



kieso
weygandt
warfield
team for success

IFRS
EDITION

ACCOUNTING

INTERMEDIATE

SECOND EDITION

WILEY

WileyPLUS is a research-based, online environment for effective teaching and learning.

The market-leading homework experience in *WileyPLUS* offers:

A Blank Sheet of Paper Effect

The *WileyPLUS* homework experience, which includes type-ahead for account title entry, imitates a blank sheet of paper format so that students use recall memory when doing homework and will do better in class, on exams, and in their professions.

A Professional Worksheet Style

The professional, worksheet-style problem layouts help students master accounting skills while doing homework that directly applies to the classroom and the real world.

The Opportunity to Catch Mistakes Earlier

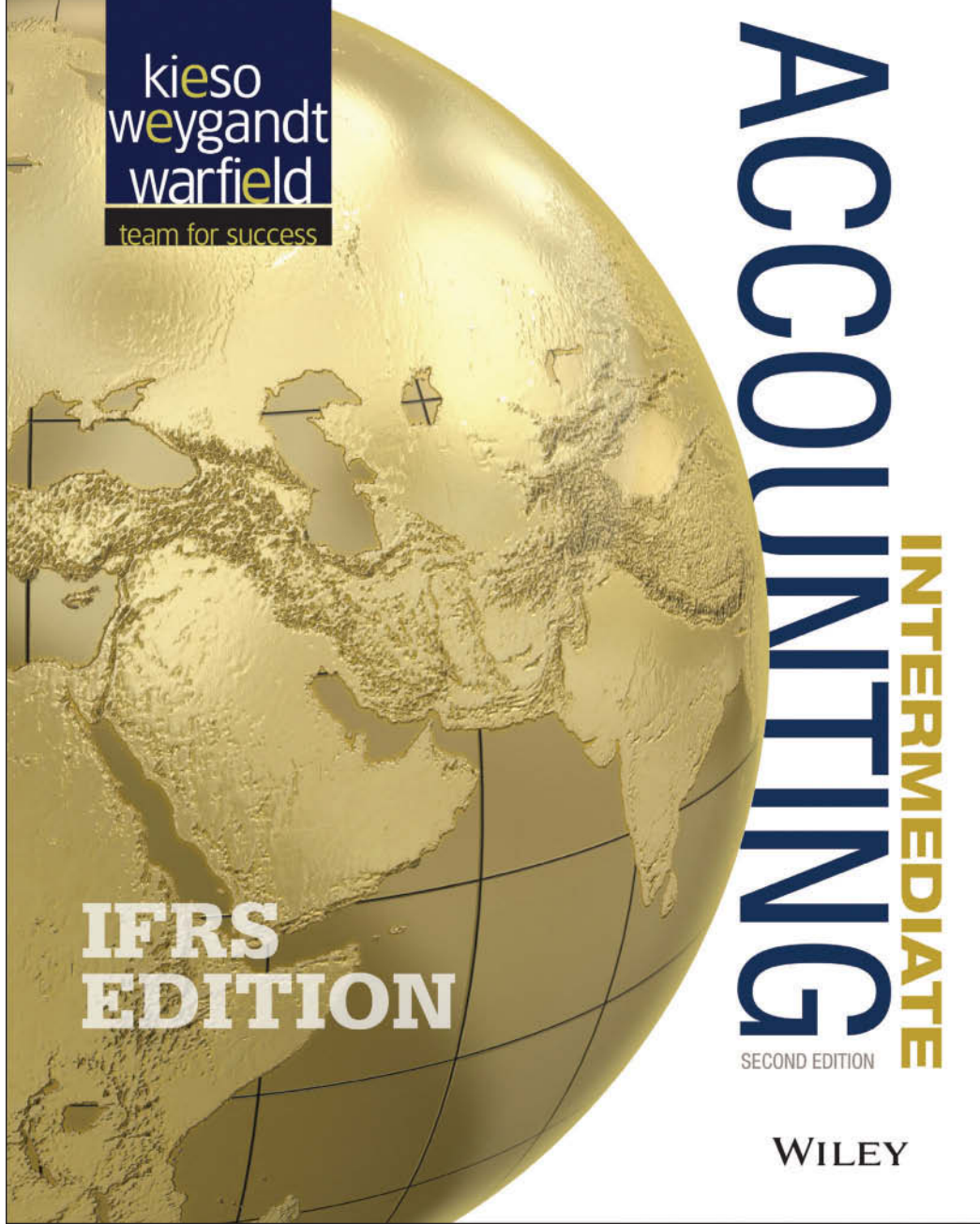
Multi-part problems further help students focus by providing feedback at the part-level. Students can catch their mistakes earlier and access content-specific resources at the point of learning.

More Assessment Options

All brief exercises, exercises, and problems from the textbook are now available for assignment in *WileyPLUS* in static or algorithmic format.

The screenshot shows the WileyPLUS instructor interface for a demo course titled "Demo: Kieso, Intermediate Accounting, IFRS, 2e". The interface includes a navigation menu with options like Home, Course Admin, Class Section Info, Prepare & Present, Read, Study & Practice, Assignment, and Gradebook. A "GO TO STUDENT VIEW" button is also present. The main content area displays a greeting to the "Demo Instructor" and identifies the course as "Demo: Kieso, Intermediate Accounting, IFRS, 2e". It lists several key features: Instructor Announcements, Instructor Documents, System Announcements, Class Section Information, Prepare & Present, Read, Study & Practice, Assignments, and Gradebook. Each feature is accompanied by a brief description of its functionality. The footer contains a license agreement, privacy policy, copyright information (© 2000-2014 John Wiley & Sons, Inc.), and the version number (Version 4.10.1.5).

WileyPLUS includes a full ebook, interactive tutorials, assessment capabilities, and **Blackboard integration**.



Donald E. Kieso PhD, CPA

Northern Illinois University
DeKalb, Illinois

Jerry J. Weygandt PhD, CPA

University of Wisconsin—Madison
Madison, Wisconsin

Terry D. Warfield, PhD

University of Wisconsin—Madison
Madison, Wisconsin

WILEY

*Dedicated to
our wives, Donna, Enid, and Mary,
for their love,
support, and encouragement*

<i>Vice President & Executive Publisher</i>	George Hoffman
<i>Executive Editor</i>	Joel Hollenbeck
<i>Customer and Market Development Manager</i>	Christopher DeJohn
<i>Project Editor</i>	Ed Brislin
<i>Senior Development Editor</i>	Terry Ann Tatro
<i>Development Editor</i>	Margaret Thompson
<i>Editorial Operations Manager</i>	Yana Mermel
<i>Senior Content Manager</i>	Dorothy Sinclair
<i>Senior Production Editor</i>	Sandra Dumas
<i>Associate Director of Marketing</i>	Amy Scholz
<i>Senior Marketing Manager</i>	Karolina Zarychta Honsa
<i>Senior Product Designer</i>	Allie K. Morris
<i>Product Designer</i>	Greg Chaput
<i>Senior Designer</i>	Maureen Eide
<i>Designer</i>	Kristine Carney
<i>Creative Director</i>	Harry Nolan
<i>Senior Photo Editor</i>	Mary Ann Price
<i>Senior Editorial Assistant</i>	Tai Harriss
<i>Marketing Assistant</i>	Mia Brady
<i>Front Cover Photo</i>	Baris Simsek/E+/Getty Images
<i>Back Cover Photo</i>	©zhang bo/iStockphoto
<i>Chapter Opener Photo</i>	©Anthony Roman/Shutterstock
<i>Cover Designer</i>	Maureen Eide

This book was set in Palatino LT Std by Aptara[®], Inc. and printed and bound by Printplus Limited and Printed in China. The cover was printed by Printplus Limited and Printed in China.

Founded in 1807, John Wiley & Sons, Inc. has been a valued source of knowledge and understanding for more than 200 years, helping people around the world meet their needs and fulfill their aspirations. Our company is built on a foundation of principles that include responsibility to the communities we serve and where we live and work. In 2008, we launched a Corporate Citizenship Initiative, a global effort to address the environmental, social, economic, and ethical challenges we face in our business. Among the issues we are addressing are carbon impact, paper specifications and procurement, ethical conduct within our business and among our vendors, and community and charitable support. For more information, please visit our website: www.wiley.com/go/citizenship.

Copyright © 2014 John Wiley & Sons, Inc. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning or otherwise, except as permitted under Sections 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, Inc., 222 Rosewood Drive, Danvers, MA 01923, website www.copyright.com. Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030-5774, (201)748-6011, fax (201)748-6008, website <http://www.wiley.com/go/permissions>.

To order books or for customer service, please call 1-800-CALL WILEY (225-5945).

ISBN-13 978-1-118-44396-5

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1



Brief Contents

1	Financial Reporting and Accounting Standards	2
2	Conceptual Framework for Financial Reporting	26
3	The Accounting Information System	64
4	Income Statement and Related Information	134
5	Statement of Financial Position and Statement of Cash Flows	180
6	Accounting and the Time Value of Money	238
7	Cash and Receivables	294
8	Valuation of Inventories: A Cost-Basis Approach	356
9	Inventories: Additional Valuation Issues	398
10	Acquisition and Disposition of Property, Plant, and Equipment	442
11	Depreciation, Impairments, and Depletion	492
12	Intangible Assets	550
13	Current Liabilities, Provisions, and Contingencies	596
14	Non-Current Liabilities	652
15	Equity	702
16	Dilutive Securities and Earnings per Share	752
17	Investments	812
18	Revenue Recognition	882
19	Accounting for Income Taxes	954
20	Accounting for Pensions and Postretirement Benefits	1010
21	Accounting for Leases	1058
22	Accounting Changes and Error Analysis	1124
23	Statement of Cash Flows	1180
24	Presentation and Disclosure in Financial Reporting	1250

Appendices

A	Specimen Financial Statements: Marks and Spencer Group plc	A-1
B	Specimen Financial Statements: adidas AG	B-1
C	Specimen Financial Statements: Puma SE	C-1

Author Commitment

Don Kieso

Donald E. Kieso, PhD, CPA, received his bachelor's degree from Aurora University and his doctorate in accounting from the University of Illinois. He has served as chairman of the Department of Accountancy and is currently the KPMG Emeritus Professor of Accountancy at Northern Illinois University. He has public accounting experience with Price Waterhouse & Co. (San Francisco and Chicago) and Arthur Andersen & Co. (Chicago) and research experience with the Research Division of the American Institute of Certified Public Accountants (New York). He has done post-doctorate work as a Visiting Scholar at the University of California at Berkeley and is a recipient of NIU's Teaching Excellence Award and four Golden Apple Teaching Awards. Professor Kieso is the author of other accounting and business books and is a member of the American Accounting Association, the American Institute of Certified Public Accountants, and the Illinois CPA Society. He has served as a member of the Board of Directors of the Illinois CPA Society, then AACSB's Accounting Accreditation Committees, the State of Illinois Comptroller's Commission, as Secretary-Treasurer of the Federation of Schools of Accountancy, and as Secretary-Treasurer of the American Accounting Association. Professor Kieso is currently serving on the Board of Trustees and Executive Committee of Aurora University, as a member of the Board of Directors of Kishwaukee Community Hospital, and as Treasurer and Director of Valley West Community Hospital. From 1989 to 1993, he served as a charter member of the National Accounting Education Change Commission. He is the recipient of the Outstanding Accounting Educator Award from the Illinois CPA Society, the FSA's Joseph A. Silviso Award of Merit, the NIU Foundation's Humanitarian Award for Service to Higher Education, a Distinguished Service Award from the Illinois CPA Society, and in 2003 an honorary doctorate from Aurora University.

