ABOUT THE AUTHOR

Prof. Vinit Mehta is a qualified Chartered Accountant, certified Financial Risk Manager (F.R.M.) & has cleared CFA Level II.

He is a Professor of Finance teaching CFA & FRM students and a visiting faculty at NMIMS & SP Jain.

He brings a decade long experience across varied finance verticals such as investment banking, corporate banking, international banking & structured financing. Working on cross - border and regional deals, for clients based in Europe, Asia, Middle East & African markets, allows him to meld his learnings into his teachings. This mapping of theory with its practical application, gives students an opportunity to not only learn the concepts but live them practically.

IFRS v/s US GAAP

CFA Level I – 2024 exams

Prof. Vinit Mehta **vinit.mht@gmail.com** **+91 93245 98369**

Exam questions will be based on International Financial Reporting Standards (IFRS), unless otherwise specified. When a question is based on U.S. GAAP, it will be stated in the question.

IFRS	US GAAP
Introduction	
International Accounting Standard Board (IASB) prescribes IFRS	Financial Accounting Standard Board (FASB) prescribes US GAAP
Income statement	
Income statement or OCI can be presented together or separately	Income statement or OCI can be presented together or separately
Outcome of long-term contract estimated reliably Revenue, exp & profit are recognised as the work is completed. If a loss is expected, recognise immediately.	*Outcome of long-term contract estimated reliably* Revenue, exp & profit are recognised as the work is completed. If a loss is expected, recognise immediately.
Balance Sheet	
Financial assets include – investment securities (stocks & bonds – listed as well as unlisted), derivative, loans to and notes receivable	
Loans to, notes receivable and unlisted equity shares are valued at historical cost on balance sheet for IFRS & US GAAP	
only DEBT securities acquired with intent to be held till maturity – Valued at amortised cost → **no terminology for classification like US GAAP – classified as securities measured at amortised cost – treatment is same as HTM securities under US GAAP** Because they are held till maturity and also valued at amortised cost, there is nothing like unrealized gains or loss	**only DEBT securities** acquired with intent to be held till maturity – Valued at amortised cost → **Classified as Held to maturity (HTM)** Because they are held till maturity and also valued at amortised cost, there is nothing like unrealized gains or loss
DEBT securities acquired with intent to collect interest but also sell – valued at fair value and unrealised gains / losses recognised in OCI → **Classified as securities measured at fair value through OCI – treatment is same as AFS under US GAAP**	**only DEBT securities** acquired with intent, other than to hold till maturity or to profit over near term – valued at fair value and unrealised gains / losses recognised in OCI → **Classified as AVAILABLE-FOR-SALE (AFS) securities**
DEBT securities acquired with intent, other than to hold till maturity or to collect interest & sell – valued at fair value and unrealised gains / losses recognised in income statement → **Classified as securities measured at fair value through income statement – treatment is same as TRADING securities under US GAAP**	**Debt securities** acquired with intent to profit over near term – valued at fair value and unrealised gains / losses recognised in income statement → **Classified as TRADING securities**
By default, all derivatives & listed equity securities irrespective of the intent – valued at fair value and unrealised gains / losses recognised in income statement → **Classified as securities measured at fair value through income statement – treatment is same as TRADING securities under US GAAP**	**All derivatives & listed equity securities** irrespective of the intent – valued at fair value and unrealised gains / losses recognised in income statement → **Classified as TRADING securities**
Only Listed equity securities at the time of purchase can FOREVER be CHOSE to recognised at fair value and unrealised gains / losses recognised in OCI → **Classified as securities measured at fair value through OCI – treatment is same as AFS under US GAAP**	Listed equity securities cannot be classified as AFS – they are only classified as TRADING securities. No option given here
Financial assets not falling in any of the above category – valued at fair value and unrealised gains / losses recognised in income statement → **Classified as securities measured at fair value through income statement**	-

