.**	**Cr.**		**Dr.**		**Cr.**	**Dr.**	**Cr.**
Cash and equivalents	55,240				5	8,500	46,740	
Accounts receivable	164,700						164,700	
Allowance for bad debts		9,900						9,900
Inventories	181,400		3A	25,800			265,900	
			3B	58,700				
Allowance to reduce inventory to market		7,100	8A	7,100	8B	16,800		16,800
Deferred income tax assets (current)	21,600				9	21,600	0	
Prepaid expenses	10,900						10,900	
Long-term investments	132,700						132,700	
Land	32,000		1A	23,000			70,000	
			1B	15,000				
Buildings	319,400						319,400	
Accumulated depreciation-buildings		126,300						126,300
Equipment	171,900						171,900	
Accumulated depreciation-equipment		108,200						108,200
Goodwill	52,000						52,000	
Licenses	34,600						34,600	
Long-term notes receivable	61,300		6	15,700			77,000	
Accounts payable		87,100						87,100
Accrued expenses		35,400						35,400
Customer deposits		26,900						26,900
Bank overdraft		8,500	5	8,500				0
Bonds payable		120,000						120,000
Long-term notes payable		113,200						113,200
Long-term lease obligations		91,600						91,600
Deferred income tax liabilities (noncurrent)		54,700	8B	5,880	1A	8,050		78,075
			9	21,600	1B	5,250		
					3A	9,030		
					3B	20,545		
					6	5,495		
					8A	2,485		

Common stock		75,000						75,000
Additional paid-in capital		138,400						138,400
Retained earnings, 1/1/11		175,647			3A	16,770		192,417
Accumulated other comprehensive income, 1/1/11		20,810			1A	14,950		35,760
Dividends	22,000						22,000	
Net sales		731,600			2A	49,670		781,270
Cost of goods sold	405,800		2A	22,500	3B	58,700	369,600	
Salaries expense	98,300		2A	6,600			104,900	
Utilities expense	27,400		2A	1,800			29,200	
Advertising expense	23,700		2A	1,100			24,800	
Repairs & maintenance expense	21,200						21,200	
Depreciation expense	16,900		2A	750			17,650	
Bad debts expense	9,800						9,800	
Amortization expense	4,300						4,300	
Dividend revenue		7,400						7,400
Gain on sale of investments		27,100						27,100
Recovery of prior write-down on notes receivable <new>					6	15,700		15,700
Interest expense	9,600						9,600	
Loss on inventory write-down	7,100		8B	16,800	8A	7,100	16,800	
Loss on retirement of debt	11,800						11,800	
Loss on sale of Florida stores <new>			2B	45,000			45,000	
Income tax expense	45,570		2A	5,922	2B	15,750	50,372	
			3B	20,545	7	8,015		
			6	5,495	8B	5,880		
			8A	2,485				
Loss from discontinued operations	18,252		2A	10,998	2B	29,250	0	
Loss from earthquake damage	14,885		7	8,015			22,900	
Unrealized gain on available-for-sale securities		9,490						9,490
Unrealized gain on revaluation of land <new>					1B	9,750		9,750
Total	1,974,347	1,974,347		329,290		329,290	2,105,762	2,105,762
Net income		51,493						93,548
Comprehensive income		60,983						112,788
Retained earnings, 12/31/11		205,140						263,965
Accumulated other comprehensive income, 12/31/11		30,300						55,000

SUGGESTED SOLUTION: (2) IFRS FINANCIAL STATEMENTS

Peyton, Inc.
Statement of Earnings
For the Year Ended December 31, 2011
(*all amounts in 000s*)

Net sales <2>		$781,270
Cost of goods sold <2 & 3>		369,600
Gross margin		411,670
Operating expenses:		
Salaries expense <2>	$104,900	
Utilities expense <2>	29,200	
Advertising expense <2>	24,800	
Repairs & maintenance expense	21,200	
Depreciation expense <2>	17,650	
Bad debts expense	9,800	
Amortization expense	4,300	211,850
Income from operations		199,820
Other revenues and gains:		
Dividend revenue	7,400	
Gain on sale of investments	27,100	
Recovery of prior write-down on notes receivable <6>	15,700	50,200
		250,020
Other expenses and losses:		
Interest expense	9,600	
Loss on inventory write-down <8>	16,800	
Loss on retirement of debt	11,800	
Loss on sale of Florida stores <2>	45,000	
Loss from earthquake damage <7>	22,900	106,100
Income before income taxes		143,920
Income tax expense (35%)		50,372
Net income		93,548