Jerry Weygandt

Jerry J. Weygandt, PhD, CPA, is Arthur Andersen Alumni Emeritus Professor of Accounting at the University of Wisconsin—Madison. He holds a Ph.D. in accounting from the University of Illinois. Articles by Professor Weygandt have appeared in the *Accounting Review*, *Journal of Accounting Research*, *Accounting Horizons*, *Journal of Accountancy*, and other academic and professional journals. These articles have examined such financial reporting issues as accounting for price-level adjustments, pensions, convertible securities, stock option contracts, and interim reports. Professor Weygandt is author of other accounting and financial reporting books and is a member of the American Accounting Association, the American Institute of Certified Public Accountants, and the Wisconsin Society of Certified Public Accountants. He has served on numerous committees of the American Accounting Association and as a member of the editorial board of the *Accounting Review*; he also has served as President and Secretary-Treasurer of the American Accounting Association. In addition, he has been actively involved with the American Institute of Certified Public Accountants and has been a member of the Accounting Standards Executive Committee (AcSEC) of that organization. He has served on the FASB task force that examined the reporting issues related to accounting for income taxes and served as a trustee of the Financial Accounting Foundation. Professor Weygandt has received the Chancellor's Award for Excellence in Teaching and the Beta Gamma Sigma Dean's Teaching Award. He is on the board of directors of M & I Bank of Southern Wisconsin. He is the recipient of the Wisconsin Institute of CPAs Outstanding Educator's Award and the Lifetime Achievement Award. In 2001, he received the American Accounting Association's Outstanding Educator Award.

Terry Warfield

Terry D. Warfield, PhD, is the PwC Professor in Accounting at the University of Wisconsin—Madison. He received a B.S. and M.B.A. from Indiana University and a Ph.D. in accounting from the University of Iowa. Professor Warfield's area of expertise is financial reporting, and prior to his academic career, he worked for five years in the banking industry. He served as the Academic Accounting Fellow in the Office of the Chief Accountant at the U.S. Securities and Exchange Commission in Washington, D.C. from 1995–1996. Professor Warfield's primary research interests concern financial accounting standards and disclosure policies. He has published scholarly articles in *The Accounting Review*, *Journal of Accounting and Economics*, *Research in Accounting Regulation*, and *Accounting Horizons*, and he has served on the editorial boards of *The Accounting Review*, *Accounting Horizons*, and *Issues in Accounting Education*. He has served as president of the Financial Accounting and Reporting Section, the Financial Accounting Standards Committee of the American Accounting Association (Chair 1995–1996), and on the AAA-FASB Research Conference Committee. He also served on the Financial Accounting Standards Advisory Council of the Financial Accounting Standards Board. He currently serves as a trustee on the Financial Accounting Foundation. Professor Warfield has received teaching awards at both the University of Iowa and the University of Wisconsin, and he was named to the Teaching Academy at the University of Wisconsin in 1995. Professor Warfield has developed and published several case studies based on his research for use in accounting classes. These cases have been selected for the AICPA Professor-Practitioner Case Development Program and have been published in *Issues in Accounting Education*.

From the Authors

Globalization is occurring rapidly. As economic and other interactions increase among countries, capital markets must provide high-quality financial information. A need therefore exists for high-quality financial reporting standards that meet this objective. Fortunately, **International Financial Reporting Standards (IFRS)** has broad international acceptance, being used in some form by more than 115 countries around the world. One securities regulator noted that IFRS is best positioned to serve as the single set of high-quality accounting standards.

Change Is the Only Constant

Most countries want rapid action related to the acceptance of IFRS. A number of countries have already switched from their own version of accounting standards to IFRS. Students and instructors need educational materials related to IFRS in order to meet this new challenge. Our objective in revising *Intermediate Accounting*, IFRS Edition, was therefore to continue to provide the tools needed to understand what IFRS is and how it is applied in practice. The emphasis on fair value, the proper accounting for financial instruments, and the new developments related to leasing, revenue recognition, and financial statement presentation are examined in light of current practice. In addition, given the rapid changes taking place, we provide and discuss the new Conceptual Framework to understand how these issues will likely be resolved in the future.

A Look at Global Accounting

While IFRS has achieved broad acceptance, not all countries have adopted it. For example, U.S. companies still follow U.S. generally accepted accounting principles (U.S. GAAP) in preparing their financial statements. In fact, the differences between IFRS and U.S. GAAP may provide certain companies with a competitive advantage, so understanding these differences may be important in analyzing company performance. In addition, the IASB and the FASB are working together to converge their standards as appropriate. Accordingly, we have included a **Global Accounting Insights** section at the end of selected chapters, to highlight the important differences that remain between IFRS and U.S. GAAP, as well as the ongoing joint convergence efforts to resolve them. As a result, students truly gain a global accounting education by studying this textbook.

"If this textbook helps you appreciate the challenges, worth, and limitations of financial reporting, if it encourages you to evaluate critically and understand financial accounting concepts and practice, and if it prepares you for advanced study, professional examinations, and the successful and ethical pursuit of your career in accounting or business in a global economy, then we will have attained our objectives."

Intermediate Accounting Works

Intermediate Accounting, Fifteenth Edition (based on U.S. GAAP) is the market-leading textbook in providing the tools needed to understand what U.S. GAAP is and how it is applied in practice. With this IFRS Second Edition, we strive to continue to provide the material needed to understand this subject area using IFRS. The book is comprehensive and up-to-date, and provides the instructor with flexibility in the topics to cover. We also include proven pedagogical tools, designed to help students learn more effectively and to answer the changing needs of this course.

We are excited about *Intermediate Accounting*, IFRS Second Edition. We believe it meets an important objective of providing useful information to educators and students interested in learning about IFRS. Suggestions and comments from users of this textbook will be appreciated. Please feel free to e-mail any one of us at AccountingAuthors@yahoo.com.

Donald E. Kieso
Somonauk, Illinois

Jerry J. Weygandt
Madison, Wisconsin

Terry D. Warfield
Madison, Wisconsin

What's New?

The Second Edition expands our emphasis on student learning and improves upon a teaching and learning package that instructors and students have rated the highest in customer satisfaction. We have developed a number of new pedagogical features and content changes, designed both to help students learn more effectively and to answer the changing needs of the course.

Evolving Issues

As we continue to strive to reflect the constant changes in the accounting environment, we have added a new feature to the Second Edition, **Evolving Issue** boxes, which highlight and discuss areas in which the profession may be encountering controversy or nearing resolution. Our hope is that these high-interest boxes will increase student engagement, as well as serve as classroom discussion points. For another source of high-interest material, see the **What Do the Numbers Mean?** boxes, most of which are new to this edition.

Global Accounting Insights

We have updated the end-of-chapter section, **Global Accounting Insights** (previously known as the Convergence Corner), throughout the textbook. In addition, we now present *Similarities* as well as *Differences* between U.S. GAAP and IFRS to increase student understanding.

Major Content Revisions

In response to the changing environment, we have significantly revised several chapters.

Chapter 2 Conceptual Framework for Financial Reporting

- Updated discussion on the IASB's guidance related to the use of fair value in financial statements, including the establishment of the fair value hierarchy.
- New illustration on the five steps of revenue recognition.
- Revised Constraints section, as now only cost constraint is included in the Conceptual Framework.

Chapter 4 Income Statement and Related Information

- New sections on the one statement and two statement formats for reporting components of other comprehensive income.
- Rewrote the Allocating to Non-Controlling Interest section to increase student understanding.

Chapter 18 Revenue Recognition

- Completely new chapter reflecting the very recent IFRS on revenue recognition.
- Numerous new illustrations providing case examples for correctly applying the new IFRS on revenue recognition.

Chapter 20 Accounting for Pensions and Postretirement Benefits

- New sections on the net defined benefit obligations and how to report changes for it.
- Updated section on past service cost, including discussion of curtailments.

Chapter 23 Statement of Cash Flows

- Reorganized chapter, to present the indirect method through preparation of the statement of cash flows first, followed by the discussion of the direct method as well as the advantages and disadvantages of both methods.
- New Evolving Issue, "Direct versus Indirect Controversy," on the arguments in favor of each method.

See the next two pages for a complete list of content revisions by chapter.

Supplementary Materials

The Solutions Manual, Test Bank, PowerPoint, Instructor's Manual, and all other materials were updated to reflect changes in the Second Edition. Instructor resources and additional student resources, such as online self-tests, are available at www.wiley.com/college/kieso. Supplementary materials are also available in *WileyPLUS* where additional resources can help instructors create assignments and track student progress. Additional Course Management Resources are available.

Content Changes by Chapter

Chapter 1 Financial Accounting and Accounting Standards

- Revised opening story, to include more recent commentaries on IFRS.
- New WDNM box, on recent progress toward global adoption of IFRS.
- Updated and expanded discussion of the IASB's standard-setting structure.
- Revised International Convergence section, to include recent developments.
- Moved Appendix 1A, The U.S. Standard-Setting Environment, to book's companion website.