Contents developed by Prof. Vinit Mehta vinit.mht@gmail.com 93245 98369

IFRS	US GAAP
Financial assets at the time of purchase can FOREVER be CHOSE to be recognised at fair value and unrealised gains / losses recognised in income statement → **Classified as securities measured at fair value through income statement**	No such choice under US GAAP
However, for all of above, dividend or interest income or REALISED gain / losses are recognised in income statement	
Cashflow statement	
Interest paid can be classified in CFO or CFF	Interest paid is classified in CFO
Interest income recd. can be classified in CFO or CFI	Interest income recd. is classified in CFO
Dividend income recd. can be classified in CFO or CFI	Dividend income recd. is classified in CFO
Dividend paid can be classified in CFO or CFF	Dividend paid is classified in CFF
Taxes reported as operating activity unless it is related to investing or financing activities	All taxes paid are part of CFO, even tax related to investing or financing transaction
Not required under IFRS	Firms using direct method presentation, must also disclose indirect method presentation
Bank overdraft considered part of cash equivalents i.e. cash balance itself	Bank overdraft considered part of CFF
Inventories	
Specific identification, FIFO & Weighted average cost	Specific identification, FIFO, LIFO & Weighted average cost
Valued @ lower of cost or NRV – for all above methods	Valued @ lower of cost or NRV – for all above methods except LIFO or retail method For LIFO or retail method – lower of cost or Market. ✓ Market = replacement cost; if replacement cost is in the range of NRV or NRV minus profit ✓ Market = NRV; if replacement cost > NRV ✓ Market = NRV minus profit margin; if replacement cost < NRV minus profit margin ✓ Shortcut → Market is always the middle value amongst NRV, replacement cost, and NRV minus profit margin – put these numbers in ascending order and you get the middle value which is the Market. Now compare this Market with Cost and use the smaller number as value of inventory.
Write down by recognising loss in income statement	Small write down amount – recognise by increasing COGS Large write down amount – recognise loss
Subsequent Write-up – recognise gain by decreasing COGS to extent of earlier loss	No write ups allowed
Change in inventory method – firms to demonstrate that change will provide reliable & more relevant info.	Change in inventory method – firms must explain why the change is preferable
Long Term Assets	
Construction interest to be capitalised	Construction interest to be capitalised
Research cost expense it in income statement	Research cost expense it in income statement
Development cost capitalise it as an asset on the balance sheet	Development cost expense it in income statement → Exception: Software – capitalise it as an asset on the balance sheet
Impairment	

vinit.mht@gmail.com 93245 98369

<table>
<tr><th>IFRS</th><th>US GAAP</th></tr>
<tr><td><u>Indication of impairment:</u> Assess annually if events or circumstances indicate impairment (eg. Natural calamity damaging asset or new technology outdating old asset)
<u>When to assess:</u> Annually
<u>When to test for impairment:</u> Only when events or circumstances indicate, except annually for intangibles assets with indefinite lives (eg. Goodwill)
<u>How to test impairment:</u> carrying value > recoverable amount.
Recoverable amount is greater of:
• Fair value less selling cost
• Value in use i.e., PV of future cashflows from continued use
<u>Impairment loss recognised on income statement</u> = Carrying value minus recoverable amount
<u>Reversal:</u>
If value recovers in future, impairment loss can be reversed to the extent of loss recognised earlier</td><td><u>Indication of impairment:</u> Assess annually if events or circumstances indicate impairment (eg. Natural calamity damaging asset or new technology outdating old asset)
<u>When to assess:</u> Annually
<u>When to test for impairment:</u> Only when events or circumstances indicate, except annually for intangibles assets with indefinite lives (eg. Goodwill)
<u>How to test impairment:</u> carrying value > undiscounted future cashflow stream.
<u>Impairment loss recognised on income statement</u> = Carrying value minus fair value (do not consider selling cost here)
✓ if fair value is not available, then use discounted future cashflow
<u>Reversal:</u> Not allowed here</td></tr>
<tr><td colspan="2">Asset reclassified from held for use to held for sale – impairment</td></tr>
<tr><td>As asset is not used anymore, hence no dep. or amort.</td><td>As asset is not used anymore, hence no dep. or amort.</td></tr>
<tr><td>Tested for impairment → carrying value > net realizable value
Where, NRV = fair value less selling cost</td><td>Tested for impairment → carrying value > net realizable value
Where, NRV = fair value less selling cost</td></tr>
<tr><td>Impairment loss = carrying value minus NRV</td><td>Impairment loss = carrying value minus NRV</td></tr>
<tr><td>Reversal:
If value recovers in future, impairment loss can be reversed to the extent of loss recognised earlier</td><td>Reversal:
If value recovers in future, impairment loss can be reversed to the extent of loss recognised earlier

This is the only place in US GAAP where reversal is allowed</td></tr>
<tr><td colspan="2">Cost Model (IFRS & US GAAP)</td></tr>
<tr><td colspan="2">Cost Model allowed:

Amortized cost = Original capitalised cost <u>minus</u> accumulated depreciation / amort / depletion / impairment</td></tr>
<tr><td colspan="2"><u>Lease accounting</u></td></tr>
<tr><td>In the books of lessee:

All the lease to be classified as finance lease, except short term lease of less than 12 months or where the PV of lease payment is less than $5,000</td><td>In the books of lessee:

If either of the following circumstances exist, classify the lease as finance lease:
• The lease transfers ownership of the underlying asset to the lessee or
• The lessee has an option to purchase the underlying asset and is reasonably certain it will do so
• The lease term is for a major part of the asset's useful life
• The present value of the sum of the lease payments equals or exceeds substantially all of the fair value of the asset
• The underlying asset has no alternative use to the lessor</td></tr>
</table>