Peyton, Inc.
Statement of Comprehensive Income
For the Year Ended December 31, 2011
(*all amounts in 000s*)

Net income		$93,548
Other comprehensive income:		
Unrealized gain on available-for-sale securities (net of tax charge of $5,110) <4>	$9,490	
Unrealized gain on revaluation of land (net of tax charge of $5,250) <1 & 4>	9,750	19,240
Comprehensive income		$112,788

SUGGESTED SOLUTION: (2) IFRS FINANCIAL STATEMENTS (CONTINUED)

Peyton, Inc
Statement of Changes in Equity
For the Year Ended December 31, 2011
(all amounts in 000s)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehnsive Income	Total
January 1, 2011 balance	$75,000	$138,400	$175,647	$20,810	$409,857
Effect of change from LIFO to average cost (net of tax charge of $9,030) <3>			16,770		16,770
Effect of election of fair value option for land (net of tax charge of $8,050) <1>				14,950	14,950
January 1, 2011 balance (adjusted)	75,000	138,400	192,417	35,760	441,577
2011 net income			93,548		93,548
2011 other comprehensive income				19,240	19,240
2011 dividends declared			(22,000)		(22,000)
December 31, 2011 balance	$75,000	$138,400	$263,965	$55,000	$532,365

SUGGESTED SOLUTION: (2) IFRS FINANCIAL STATEMENTS (CONTINUED)

Peyton, Inc.
Statement of Financial Position
As of December 31, 2011
(*all amounts in 000s*)

	Assets		
Current assets			
Cash and equivalents <5>		$46,740	
Accounts receivable	$164,700		
Less: Allowance for bad debts	9,900	154,800	
Inventories <3>	265,900		
Less: Allowance to reduce to market <8>	16,800	249,100	
Prepaid expenses		10,900	
Total current assets			$461,540
Long-term investments			132,700
Property, plant & equipment:			
Land <1>		70,000	
Buildings	319,400		
Less Accumulated depreciation	126,300	193,100	
Equipment	171,900		
Less: Accumulated depreciation	108,200	63,700	326,800
Intangible assets:			
Goodwill		52,000	
Licenses		34,600	86,600
Other assets:			
Long-term notes receivable <6>			77,000
Total assets			$1,084,640
	Liabilities & Stockholders' Equity		
Current liabilities:			
Accounts payable		$87,100	
Accrued expenses		35,400	
Customer deposits		26,900	
Total current liabilities			$149,400
Noncurrent liabilities:			
Bonds payable		120,000	
Long-term notes payable		113,200	
Long-term lease obligations		91,600	
Deferred income taxes <9 & 10>		78,075	402,875
Total liabilities			552,275
Stockholders' equity:			
Common stock	$75,000		
Additional paid-in capital	138,400	213,400	
Retained earnings		263,965	
Accumulated other comprehensive income		55,000	
Total stockholders' equity			532,365
Total liabilities and stockholders' equity			$1,084,640

SUGGESTED SOLUTION: (2) COMMENTS ON INFORMATION ITEMS

This section gives a brief explanation of the required treatment for each of the 10 information items. The items are addressed, in order, below.

Item 1

As permitted by IAS 16, Peyton elects to use the revaluation model for its land (¶ 29). Peyton must establish the relevant account balances at January 1, 2011 as if it had always applied the revaluation model. Any adjustment needed to move the land to its fair value on that date would have been reported as other comprehensive income (OCI) in years prior to 2011. Thus, the total increase in fair value as of that date, net of taxes, of $14,950 must be reported in the statement of changes in equity as a positive adjustment to the opening balance of accumulated OCI (see IFRS 1 ¶ 11).

The additional increase in the land's fair value during 2011 must be included in the 2011 OCI (see IAS 16 ¶ 39). Peyton must show an unrealized gain, net of taxes, of $9,750 as part of its 2011 OCI. In addition, the land must be reported at its fair value of $70,000 in the December 31, 2011 balance sheet.