Chapter 2 Conceptual Framework for Financial Reporting

- Updated Conceptual Framework discussion to reflect recent IASB discussion paper, e.g., materiality no longer considered a separate constraint.
- Updated discussion on fair value, including the establishment of the fair value hierarchy, and the revenue recognition principle.
- New WDNM boxes, on the importance of faithful representation, as exemplified by the scandal at **Olympus Corp.**, and the concept of prudence.
- Updated discussion plus added an illustration on the five steps of revenue recognition.
- Updated Constraints section as now only cost constraint is included in the Conceptual Framework.

Chapter 3 The Accounting Information System

- New opening story on impact of global economic crime.
- Enhanced Adjusting Entries section, to provide additional explanation and visuals to students.
- New WDNM box, on companies' need to update their accounting information systems yet unwillingness to interrupt their operations to do so.

Chapter 4 Income Statement and Related Information

- Updated opening story, to discuss recent IASB project on financial statement presentation.
- New sections on the one statement and two statement formats for reporting components of other comprehensive income.
- Rewrote Allocation to Non-Controlling Interest section, to increase student understanding.
- New WDNM boxes, on a recent study that reinforces concerns about earnings management and the use of pro forma earnings measures.
- New Evolving Issue on income reporting.

Chapter 5 Statement of Financial Position and Statement of Cash Flows

- New WDNM box, on presentation order of assets on the statement of financial position.
- New Evolving Issue, on statement of financial position reporting.

- Moved **M&S's** financial statements from Appendix 5B to Appendix A at end of textbook.

Chapter 6 Accounting and the Time Value of Money

- New opening story, about developing fair value estimates and applying fair value guidance to specific examples.

Chapter 7 Cash and Receivables

- Revised opening story, about banks' bad debt allowances.
- New WDNM box, on consequences of requiring companies to value their securities at fair value.
- New Evolving Issue, on the three-bucket approach of classifying loans and impairment stages.

Chapter 8 Valuation of Inventories: A Cost-Basis Approach

- New opening story, about the difficulties in determining the point at which inventory is considered to be sold.
- Moved Appendix 8B (Special Issues Related to LIFO) and related assignment material to book's companion website.
- Deleted material on sales on installment in Special Sales Agreements section.

Chapter 9 Inventories: Additional Valuation Issues

- New opening story, about why investors need comparable information about inventory when evaluating retailers' financial statements.

Chapter 10 Acquisition and Disposition of Property, Plant, and Equipment

- New opening story, about importance of capital expenditures and how they can affect a company's income.

Chapter 11 Depreciation, Impairments, and Depletion

- New WDNM box, on why some companies do not use revaluation accounting.

Chapter 12 Intangible Assets

- New opening story, on increasing amount of sustainable information provided by companies.
- New Underlying Concepts note about surrounding controversy for R&D accounting.
- New WDNM boxes: (1) how companies protect their intangible assets, (2) the patent battles between e-tailers and cell phone companies, and (3) global R&D incentives.
- New Evolving Issue, on the recognition of R&D and internally generated intangibles.

Chapter 13 Current Liabilities, Provisions, and Contingencies

- Revised Unearned Revenues section, to correspond to recent revenue recognition standard.
- New section on value-added tax (VAT).
- New sections on assurance-type and service-type warranties.
- New Evolving Issue, on how to account for greenhouse gases.

Chapter 14 Non-Current Liabilities

- New opening story, about the impact of long-term debt on governments and companies.
- New WDNM box, on why companies issue 100-year bonds.
- Updated Fair Value Option section, on how to treat changes in liability value due to credit risk changes.
- New footnote on IASB consolidation guidance for whether an off-balance-sheet entity should be on-balance-sheet.

Chapter 15 Equity

- Updated opening story, on the global IPO market.
- New WDNM boxes, on whether buybacks signal good or bad news about companies, and an analysis of recent company dividend payouts.
- Significantly enhanced Share Dividends and Share Splits sections to reflect recent information and pronouncements.

Chapter 16 Dilutive Securities and Earnings per Share

- Updated WDNM box on convertible bonds, to include more recent offerings from Asian companies.
- New illustration on company equity grants.

Chapter 17 Investments

- Revised WDNM box on fair value, to discuss controversial valuation of Greek government bond holdings.
- New illustration to clarify how to determine the adjustment to the carrying value of an investment.
- New Evolving Issue, on fair value controversy.
- New Appendix 17B on required fair value disclosures; deleted discussion of reclassification adjustments (old Appendix 17A).

Chapter 18 Revenue Recognition

- Completely rewritten chapter to reflect recently issued revenue recognition standard, including an overview and discussion of the five-step process.
- New opening story, featuring **Rolls-Royce**, **Qwest Communications**, **Sinovel Wind Group**, and **iGo**, to demonstrate challenges of recognizing revenue properly.
- New Evolving Issue, on the implementation of the recently issued revenue recognition standard.

Chapter 19 Accounting for Income Taxes

- Updated opening story, to include the most recent tax system recommendations by the G20.
- Updated footnotes on determining true cost of taxes and deferred tax assets (**Sony's** experience in post-quake Japan).
- Expanded discussion of the components of income tax expense on the income statement.
- New WDNM box, on how a reduction in tax rates can be a double-edged sword for companies that have large deferred tax asset balances.

Chapter 20 Accounting for Pensions and Postretirement Benefits

- Chapter has been significantly revised to reflect recent IASB standards. Details are given below.
- Updated opening story, to include recent information about swings in pension plans' status.

- Updated WDNM box, to highlight increased popularity of defined contribution plans with employers as well as differences between countries in which plans are offered.
- New section on Net Defined Benefit Obligation (Asset).
- Rewrote Components of Pension Expense as new section, Reporting Changes in the Defined Benefit Obligation (Asset) to reflect recent IFRS.
- Expanded and updated section on Past Service Cost to reflect recent IASB rulings, including discussion of curtailments.
- New section on Remeasurements, replacing outdated discussion of corridor amortization.

Chapter 21 Accounting for Leases

- Updated opening story on aircraft leasing data and added information about IASB's work on new lease standard.
- New Evolving Issue, on proposal to address off-balance-sheet reporting of leases.

Chapter 22 Accounting Changes and Error Analysis

- New WDNM box, on how accounting changes create comparability challenges.
- Revised WDNM box, on need to protect company statements from negative effects of fraud.
- Reformatted examples of counterbalancing and non-counterbalancing errors as illustrations, for improved student understanding.

Chapter 23 Statement of Cash Flows

- Reorganized chapter, to present indirect method through preparation of the statement of cash flows first, followed by discussion of the direct method and advantages and disadvantages of both methods.
- New WDNM box, on COROA (cash operating return on assets), a new measure of profitability.
- Reformatted "Direct versus Indirect Controversy" as new Evolving Issue box, to highlight the arguments in favor of each method.
- New Underlying Concepts, on how statement of cash flows information and disclosures relate to the objective of financial reporting and the full disclosure principle.

Chapter 24 Presentation and Disclosure in Financial Reporting

- New opening story, about IASB survey of criticisms of current financial statement disclosures and how the Board plans to respond.
- New WDNM boxes: (1) requirements for disclosing collateral arrangements in repurchase agreements, (2) how note disclosure requirements can positively affect securities markets, and (3) differences in British forecasted information.
- New Evolving Issue, on anticipated increase in note disclosure requirements as IFRS and U.S. GAAP converge.
- New graphs on types and trends of economic crime and fraud.

Appendices A-C (New!)

Financial statements for **Marks & Spencer**, **adidas**, and **Puma**.

Contents

Chapter 1

Financial Reporting and Accounting Standards 2

Revolution in International Financial Reporting

Global Markets 4

Financial Statements and Financial Reporting 5
Accounting and Capital Allocation 5
High-Quality Standards 6

Objective of Financial Reporting 7

General-Purpose Financial Statements 7
Equity Investors and Creditors 7
What Do the Numbers Mean? Don't Forget Stewardship 7
Entity Perspective 7
Decision-Usefulness 8

Standard-Setting Organizations 8

International Organization of Securities Commissions (IOSCO) 9
What Do the Numbers Mean? How Is It Going? 9
International Accounting Standards Board (IASB) 10
Hierarchy of IFRS 13

Financial Reporting Challenges 13

IFRS in a Political Environment 13
What Do the Numbers Mean? Fair Consequences? 14
The Expectations Gap 15
Significant Financial Reporting Issues 15
Ethics in the Environment of Financial Accounting 16
International Convergence 16

Conclusion 17

Global Accounting Insights 17

Authoritative Literature 19

Chapter 2

Conceptual Framework for Financial Reporting 26

What Is It?

Conceptual Framework 28

Need for a Conceptual Framework 28
What Do the Numbers Mean? What's Your Principle? 29
Development of a Conceptual Framework 29
Overview of the Conceptual Framework 30

First Level: Basic Objective 30

Second Level: Fundamental Concepts 31

Qualitative Characteristics of Accounting Information 31
What Do the Numbers Mean? Unfaithful—For 20 Years 35
Basic Elements 37

Third Level: Recognition, Measurement, and Disclosure Concepts 38

Basic Assumptions 38
Basic Principles of Accounting 40
Cost Constraint 45
What Do the Numbers Mean? Let's Be Prudent 46
Summary of the Structure 46

Global Accounting Insights 47

Authoritative Literature 50

Chapter 3

The Accounting Information System 64

Needed: A Reliable Information System

Accounting Information System 66

Basic Terminology 66
Debits and Credits 67
The Accounting Equation 68
Financial Statements and Ownership Structure 70

The Accounting Cycle 71

Identifying and Recording Transactions and Other Events 72
Journalizing 73
Posting 74
Trial Balance 77
What Do the Numbers Mean? Change Management 78
Adjusting Entries 79
Adjusted Trial Balance 90
Preparing Financial Statements 90
What Do the Numbers Mean? 24/7 Accounting 91
Closing 92
Post-Closing Trial Balance 93
Reversing Entries—An Optional Step 95

- What Do the Numbers Mean? Hey, It's Complicated 95
- The Accounting Cycle Summarized 95
- Financial Statements for a Merchandising Company 96**
 - Income Statement 96
 - Retained Earnings Statement 97
 - Statement of Financial Position 97
 - Closing Entries 98
- Global Accounting Insights 99**
- APPENDIX 3A Cash-Basis Accounting versus Accrual-Basis Accounting 101**
- Conversion from Cash Basis to Accrual Basis 103**
 - Service Revenue Computation 103
 - Operating Expense Computation 104
- Theoretical Weaknesses of the Cash Basis 105**
- APPENDIX 3B Using Reversing Entries 106**
- Illustration of Reversing Entries—Accruals 106**
- Illustration of Reversing Entries—Deferrals 107**
- Summary of Reversing Entries 108**
- APPENDIX 3C Using a Worksheet: The Accounting Cycle Revisited 109**
- Worksheet Columns 109**
 - Trial Balance Columns 109
 - Adjustments Columns 109
- Adjustments Entered on the Worksheet 109**
 - Adjusted Trial Balance 111
 - Income Statement and Statement of Financial Position Columns 111
- Preparing Financial Statements from a Worksheet 112**