Contents developed by Prof. Vinit Mehta ✉ vinit.mht@gmail.com ✆ 93245 98369

IFRS	US GAAP
	If none of the above condition exists, classify as operating lease
In the books of lessee (Finance lease) **At inception:** Recognise lease liability = PV of lease payment Recognise 'Right of Use' asset = PV of lease payment **Over the term of lease:** Charge depreciation on ROU asset Recognise interest expense = lease interest rate x Beginning lease liability Interest expense → CFO Principal repaid → CFF	In the books of lessee (Finance lease) **At inception:** Recognise lease liability = PV of lease payment Recognise 'Right of Use' asset = PV of lease payment **Over the term of lease:** Charge depreciation on ROU asset Recognise interest expense = lease interest rate x Beginning lease liability Interest expense → CFO Principal repaid → CFF
In the books of lessee (Short-term or Low-value lease) **At inception:** No asset or liability is reported **Over the term of lease:** No depreciation expense or interest expense recognised Only lease rental expense recognised in income statement Lease rental expense → CFO	In the books of lessee (Operating lease) **At inception:** Recognise lease liability = PV of lease payment Recognise 'Right of Use' asset = PV of lease payment **Over the term of lease:** No depreciation expense or interest expense recognised Only lease rental expense recognised in income statement Each year lease liability is reduced by 'lease rental expense minus effective interest component' Each year ROU asset is also reduced by the same amount as lease liability At end of lease, both lease liability & ROU asset becomes zero Lease rental expense → CFO
In the books of lessor: Classify either as finance lease or operating lease	In the books of lessor: US GAAP requires the lessor to classify the lease as finance lease if any criteria is fulfilled ✓ The lease transfers ownership of the underlying asset to the lessee ✓ The lessee has an option to purchase the underlying asset and is reasonably certain it will do so ✓ The lease term is for a major part of the asset's useful life ✓ The present value of the sum of the lease payments equals or exceeds substantially all of the fair value of the asset

IFRS	US GAAP
	✓ The underlying asset has no alternative use to the lessor None of the criteria's fulfilled, it is classified as operating lease
In the books of Lessor: If there is transfer of ownership → classify as finance lease (treatment is same as Sale type method used in US GAAP) Operating lease (treatment is same as Operating lease used in US GAAP)	In the books of Lessor: If it is finance lease: **At inception:** *No effect on income statement* *Balance sheet effect:* Remove asset by carrying value and create lease receivable = PV of lease payment *No effect on cashflow statement* **Over the term of lease:** *Income statement effect:* No depreciation Recognise interest income: lease interest rate x beginning balance of lease receivable *Balance sheet effect:* Reduce lease receivable by principal repaid which is equal to lease rental *minus* interest expense *Cashflow statement effect:* Interest income → CFO Principal repaid → CFO If it is classified as **operating lease** **At inception:** *No effect on income statement* *Balance sheet effect:* No removal of asset *No effect on cashflow statement* **Over the term of lease:** *Income statement effect:* Recognise lease rental income and Charge depreciation as usual *Balance sheet effect:*

IFRS	US GAAP
	Reduce asset by depreciation amount – amortised cost *Cashflow statement effect:* Lease income → CFO
Pension accounting	
Pension → Components leading to changes in net pension asset or liability that go directly to equity as OCI are NOT amortised.	Pension → Components leading to changes in net pension asset or liability that go directly to equity as OCI are amortised to income statement
Financial Reporting Quality	
Usage of non-IFRS measures, IFRS requires: • Explaining the relevance of such non-IFRS measure • Reconcile difference between non-IFRS & comparable IFRS measure	Usage of non-GAAP measures, US GAAP requires: • Display the most comparable GAAP measure with equal prominence • Explain as to why non-GAAP measure is useful • Reconcile difference between non-GAAP & comparable GAAP measure • Disclose other purposed for using non-GAAP measure • Include any item that are likely to occur in future even if reported as non-recurring
Deferred taxes	
There is no specific mention of reporting DTL and DTA separately under IFRS. Usually, companies report separately.	US GAAP requires DTL & DTA to be reported separately and are not to be netted
IFRS requires creation of DTA when the it is 'probable' that sufficient taxable income will be available to recover the tax assets in the form deductions. If it is less probable, reduce DTA and create Valuation allowance	US GAAP mentions that if the probability of non-reversal is more than 50%, than reduce DTA and create Valuation allowance.
Revaluation of fixed & intangible assets - Deferred taxes are recognised in equity	No revaluation allowed
Deferred tax asset recognition - Recognised if "probable" that sufficient tax will be available to recover the tax asset	Deferred tax asset recognition - Recognised in full and then reduced if "more likely than not" that the assets will not be realised
Tax rate used to measure deferred tax - Enacted or substantially enacted rate	Tax rate used to measure deferred tax - Enacted tax rate
Deferred taxes are classified as non-current on balance sheet	Deferred taxes are classified as current or non-current based on the underlying asset or liability
Undistributed profit from an investment in subsidiary or JV → Deferred taxes are recognized unless the parent or venturer is able to control distribution/sharing of profit & it is probable that temp. diff. will not be reversed in future	Undistributed profit from an investment in subsidiary or JV → No deferred taxes that meet indefinite reversal criterion
Undistributed profit from an investment in associate → Deferred taxes are recognized unless the investor is able to control sharing of profit & it is probable that temp. diff. will not be reversed in future	Undistributed profit from an investment in associate → Deferred taxes are recognized from temporary differences