Item 2

IFRS sets a tighter standard than US GAAP for defining a component of an entity that qualifies for discontinued operations reporting. The component must represent a separate major line of business or geographical area of operations (see IFRS 5 ¶ 32). The facts provided state that the Florida stores do not satisfy this requirement. Thus, the loss from discontinued operations of $18,252 reported under US GAAP must be reclassified into continuing operations. The pretax operating income of $16,920 must be decomposed and the component revenue and expense amounts added back to the like line items in the operating income section. The pretax loss on disposal of $45,000 should be reported as a separate line item in the other expenses and losses section.

Item 3

IFRS does not permit use of the LIFO method (see IAS 2 ¶ 25). So, Peyton must switch to one of the two methods IFRS does allow, FIFO or average cost. Item 3 gives data to convert the company's inventory to an average cost basis. Similar to the situation for item 1, Peyton must establish the relevant account balances at January 1, 2011 as if it had always used the average cost method.

Peyton must address three issues in converting its accounts to average cost. One, it must present a positive adjustment to the opening retained earnings in the statement of changes in equity to reflect a smaller cost of goods sold being recognized for years prior to 2011 under the new method. Two, Peyton must decrease the cost of goods sold for 2011 by $58,700 to reflect use of the new method. And three, it must increase the inventory cost figure in the December 31, 2011 balance sheet by the sum of these effects, before income taxes, of $84,500.

Item 4

IAS 1 allows the same two display options for OCI as US GAAP (¶¶ 12 & 81). So, Peyton may continue to present its OCI items in a separate statement of comprehensive income that immediately follows the statement of earnings.

Item 5

IAS 7 permits a bank overdraft that arises routinely as part of a company's cash management to be netted into cash and equivalents (¶ 8). Thus, the bank overdraft of $8,500 is removed from current liabilities and netted into cash and equivalents to yield a net balance for the latter of $46,740.

Item 6

IAS 39 permits companies to recognize a recovery of a previously recognized impairment loss on receivables (¶ 65). Peyton must present a loss recovery of $15,700 in the other revenues and gains section of the income statement. In addition, the carrying amount of the long-term notes receivable in the balance sheet must be increased to the full face value of $77,000.

Item 7

IAS 1 does not permit the presentation of gains and losses as extraordinary items (¶ 87). They may be shown as separate line items, though, within the continuing operations section. The after-tax extraordinary loss from earthquake damage of $14,885 must be reclassified into other expenses and losses and shown there on a pretax basis.

Item 8

Similar to US GAAP, IFRS requires companies to consider the need for a write-down of inventories at reporting dates if their market value has fallen below cost. IAS 2 directs companies to use net realizable value as the measure of market value for purposes of this comparison (¶ 28). From item 3 above, the new inventory cost figure according to the average cost method is $265,900. Peyton must write down its inventory to the net realizable value of $249,100. It must remove the existing write-down under US GAAP and replace it with a write-down, before taxes, of $16,800. In addition, Peyton must report an allowance for the same amount as a subtraction from the inventory cost figure in the balance sheet.

Item 9

IAS 1 states that deferred income taxes must be classified as noncurrent (¶ 56). Furthermore, IAS 12 states that deferred income tax asset and liability balances may be netted if they result from taxes levied by the same taxing authority (¶ 74). The facts given indicate that Peyton's deferred income taxes are levied by the same taxing authority, so the effects may be netted and reported as either a net noncurrent asset or noncurrent liability.

Item 10

The table below provides the calculation of the company's net deferred income tax amount of $78,075 (credit).

Information item	Description	Calculation of Temporary Difference	Deferred Income Tax Debit (+) or Credit (–)
	US GAAP current		$21,600
	US GAAP noncurrent		–54,700
1	Land (1/1/11)	$55,000 – $32,000	–8,050
1	Land (12/31/11)	$70,000 – $55,000	–5,250
3	Inventory cost (1/1/11)	$2,160,000 – $2,134,200	–9,030
3	Inventory cost (12/31/11)	$405,800 – $347,100	–20,545
6	Notes receivable	$77,000 – $61,300	–5,495
8	Inventory allowance	$7,100 – $16,800	3,395
	IFRS noncurrent		–$78,075