Chapter 4

Income Statement and Related Information 134

- Financial Statements Are Changing*
- Income Statement 136**
 - Usefulness of the Income Statement 136
 - Limitations of the Income Statement 136
 - Quality of Earnings 137
 - What Do the Numbers Mean? Four: The Loneliest Number 138
- Format of the Income Statement 138**
 - Elements of the Income Statement 138
 - Intermediate Components of the Income Statement 139
 - Illustration 140
 - Condensed Income Statements 140
 - What Do the Numbers Mean? You May Need a Map 142
- Reporting Within the Income Statement 143**
 - Gross Profit 143
 - Income from Operations 143

- What Do the Numbers Mean? Are One-Time Charges Bugging You? 146
- Income before Income Tax 146
- Net Income 147
- Allocating to Non-Controlling Interest 147
- Earnings per Share 148
- Discontinued Operations 148
- Intraperiod Tax Allocation 150
- Summary 151
- What Do the Numbers Mean? Different Income Concepts 152

- Other Reporting Issues 153**
 - Accounting Changes and Errors 153
 - Retained Earnings Statement 155
 - Comprehensive Income 156
 - Evolving Issue** Income Reporting 158
 - Statement of Changes in Equity 158
- Global Accounting Insights 159**
- Authoritative Literature 162**

Chapter 5

Statement of Financial Position and Statement of Cash Flows 180

- Hey, It Doesn't Balance!*
- Statement of Financial Position 182**
 - Usefulness of the Statement of Financial Position 182
 - Limitations of the Statement of Financial Position 182
 - Classification in the Statement of Financial Position 183
 - What Do the Numbers Mean? What Comes First? 184
 - Statement of Financial Position Format 194
 - What Do the Numbers Mean? Warning Signals 196
- Statement of Cash Flows 196**
 - Purpose of the Statement of Cash Flows 196
 - What Do the Numbers Mean? Watch That Cash Flow 197
 - Content and Format of the Statement of Cash Flows 197
 - Overview of the Preparation of the Statement of Cash Flows 198
 - Usefulness of the Statement of Cash Flows 201
- Additional Information 204**
 - Notes to the Financial Statements 204
 - Techniques of Disclosure 207
 - Other Guidelines 208
 - Evolving Issue** Statement of Financial Position Reporting: Gross or Net? 209
- Global Accounting Insights 210**
- APPENDIX 5A Ratio Analysis—A Reference 213**
- Using Ratios to Analyze Performance 213**
- Authoritative Literature 215**

Chapter 6

Accounting and the Time Value of Money 238

How Do I Measure That?

Basic Time Value Concepts 240

Applications of Time Value Concepts 240

The Nature of Interest 241

Simple Interest 242

Compound Interest 242

What Do the Numbers Mean? A Pretty

Good Start 243

Fundamental Variables 246

Single-Sum Problems 246

Future Value of a Single Sum 247

Present Value of a Single Sum 248

Solving for Other Unknowns in

Single-Sum Problems 250

Annuities 251

Future Value of an Ordinary Annuity 252

Future Value of an Annuity Due 254

Examples of Future Value of Annuity

Problems 255

Present Value of an Ordinary Annuity 257

What Do the Numbers Mean? Up in Smoke 259

Present Value of an Annuity Due 259

Examples of Present Value of Annuity Problems 260

More Complex Situations 262

Deferred Annuities 262

Valuation of Long-Term Bonds 264

Effective-Interest Method of Amortization

of Bond Discount or Premium 265

Present Value Measurement 266

Choosing an Appropriate Interest Rate 267

Example of Expected Cash Flow 267

Authoritative Literature 270

Chapter 7

Cash and Receivables 294

No-Tell Nortel

Cash 296

What Is Cash? 296

Reporting Cash 296

Summary of Cash-Related Items 298

What Do the Numbers Mean? Deep Pockets 299

Accounts Receivable 299

Recognition of Accounts Receivable 300

Valuation of Accounts Receivable 302

Impairment Evaluation Process 307

Notes Receivable 308

Recognition of Notes Receivable 308

Valuation of Notes Receivable 312

What Do the Numbers Mean? Economic

Consequences and Write-Offs 313

Special Issues Related to Receivables 314

Fair Value Option 314

Derecognition of Receivables 315

Evolving Issue A Cure for “Too Little,
Too Late”? 319

Presentation and Analysis 320

Global Accounting Insights 322

APPENDIX 7A Cash Controls 325

Using Bank Accounts 325

The Imprest Petty Cash System 326

Physical Protection of Cash Balances 327

Reconciliation of Bank Balances 327

APPENDIX 7B Impairments of Receivables 330

Impairment Measurement and Reporting 330

Impairment Loss Example 331

Recording Impairment Losses 331

Recovery of Impairment Loss 332

Authoritative Literature 332

Chapter 8

Valuation of Inventories: A Cost-Basis Approach 356

It Should Be Easy, but It Isn't!

Inventory Issues 358

Classification 358

Inventory Cost Flow 359

Inventory Control 361

Basic Issues in Inventory Valuation 362

Physical Goods Included in Inventory 362

Goods in Transit 363

Consigned Goods 363

Special Sales Agreements 364

What Do the Numbers Mean? No Parking! 365

Effect of Inventory Errors 365

Costs Included in Inventory 367

Product Costs 367

Period Costs 368

Treatment of Purchase Discounts 368

Which Cost Flow Assumption to Adopt? 369

Specific Identification 370

Average-Cost 371

First-In, First-Out (FIFO) 372

Inventory Valuation Methods—Summary

Analysis 373

APPENDIX 8A LIFO Cost Flow Assumption 375

Last-In, First-Out (LIFO) 376

Inventory Valuation Methods—Summary Analysis 377

Authoritative Literature 378

Chapter 9

Inventories: Additional Valuation Issues 398

Not What It Seems to Be

Lower-of-Cost-or-Net Realizable Value (LCNRV) 400

Net Realizable Value 400

Illustration of LCNRV 400

- Methods of Applying LCNRV 401
- Recording Net Realizable Value Instead of Cost 402
- Use of an Allowance 403
- Recovery of Inventory Loss 403
- Evaluation of the LCNRV Rule 404
- Valuation Bases 404**
 - Special Valuation Situations 404
 - Valuation Using Relative Standalone Sales Value 407
 - Purchase Commitments—A Special Problem 408
- The Gross Profit Method of Estimating Inventory 409**
 - Computation of Gross Profit Percentage 410
 - Evaluation of Gross Profit Method 412
 - What Do the Numbers Mean? The Squeeze* 412
- Retail Inventory Method 413**
 - Retail-Method Concepts 414
 - Retail Inventory Method with Markups and Markdowns—Conventional Method 414
 - Special Items Relating to Retail Method 417
 - Evaluation of Retail Inventory Method 418
- Presentation and Analysis 418**
 - Presentation of Inventories 418
 - Analysis of Inventories 420
- Global Accounting Insights 421**
- Authoritative Literature 423**

Chapter 10

Acquisition and Disposition of Property, Plant, and Equipment 442

Watch Your Spending

- Property, Plant, and Equipment 444**
- Acquisition of Property, Plant, and Equipment 444**
 - Cost of Land 445
 - Cost of Buildings 446
 - Cost of Equipment 446
 - Self-Constructed Assets 446
 - Interest Costs During Construction 447
 - Observations 453
 - What Do the Numbers Mean? What's in Your Interest?* 453
- Valuation of Property, Plant, and Equipment 453**
 - Cash Discounts 453
 - Deferred-Payment Contracts 453
 - Lump-Sum Purchases 454
 - Issuance of Shares 455
 - Exchanges of Non-Monetary Assets 456
 - Government Grants 459
- Costs Subsequent to Acquisition 463**
 - Additions 463
 - What Do the Numbers Mean?*
 - Disconnected 464
 - Improvements and Replacements 464
 - Rearrangement and Reorganization 465
 - Repairs 465

- Summary of Costs Subsequent to Acquisition 466
- Disposition of Property, Plant, and Equipment 466**
 - Sale of Plant Assets 467
 - Involuntary Conversion 467
- Authoritative Literature 469**

Chapter 11

Depreciation, Impairments, and Depletion 492

Here Come the Write-Offs

- Depreciation—A Method of Cost Allocation 494**
 - Factors Involved in the Depreciation Process 494
 - Methods of Depreciation 495
 - Component Depreciation 499
 - Special Depreciation Issues 500
 - What Do the Numbers Mean? Depreciation Choices* 503
- Impairments 503**
 - Recognizing Impairments 503
 - Impairment Illustrations 505
 - Reversal of Impairment Loss 506
 - Cash-Generating Units 507
 - Impairment of Assets to Be Disposed Of 507
- Depletion 508**
 - Establishing a Depletion Base 508
 - Write-Off of Resource Cost 510
 - Estimating Recoverable Reserves 511
 - Liquidating Dividends 511
 - Presentation on the Financial Statements 512
- Revaluations 513**
 - Recognizing Revaluations 513
 - Revaluation Issues 514
 - What Do the Numbers Mean? To Revalue or Not* 515
- Presentation and Analysis 515**
 - Presentation of Property, Plant, Equipment, and Mineral Resources 515
 - Analysis of Property, Plant, and Equipment 517
- Global Accounting Insights 519**
- APPENDIX 11A Revaluation of Property, Plant, and Equipment 522**
- Revaluation of Land 522**
 - Revaluation—2015: Valuation Increase 522
 - Revaluation—2016: Decrease below Historical Cost 523
 - Revaluation—2017: Recovery of Impairment Loss 523
- Revaluation of Depreciable Assets 524**
 - Revaluation—2015: Valuation Increase 524
 - Revaluation—2016: Decrease below Historical Cost 525
 - Revaluation—2017: Recovery of Impairment Loss 527
- Authoritative Literature 529**

Chapter 12

Intangible Assets 550

Is This Sustainable?

Intangible Asset Issues 552

Characteristics 552

Valuation 552

Amortization of Intangibles 553

Types of Intangible Assets 555

Marketing-Related Intangible Assets 555

What Do the Numbers Mean? Keep Your Hands
Off My Intangible! 556

Customer-Related Intangible Assets 556

Artistic-Related Intangible Assets 557

Contract-Related Intangible Assets 558

Technology-Related Intangible Assets 558

What Do the Numbers Mean? Patents—
Strategic Lifeblood 560

Goodwill 561

Impairment of Intangible Assets 564

Impairment of Limited-Life Intangibles 565

Reversal of Impairment Loss 565

Impairment of Indefinite-Life Intangibles Other
Than Goodwill 566

Impairment of Goodwill 567

Research and Development Costs 568

What Do the Numbers Mean? Global
R&D Incentives 569

Identifying R&D Activities 569

Accounting for R&D Activities 570

Evolving Issue Recognition of R&D and Internally
Generated Intangibles 571

Costs Similar to R&D Costs 572

What Do the Numbers Mean? Branded 573

Presentation of Intangibles and Related Items 574

Presentation of Intangible Assets 574

Presentation of Research and Development
Costs 575

Global Accounting Insights 576

Authoritative Literature 579

Chapter 13

Current Liabilities, Provisions, and Contingencies 596

Now You See It, Now You Don't

Current Liabilities 598

Accounts Payable 599

Notes Payable 599

Current Maturities of Long-Term Debt 601

Short-Term Obligations Expected
to Be Refinanced 601

What Do the Numbers Mean? Going, Going,
Gone 602

Dividends Payable 603

Customer Advances and Deposits 603

Unearned Revenues 604

Sales and Value-Added Taxes Payable 605

Employee-Related Liabilities 607

Provisions 610

Recognition of a Provision 611

Measurement of Provisions 612

Common Types of Provisions 613

What Do the Numbers Mean? Frequent Flyers 618

Disclosures Related to Provisions 622

Contingencies 623

Contingent Liabilities 623

Contingent Assets 625

Presentation and Analysis 625

Presentation of Current Liabilities 625

Analysis of Current Liabilities 626

Evolving Issue Greenhouse Gases: Let's Be
Standard-Setters 627

Authoritative Literature 629

Chapter 14

Non-Current Liabilities 652

Going Long

Bonds Payable 654

Issuing Bonds 654

Types and Ratings of Bonds 654

What Do the Numbers Mean?

All About Bonds 655

Valuation of Bonds Payable 656

What Do the Numbers Mean? How about a
100-Year Bond? 658

Effective-Interest Method 659

What Do the Numbers Mean? Your Debt Is
Killing My Equity 664

Long-Term Notes Payable 665

Notes Issued at Face Value 665

Notes Not Issued at Face Value 665

Special Notes Payable Situations 668

Mortgage Notes Payable 670

Special Issues Related to Non-Current Liabilities 671

Extinguishment of Non-Current Liabilities 671

Fair Value Option 675

Off-Balance-Sheet Financing 677

Evolving Issue Off-and-On Reporting 679

Presentation and Analysis 679

Global Accounting Issues 681

Authoritative Literature 684

Chapter 15

Equity 702

It's a Global Market

The Corporate Form of Organization 704

Corporate Law 704

Share System 704

Variety of Ownership Interests 705

What Do the Numbers Mean? A Class (B)
Act 705

Equity 706

- Issuance of Shares 707
- Reacquisition of Shares 711
- What Do the Numbers Mean?* Signals to Buy? 712
- What Do the Numbers Mean?* Buyback Volatility 715

Preference Shares 715

- Features of Preference Shares 716
- Accounting for and Reporting of Preference Shares 717

Dividend Policy 717

- Financial Condition and Dividend Distributions 718
- Types of Dividends 719
- Share Dividends and Share Splits 721
- What Do the Numbers Mean?* Dividends Up, Dividends Down 724
- Disclosure of Restrictions on Retained Earnings 725

Presentation and Analysis of Equity 726

- Presentation of Equity 726
- Analysis 727

Global Accounting Insights 729

APPENDIX 15A Dividend Preferences and Book

Value per Share 732

Dividend Preferences 732

Book Value per Share 733

Authoritative Literature 735

Chapter 16

Dilutive Securities and Earnings per Share 752

Kicking the Habit

Dilutive Securities and Compensation Plans 754

- Debt and Equity 754
- Convertible Debt 754
- Convertible Preference Shares 759
- What Do the Numbers Mean?* How Low Can You Go? 760
- Share Warrants 760
- Accounting for Share Compensation 764
- Debate over Share-Option Accounting 770

Computing Earnings per Share 770

- Earnings per Share—Simple Capital Structure 771
- Earnings per Share—Complex Capital Structure 775

Global Accounting Insights 783

APPENDIX 16A Accounting for Share-Appreciation

Rights 785

SARS—Share-Based Equity Awards 786

SARS—Share-Based Liability Awards 786

Share-Appreciation Rights Example 787

APPENDIX 16B Comprehensive Earnings

per Share Example 788

Diluted Earnings per Share 790

Authoritative Literature 794

xiv

Chapter 17

Investments 812

What to Do?

Accounting for Financial Assets 814

- Measurement Basis—A Closer Look 814

Debt Investments 815

- Debt Investments—Amortized Cost 815
- Debt Investments—Fair Value 818
- What Do the Numbers Mean?* What Is Fair Value? 820
- Fair Value Option 823
- Summary of Debt Investment Accounting 823

Equity Investments 824

- Holdings of Less Than 20% 825
- Holdings Between 20% and 50% 829
- Holdings of More Than 50% 831
- What Do the Numbers Mean?* Who's in Control Here? 832

Other Reporting Issues 832

- Impairment of Value 832
- Transfers Between Categories 834
- Evolving Issue** Fair Value Controversy 834
- Summary of Reporting Treatment of Investments 835

Global Accounting Insights 836

APPENDIX 17A Accounting for Derivative

Instruments 838

Defining Derivatives 838

Who Uses Derivatives, and Why? 839

- Producers and Consumers 839
- Speculators and Arbitrageurs 840

Basic Principles in Accounting for Derivatives 841

- Derivative Financial Instrument (Speculation) 841
- Differences Between Traditional and Derivative Financial Instruments 844

Derivatives Used for Hedging 844

- What Do the Numbers Mean?* Risky Business 845
- Fair Value Hedge 845
- Cash Flow Hedge 848

Other Reporting Issues 850

- Embedded Derivatives 850
- Qualifying Hedge Criteria 850
- Summary of Derivatives Accounting 851

Comprehensive Hedge Accounting Example 852

- Fair Value Hedge 853
- Financial Statement Presentation of an Interest Rate Swap 854

Controversy and Concluding Remarks 855

APPENDIX 17B Fair Value Disclosures 857

Disclosure of Fair Value Information: Financial Instruments 857

Disclosure of Fair Values: Impaired Assets or Liabilities 860

Conclusion 860
Authoritative Literature 861

Chapter 18

Revenue Recognition 882

It's Back

Overview of Revenue Recognition 884

Background 884
New Revenue Recognition Standard 885

The Five-Step Process 885

Identifying the Contract with Customers—
Step 1 886
Identifying Separate Performance Obligations—
Step 2 889
Determining the Transaction Price—Step 3 890
Allocating the Transaction Price to Separate
Performance Obligations—Step 4 894
Recognizing Revenue When (or as)
Each Performance Obligation Is
Satisfied—Step 5 897
Summary 898

Other Revenue Recognition Issues 899

Right of Return 899
Repurchase Agreements 901
What Do the Numbers Mean? No Take-Backs 902
Bill-and-Hold Arrangements 902
Principal-Agent Relationships 903
What Do the Numbers Mean? Grossed Out 904
Consignments 904
Warranties 906
Non-Refundable Upfront Fees 907
Summary 907

Presentation and Disclosure 908

Presentation 908
Disclosure 911
Evolving Issue Ch, Ch, Ch Changes
in Revenue Recognition 912

APPENDIX 18A Long-Term Construction

Contracts 913

Revenue Recognition over Time 913

Percentage-of-Completion Method 915
Cost-Recovery (Zero-Profit) Method 920
Long-Term Contract Losses 921

APPENDIX 18B Revenue Recognition

for Franchises 925

Franchise Accounting 926

Recognition of Franchise Rights Revenue over Time 928

Authoritative Literature 930

Chapter 19

Accounting for Income Taxes 954

Safe (Tax) Haven?

Fundamentals of Accounting for Income Taxes 956

Future Taxable Amounts and Deferred Taxes 957

What Do the Numbers Mean?

“Real Liabilities” 960

Future Deductible Amounts and Deferred
Taxes 961

What Do the Numbers Mean?

“Real Assets” 963

Deferred Tax Asset (Non-Recognition) 963

Income Statement Presentation 964

Specific Differences 965

Tax Rate Considerations 968

What Do the Numbers Mean? Global
Tax Rates 969

Accounting for Net Operating Losses 970

Loss Carryback 970

Loss Carryforward 970

Loss Carryback Example 971

Loss Carryforward Example 971

Financial Statement Presentation 975

Statement of Financial Position 975

Income Statement 976

Tax Reconciliation 978

What Do the Numbers Mean? The Tax
Twist 979

Review of the Asset-Liability Method 980

Global Accounting Insights 982

APPENDIX 19A Comprehensive Example of

Interperiod Tax Allocation 985

First Year—2014 985

Taxable Income and Income Taxes
Payable—2014 986

Computing Deferred Income Taxes—End
of 2014 986

Deferred Tax Expense (Benefit) and the Journal
Entry to Record Income Taxes—2014 987

Financial Statement Presentation—2014 988

Second Year—2015 988

Taxable Income and Income Taxes
Payable—2015 989

Computing Deferred Income Taxes—End
of 2015 990

Deferred Tax Expense (Benefit) and the Journal
Entry to Record Income Taxes—2015 990

Financial Statement Presentation—2015 991

Authoritative Literature 992

Chapter 20

Accounting for Pensions and Postretirement Benefits 1010

Pension Peril

Nature of Pension Plans 1012

Defined Contribution Plan 1013

Defined Benefit Plan 1013

What Do the Numbers Mean? Which Plan Is Right
for You? 1014

The Role of Actuaries in Pension
Accounting 1015

Accounting for Pensions 1016

- Measures of the Pension Liability 1016
- Net Defined Benefit Obligation (Asset) 1017
- Reporting Changes in the Defined Benefit Obligation (Asset) 1018
- Plan Assets and Actual Return 1020

Using a Pension Worksheet 1021

- 2015 Entries and Worksheet 1022
- Past Service Cost 1024
- 2016 Entries and Worksheet 1025
- Remeasurements 1026
- 2017 Entries and Worksheet 1027
- What Do the Numbers Mean?*
 - Roller Coaster 1029

Reporting Pension Plans in Financial Statements 1030

- Within the Financial Statements 1030
- Within the Notes to the Financial Statements 1033
- Other Postretirement Benefits 1034
- Concluding Observations 1035
- What Do the Numbers Mean? How's Your Volatility?* 1035

Global Accounting Insights 1036

Authoritative Literature 1039

Chapter 21

Accounting for Leases 1058

More Companies Ask, "Why Buy?"

The Leasing Environment 1060

- Who Are the Players? 1060
- Advantages of Leasing 1061
- What Do the Numbers Mean?* Off-Balance-Sheet Financing 1063
- Conceptual Nature of a Lease 1064

Accounting by the Lessee 1065

- Capitalization Criteria 1066
- Asset and Liability Accounted for Differently 1069
- Finance Lease Method (Lessee) 1070
- Operating Method (Lessee) 1072
- Comparison of Finance Lease with Operating Lease 1072

Accounting by the Lessor 1073

- Economics of Leasing 1074
- Classification of Leases by the Lessor 1074
- Direct-Financing Method (Lessor) 1075
- Operating Method (Lessor) 1078

Special Accounting Problems 1078

- Residual Values 1079
- Sales-Type Leases (Lessor) 1084
- Bargain-Purchase Option (Lessee) 1087
- Initial Direct Costs (Lessor) 1087
- Current versus Non-Current 1088
- Disclosing Lease Data 1089
- Unresolved Lease Accounting Problems 1091

Evolving Issue Lease Accounting—If It Quacks Like a Duck 1093

Global Accounting Insights 1094

APPENDIX 21A Examples of Lease

Arrangements 1097

Example 1: Harmon, Inc. 1098

Example 2: Arden's Oven Co. 1099

Example 3: Mendota Truck Inc. 1100

Example 4: Appleland Computer 1100

APPENDIX 21B Sale-Leasebacks 1101

Determining Asset Use 1102

Lessee 1102

Lessor 1102

Sale-Leaseback Example 1102

Authoritative Literature 1104

Chapter 22

Accounting Changes and Error Analysis 1124

Needed: Valid Comparisons

Accounting Changes 1126

Changes in Accounting Policy 1126

What Do the Numbers Mean? Comparison

Challenges—Squared 1128

Retrospective Accounting Change Approach 1128

Direct and Indirect Effects of Changes 1137

Impracticability 1138

Changes in Accounting Estimates 1138

Prospective Reporting 1139

Disclosures 1140

Accounting Errors 1140

Example of Error Correction 1141

What Do the Numbers Mean? Guard the Financial Statements! 1144

Summary of Accounting Changes and Correction of Errors 1144

Motivations for Change of Accounting Policy 1145

Error Analysis 1147

Statement of Financial Position Errors 1147

Income Statement Errors 1147

Statement of Financial Position and Income Statement Errors 1148

Comprehensive Example: Numerous Errors 1152

Preparation of Financial Statements with Error Corrections 1154

Global Accounting Insights 1156

Authoritative Literature 1158

Chapter 23

Statement of Cash Flows 1180

Show Me the Money!

Preparation of the Statement of Cash Flows 1182

Usefulness of the Statement of Cash Flows 1182

Classification of Cash Flows 1183

Cash and Cash Equivalents	1184	Disclosure of Special Transactions or Events	1258
<i>What Do the Numbers Mean? How's My Cash Flow?</i>	1185	Events after the Reporting Period (Subsequent Events)	1259
Format of the Statement of Cash Flows	1185	Reporting for Diversified (Conglomerate) Companies	1261
Steps in Preparation	1186	Interim Reports	1266
Illustrations—Tax Consultants Inc.	1187	Auditor's and Management's Reports	1270
Step 1: Determine the Change in Cash	1187	Auditor's Report	1270
Step 2: Determine Net Cash Flow from Operating Activities	1188	<i>What Do the Numbers Mean? Heart of the Matter</i>	1274
Step 3: Determine Net Cash Flows from Investing and Financing Activities	1189	Management's Reports	1274
Statement of Cash Flows—2015	1190	Current Reporting Issues	1277
Illustration—2016	1190	Reporting on Financial Forecasts and Projections	1277
Illustration—2017	1193	<i>What Do the Numbers Mean? Global Forecasts</i>	1279
Sources of Information for the Statement of Cash Flows	1197	Internet Financial Reporting	1280
Net Cash Flow from Operating Activities—Direct Method	1197	Fraudulent Financial Reporting	1280
Evolving Issue Direct versus Indirect	1203	Criteria for Making Accounting and Reporting Choices	1282
Special Problems in Statement Preparation	1203	Evolving Issue Disclosure Overload	1283
Adjustments to Net Income	1203	Global Accounting Insights	1284
Accounts Receivable (Net)	1206	APPENDIX 24A Basic Financial Statement Analysis	1287
Other Working Capital Changes	1208	Perspective on Financial Statement Analysis	1288
Net Losses	1208	Ratio Analysis	1288
Disclosures	1209	Limitations of Ratio Analysis	1290
<i>What Do the Numbers Mean? Better than ROA?</i>	1211	Comparative Analysis	1291
Use of a Worksheet	1212	Percentage (Common-Size) Analysis	1292
Preparation of the Worksheet	1213	APPENDIX 24B First-Time Adoption of IFRS	1294
Analysis of Transactions	1213	General Guidelines	1295
Preparation of Final Statement	1220	Relevant Dates	1295
Global Accounting Insights	1220	Implementation Steps	1296
Authoritative Literature	1223	Opening IFRS Statement of Financial Position	1296
Chapter 24		Exemptions from Retrospective Treatment	1297
Presentation and Disclosure in Financial Reporting	1250	Presentation and Disclosure	1299
<i>We Need Better, Not More</i>		Summary	1300
Full Disclosure Principle	1252	Authoritative Literature	1301
Increase in Reporting Requirements	1253	Appendix A Specimen Financial Statements: Marks and Spencer Group plc	A-1
Differential Disclosure	1253	Appendix B Specimen Financial Statements: adidas AG	B-1
Notes to the Financial Statements	1254	Appendix C Specimen Financial Statements: Puma SE	C-1
Accounting Policies	1254	Index	I-1
Common Notes	1256		
<i>What Do the Numbers Mean? Footnote Secrets</i>	1257		
Disclosure Issues	1258		

Acknowledgments

Second Edition Reviewers

Hsin-Tsai Liu, *National Taiwan University*; Daphne Main, *Loyola University—New Orleans*; Hannah Pantaran, *Silliman University, Philippines*; Fernando Penalva, *IESE Business School*; Dr. Charlie Sohn, *University of Macau*; Nai Hui Su (Suzanne), *National Chung Hsing University*; Professor Ting-Wong, *National Chengchi University*; Rita Yip, *Lingnan University*; Stephen Zeff, *Rice University*.

Ancillary Authors, Contributors, Proofers, and Accuracy Checkers

LuAnn Bean, *Florida Institute of Technology*; John C. Borke, *University of Wisconsin—Platteville*; Jack Cathey, *University of North Carolina—Charlotte*; Jim Emig, *Villanova University*; Larry Falcetto, *Emporia State University*; Coby Harmon, *University of California, Santa Barbara*; Mark Kohlbeck, *Florida Atlantic University*; Steven Lifland, *High Point University*; Jill Misuraca, *University of Tampa*; Barbara Muller, *Arizona State University*;

Yvonne Phang, *Borough of Manhattan Community College*; Laura Prosser, *Black Hills State University*; Lynn Stallworth, *Appalachian State University*; Dick D. Wasson, *Southwestern College*.

Practicing Accountants and Business Executives

From the fields of corporate and public accounting, we owe thanks to the following practitioners for their technical advice and for consenting to interviews.

Mike Crooch, *FASB (retired)*; Tracy Golden, *Deloitte LLP*; John Gribble, *PricewaterhouseCoopers (retired)*; Darien Griffin, *S.C. Johnson & Son*; Michael Lehman, *Sun Microsystems, Inc.*; Tom Linsmeier, *FASB*; Michele Lippert, *Evoke.com*; Sue McGrath, *Vision Capital Management*; David Miniken, *Sweeney Conrad*; Robert Sack, *University of Virginia*; Clare Schulte, *Deloitte LLP*; Willie Sutton, *Mutual Community Savings Bank, Durham, NC*; Lynn Turner, *former SEC Chief Accountant*; Rachel Woods, *PricewaterhouseCoopers*; Arthur Wyatt, *Arthur Andersen & Co., and the University of Illinois—Urbana*.

Finally, we appreciate the exemplary support and professional commitment given us by the development, marketing, production, and editorial staffs of John Wiley & Sons, including the following: Joel Hollenbeck, Chris DeJohn, Karolina Zarychta, Ed Brislin, Sandra Dumas, Brian Kamins, Tai Harriss, Allie Morris, Greg Chaput, Harry Nolan, Maureen Eide, and Kristine Carney. Thanks, too, to Jackie Henry and the staff at Aptara®, Inc. for their work on the textbook, Cyndy Taylor, and to Rebecca Sage and the staff at Integra Publishing Services for their work on the solutions manual.

Suggestions and comments from users of this book will be appreciated. Please feel free to e-mail any one of us at AccountingAuthors@yahoo.com.

Donald E. Kieso
Somonauk, Illinois

Jerry J. Weygandt
Madison, Wisconsin

Terry D. Warfield
Madison, Wisconsin

Financial Reporting and Accounting Standards

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- 1** Describe the growing importance of global financial markets and its relation to financial reporting.
- 2** Identify the major financial statements and other means of financial reporting.
- 3** Explain how accounting assists in the efficient use of scarce resources.
- 4** Explain the need for high-quality standards.
- 5** Identify the objective of financial reporting.
- 6** Identify the major policy-setting bodies and their role in the standard-setting process.
- 7** Explain the meaning of IFRS.
- 8** Describe the challenges facing financial reporting.

Revolution in International Financial Reporting

The age of free trade and the interdependence of national economies is now with us. Many of the largest companies in the world often do more of their business in foreign lands than in their home country. Companies now access not only their home capital markets for financing but others as well. As this globalization takes place, companies are recognizing the need to have one set of financial reporting standards. For globalization to be efficient, what is reported for a transaction in Beijing should be reported the same way in Paris, New York, or London.

A revolution is therefore occurring in financial reporting. In the past, many countries used their own set of standards or followed standards set by larger countries, such as those in Europe or in the United States. However, that situation is changing rapidly. A single set of rules, called International Financial Reporting Standards (IFRS), is now being used by over 115 countries. Here is what some are saying about IFRS.

- “The global financial crisis that began in 2007 and continues today provides a very clear illustration of the globally connected nature of financial markets and the pressing need for a single set of high quality global accounting standards. That is why the G20 . . . has supported the work of the IASB and called for a rapid move towards global accounting.” [Michael Prada, chairman of the IFRS Foundation.]
- “Large multi-national companies stand to realize great benefits from a move to a single set of standards. Companies will have more streamlined IT, easier training, and there will be better communication with outside parties. In fact, the move to IFRS is not so much about the accounting but about the economics of a shrinking world.” [Sir David Tweedie, former chairman of the IASB.]
- “The added costs from having to use this complex hodgepodge (different country reporting standards) of financial information can run in the tens of millions of dollars annually. In the international arena, they can act as a barrier to forming and allocating capital efficiently. Thus, there are growing demands for the development of a single set of high quality international accounting standards.” [Robert Herz, former chairman of the FASB.]



INTERNATIONAL FOCUS

> Read the **Global Accounting Insights** on pages 17–18 for a discussion of international financial reporting.

- “The current and growing breadth of IFRS adoption across the world suggests that IFRS has become the most practical approach to achieving the objective of having a single set of high-quality, generally accepted standards for financial reporting. Those who share this belief are influenced by the fact that the IASB’s structure and due-process procedures are open, accessible, responsive, and marked by extensive consultation.” [KPMG Defining Issues.]
- “Developments such as the shocks of the Asian financial crisis, the Enron and WorldCom scandals, and Europe’s creation of a unified financial market helped build consensus for global accounting standards. Every relevant international organization has expressed its support for our work to develop a global language for financial reporting.” [Hans Hoogervorst, chairman of the IASB, June 2013.]

What these statements suggest is that the international standard-setting process is rapidly changing. And with these changes, it is hoped that a more effective system of reporting will develop, which will benefit all.

PREVIEW OF CHAPTER 1

As the opening story indicates, countries are moving quickly to adopt International Financial Reporting Standards (IFRS). It is estimated that as many as 310 of the 500 largest global companies are using IFRS.

However, the accounting profession faces many challenges in establishing these standards, such as developing a sound conceptual framework, use of fair value measurements, proper consolidation of financial results, off-balance-sheet financing, and proper accounting for leases and pensions. This chapter discusses the international financial reporting environment and the many factors affecting it, as follows.

Financial Reporting and Accounting Standards

Global Markets	Objective of Financial Reporting	Standard-Setting Organizations	Financial Reporting Challenges
<ul style="list-style-type: none"> • Financial statements and financial reporting • Accounting and capital allocation • High-quality standards 	<ul style="list-style-type: none"> • General-purpose financial statements • Equity investors and creditors • Entity perspective • Decision-usefulness 	<ul style="list-style-type: none"> • IOSCO • IASB • Hierarchy of IFRS 	<ul style="list-style-type: none"> • Political environment • Expectations gap • Significant financial reporting issues • Ethics • International convergence

GLOBAL MARKETS

LEARNING OBJECTIVE 1

Describe the growing importance of global financial markets and its relation to financial reporting.

World markets are becoming increasingly intertwined. International consumers drive Japanese cars, wear Italian shoes and Scottish woolens, drink Brazilian coffee and Indian tea, eat Swiss chocolate bars, sit on Danish furniture, watch U.S. movies, and use Arabian oil. The tremendous variety and volume of both exported and imported goods indicates the extensive involvement in international trade—for many companies, the world is their market.

To provide some indication of the extent of globalization of economic activity, Illustration 1-1 provides a listing of the top 20 global companies in terms of sales.

Rank	Company	Country	Revenues (\$ millions)	Rank	Company	Country	Revenues (\$ millions)
1	Royal Dutch Shell	Netherlands	484,489	11	Total	France	231,580
2	ExxonMobil	U.S.	452,926	12	Volkswagen	Germany	221,551
3	Wal-Mart Stores	U.S.	446,950	13	Japan Post Holdings	Japan	211,019
4	BP	U.K.	386,463	14	Glencore International	Switzerland	186,152
5	Sinopec Group	China	375,214	15	Gazprom	Russia	157,831
6	China National Petroleum	China	352,338	16	E.ON	Germany	157,057
7	State Grid	China	259,142	17	ENI	Italy	153,676
8	Chevron	U.S.	245,621	18	ING Group	Netherlands	150,571
9	ConocoPhillips	U.S.	237,272	19	General Motors	U.S.	150,276
10	Toyota Motor	Japan	235,364	20	Samsung Electronics	South Korea	148,944

Source: http://money.cnn.com/magazines/fortune/global500/2012/full_list/index.html.

ILLUSTRATION 1-1

Top 20 Global Companies in Terms of Sales

In addition, due to technological advances and less onerous regulatory requirements, investors are able to engage in financial transactions across national borders and to make investment, capital allocation, and financing decisions involving many foreign companies. Also, many investors, in attempts to diversify their portfolio risk, have invested more heavily in international markets. As a result, an increasing number of investors are holding securities of foreign companies. For example, over a recent seven-year period, estimated investments in foreign equity securities by U.S. investors increased over 20-fold, from \$200 billion to \$4,200 billion.

An indication of the significance of these international investment opportunities can be found when examining the number of foreign registrations on various securities exchanges. As shown in Illustration 1-2, a significant number of foreign companies are found on national exchanges.

ILLUSTRATION 1-2

International Exchange Statistics

Exchange (Location)	Total Share Trading (\$ billions)	Total Listings	Domestic Listings	Foreign Listings	Foreign %
NYSE Euronext (U.S.)	18,027,080	2,308	1,788	520	22.5
NASDAQ OMX	12,723,520	2,680	2,383	297	11.1
Tokyo SE Group	3,986,204	2,291	2,280	11	0.5
London SE Group	2,825,662	2,886	2,288	598	20.7
NYSE Euronext (Europe)	2,125,422	1,112	969	143	12.9
Korea Exchange	2,022,640	1,816	1,799	17	0.9
Deutsche Börse (Germany)	1,750,853	746	670	76	10.2
Hong Kong Exchanges	1,444,712	1,496	1,472	24	1.6
Australian Securities Exchange	1,194,163	2,079	1,983	96	4.6
Taiwan SE Corporation	887,520	824	772	52	6.3
Singapore Exchange	284,289	773	462	311	40.2

Source: Focus: The Monthly Newsletter of Regulated Exchanges (September 2011).

As indicated, capital markets are increasingly integrated and companies have greater flexibility in deciding where to raise capital. In the absence of market integration, there can be company-specific factors that make it cheaper to raise capital and list/trade securities in one location versus another. With the integration of capital markets, the automatic linkage between the location of the company and location of the capital market is loosening. As a result, companies have expanded choices of where to raise capital, either equity or debt. The move toward adoption of global accounting standards has and will continue to facilitate this trend.

Financial Statements and Financial Reporting

Accounting is the universal language of business. One noted economist and politician indicated that the single-most important innovation shaping capital markets was the development of sound accounting principles. The essential characteristics of accounting are (1) the identification, measurement, and communication of financial information about (2) economic entities to (3) interested parties. **Financial accounting** is the process that culminates in the preparation of financial reports on the enterprise for use by both internal and external parties. Users of these financial reports include investors, creditors, managers, unions, and government agencies. In contrast, **managerial accounting** is the process of identifying, measuring, analyzing, and communicating financial information needed by management to plan, control, and evaluate a company's operations.

Financial statements are the principal means through which a company communicates its financial information to those outside it. These statements provide a company's history quantified in money terms. The **financial statements** most frequently provided are (1) the statement of financial position, (2) the income statement (or statement of comprehensive income), (3) the statement of cash flows, and (4) the statement of changes in equity. Note disclosures are an integral part of each financial statement.

Some financial information is better provided, or can be provided only, by means of **financial reporting** other than formal financial statements. Examples include the president's letter or supplementary schedules in the corporate annual report, prospectuses, reports filed with government agencies, news releases, management's forecasts, and social or environmental impact statements. Companies may need to provide such information because of authoritative pronouncements, regulatory rule, or custom. Or, they may supply it because management wishes to disclose it voluntarily.

In this textbook, we focus on the development of two types of financial information: (1) the basic financial statements and (2) related disclosures.

Accounting and Capital Allocation

Resources are limited. As a result, people try to conserve them and ensure that they are used effectively. Efficient use of resources often determines whether a business thrives. This fact places a substantial burden on the accounting profession.

Accountants must measure performance accurately and fairly on a timely basis, so that the right managers and companies are able to attract investment capital. For example, relevant financial information that faithfully represents financial results allows investors and creditors to compare the income and assets employed by such companies as **Nokia** (FIN), **McDonald's** (USA), **Air China Ltd.** (CHN), and **Toyota Motor** (JPN). Because these users can assess the relative return and risks associated with investment opportunities, they channel resources more effectively. Illustration 1-3 (on page 6) shows how this process of capital allocation works.

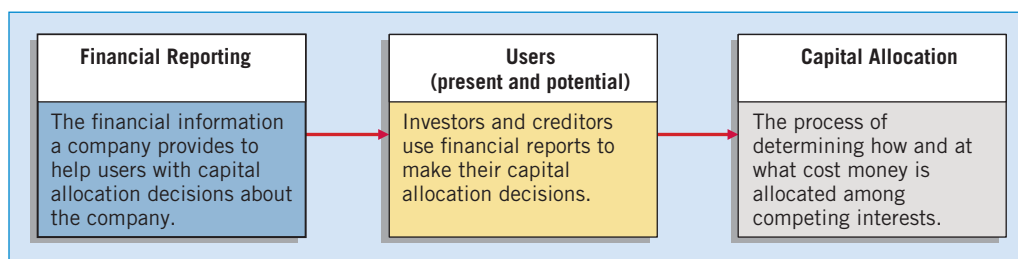
2 LEARNING OBJECTIVE

Identify the major financial statements and other means of financial reporting.

3 LEARNING OBJECTIVE

Explain how accounting assists in the efficient use of scarce resources.

ILLUSTRATION 1-3
Capital Allocation
Process



An effective process of capital allocation is critical to a healthy economy. It promotes productivity, encourages innovation, and provides an efficient and liquid market for buying and selling securities and obtaining and granting credit. Unreliable and irrelevant information leads to poor capital allocation, which adversely affects the securities markets.

High-Quality Standards

LEARNING OBJECTIVE 4

Explain the need for high-quality standards.

To facilitate efficient capital allocation, investors need relevant information and a faithful representation of that information to enable them to make comparisons across borders. For example, assume that you were interested in investing in the telecommunications industry. Four of the largest telecommunications companies in the world are **Nippon Telegraph and Telephone** (JPN), **Deutsche Telekom** (DEU), **Telefonica** (ESP and PRT), and **AT&T** (USA). How do you decide which, if any, of these telecommunications companies you should invest in? How do you compare, for example, a Japanese company like Nippon Telegraph and Telephone with a German company like Deutsche Telekom?

A single, widely accepted set of high-quality accounting standards is a necessity to ensure adequate comparability. Investors are able to make better investment decisions if they receive financial information from Nippon Telegraph and Telephone that is comparable with Deutsche Telekom. Globalization demands a single set of high-quality international accounting standards. But how is this to be achieved? Here are some elements:

1. Single set of high-quality accounting standards established by a single standard-setting body.
2. Consistency in application and interpretation.
3. Common disclosures.
4. Common high-quality auditing standards and practices.
5. Common approach to regulatory review and enforcement.
6. Education and training of market participants.
7. Common delivery systems (e.g., eXtensible Business Reporting Language—XBRL).
8. Common approach to corporate governance and legal frameworks around the world.¹

Fortunately, as indicated in the opening story, significant changes in the financial reporting environment are taking place, which hopefully will lead to a single, widely accepted set of high-quality accounting standards. The major standard-setters of the world, coupled with regulatory authorities, now recognize that capital formation and investor understanding is enhanced if a single set of high-quality accounting standards is developed.

¹Robert H. Herz, "Towards a Global Reporting System: Where Are We and Where Are We Going?" AICPA National Conference on SEC and PCAOB Reporting Developments (December 10, 2007).

OBJECTIVE OF FINANCIAL REPORTING

What is the **objective (or purpose) of financial reporting**? The objective of general-purpose financial reporting is to **provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions about providing resources to the entity**. Those decisions involve buying, selling, or holding equity and debt instruments, and providing or settling loans and other forms of credit. [1] Information that is decision-useful to capital providers (investors) may also be useful to other users of financial reporting who are not investors. Let's examine each of the elements of this objective.

5 LEARNING OBJECTIVE

Identify the objective of financial reporting.

I
F
R
S

See the Authoritative Literature section (page 19).

General-Purpose Financial Statements

General-purpose financial statements provide financial reporting information to a wide variety of users. For example, when **Nestlé** (CHE) issues its financial statements, these statements help shareholders, creditors, suppliers, employees, and regulators to better understand its financial position and related performance. Nestlé's users need this type of information to make effective decisions. To be cost-effective in providing this information, general-purpose financial statements are most appropriate. In other words, general-purpose financial statements provide at the **least cost the most useful information possible**.

Equity Investors and Creditors

The objective of financial reporting identifies investors and creditors as the primary user group for general-purpose financial statements. Identifying investors and creditors as the primary user group provides an important focus of general-purpose financial reporting. For example, when Nestlé issues its financial statements, its primary focus is on investors and creditors because they have the most critical and immediate need for information in financial reports. Investors and creditors need this financial information to assess Nestlé's ability to generate net cash inflows and to understand management's ability to protect and enhance the assets of the company, which will be used to generate future net cash inflows. As a result, the primary user groups are not management, regulators, or some other non-investor group.

What do the numbers mean?

DON'T FORGET STEWARDSHIP

In addition to providing decision-useful information about future cash flows, management also is accountable to investors for the custody and safekeeping of the company's economic resources and for their efficient and profitable use. For example, the management of Nestlé has the responsibility for protecting its economic resources from unfavorable effects of

economic factors, such as price changes, and technological and social changes. Because Nestlé's performance in discharging its responsibilities (referred to as its **stewardship** responsibilities) usually affects its ability to generate net cash inflows, financial reporting may also provide decision-useful information to assess management performance in this role. [2]

Entity Perspective

As part of the objective of general-purpose financial reporting, an **entity perspective** is adopted. Companies are viewed as separate and distinct from their owners (present shareholders) using this perspective. The assets of Nestlé are viewed as assets of the company and not of a specific creditor or shareholder. Rather, these investors have claims on Nestlé's assets in the form of liability or equity claims. The entity perspective is consistent

with the present business environment where most companies engaged in financial reporting have substance distinct from their investors (both shareholders and creditors). Thus, a perspective that financial reporting should be focused only on the needs of shareholders—often referred to as the **proprietary perspective**—is not considered appropriate.

Decision-Usefulness

Investors are interested in financial reporting because it provides information that is useful for making decisions (referred to as the **decision-usefulness** approach). As indicated earlier, when making these decisions, investors are interested in assessing (1) the company's ability to generate net cash inflows and (2) management's ability to protect and enhance the capital providers' investments. Financial reporting should therefore help investors assess the amounts, timing, and uncertainty of prospective cash inflows from dividends or interest, and the proceeds from the sale, redemption, or maturity of securities or loans. In order for investors to make these assessments, the economic resources of an enterprise, the claims to those resources, and the changes in them must be understood. Financial statements and related explanations should be a primary source for determining this information.

The emphasis on "assessing cash flow prospects" does not mean that the cash basis is preferred over the accrual basis of accounting. Information based on accrual accounting generally better indicates a company's present and continuing ability to generate favorable cash flows than does information limited to the financial effects of cash receipts and payments.

Recall from your first accounting course the objective of **accrual-basis accounting**: It ensures that a company records events that change its financial statements in the periods in which the events occur, rather than only in the periods in which it receives or pays cash. Using the accrual basis to determine net income means that a company recognizes revenues when it provides the goods or performs the services rather than when it receives cash. Similarly, it recognizes expenses when it incurs them rather than when it pays them. Under accrual accounting, a company generally recognizes revenues when it makes sales. The company can then relate the revenues to the economic environment of the period in which they occurred. Over the long run, trends in revenues and expenses are generally more meaningful than trends in cash receipts and disbursements.²

STANDARD-SETTING ORGANIZATIONS

LEARNING OBJECTIVE 6

Identify the major policy-setting bodies and their role in the standard-setting process.

For many years, many nations have relied on their own standard-setting organizations. For example, Canada has the Accounting Standards Board, Japan has the Accounting Standards Board of Japan, Germany has the German Accounting Standards Committee, and the United States has the Financial Accounting Standards Board (FASB). The standards issued by these organizations are sometimes principles-based, rules-based, tax-oriented, or business-based. In other words, they often differ in concept and objective.

The main international standard-setting organization is based in London, United Kingdom, and is called the **International Accounting Standards Board (IASB)**. The IASB issues **International Financial Reporting Standards (IFRS)**, which are used on most foreign exchanges. As indicated earlier, IFRS is presently used or permitted in over 115 countries and is rapidly gaining acceptance in other countries as well.

²As used here, cash flow means "cash generated and used in operations." The term *cash flows* also frequently means cash obtained by borrowing and used to repay borrowing, cash used for investments in resources and obtained from the disposal of investments, and cash contributed by or distributed to owners.

IFRS has the best potential to provide a common platform on which companies can report and investors can compare financial information. As a result, our discussion focuses on IFRS and the organization involved in developing these standards—the International Accounting Standards Board (IASB). (A detailed discussion of the U.S. system is provided at the book’s companion website, www.wiley.com/college/kieso.) The two organizations that have a role in international standard-setting are the **International Organization of Securities Commissions (IOSCO)** and the IASB.

International Organization of Securities Commissions (IOSCO)

The **International Organization of Securities Commissions (IOSCO)** is an association of organizations that regulate the world’s securities and futures markets. Members are generally the main financial regulator for a given country. IOSCO does not set accounting standards. Instead, this organization is dedicated to ensuring that the global markets can operate in an efficient and effective basis. The member agencies (such as from France, Germany, New Zealand, and the United States) have resolved to:

- Cooperate together to promote high standards of regulation in order to maintain just, efficient, and sound markets.
- Exchange information on their respective experiences in order to promote the development of domestic markets.
- Unite their efforts to establish standards and an effective surveillance of international securities transactions.
- Provide mutual assistance to promote the integrity of the markets by a rigorous application of the standards and by effective enforcement against offenses.

IOSCO supports the development and use of IFRS as the single set of high-quality international standards in cross-border offerings and listings. It recommends that its members allow multinational issuers to use IFRS in cross-border offerings and listings, as supplemented by reconciliation, disclosure, and interpretation where necessary to address outstanding substantive issues at a national or regional level. (For more information, go to <http://www.iosco.org/>.)

What do the numbers mean? HOW IS IT GOING?

How much progress has been made toward the goal of one single set of global accounting standards? To answer this question, the IASB conducted a major survey on IFRS adoption. The survey indicates that there is almost universal support (95 percent) for IFRS as the single set of global accounting standards. This includes those jurisdictions that have yet to make a decision on adopting IFRS, such as the United States.

More than 80 percent of the jurisdictions report IFRS adoption for all (or in five cases, almost all) public companies. Most of the remaining 11 non-adopters have made significant progress toward IFRS adoption. In addition, those jurisdictions that have adopted IFRS have made very few modifications to the standards. More than 40 percent of the IFRS adopters do so automatically, without an endorsement process. Moreover, where modifications have occurred, they

are regarded as temporary arrangements to assist in the migration from national accounting standards to IFRS. It is expected that most of these transitional adjustments will ultimately disappear.

Admittedly, a few large and important economies have not yet (fully) adopted IFRS. But even in such countries, more progress is being made than many people are aware of. Japan already permits the use of full IFRS and has recently widened the scope of companies that are allowed to adopt it. In the United States, non-U.S. companies are allowed to use IFRS for listings on their exchanges. Today, more than 450 foreign private issuers are reporting using IFRS in U.S. regulatory filings, which represents trillions of dollars in market capitalization. In short, much progress has been made by countries in using IFRS.

Source: Adapted from Hans Hoogervorst, “Breaking the Boilerplate,” IFRS Foundation Conference (June 13, 2013).