Welcome to *Financial Accounting & Reporting*. This exam is demanding and the relative size of our four textbooks shows why. Most students find these topics to be the most challenging:

- Consolidations and Investments (F3)
- Leases (F5)
- Bonds and Long-Term Liabilities (F5)
- Pensions (F6)
- Accounting for Income Taxes (F6)
- Derivatives (F7)
- Governmental and Not-for-Profit (F8 and F9)

The AICPA Content Specifications for FAR break down the exam into the following general areas and approximate percentages of exam points:

1. Conceptual framework, standards, standard setting, and presentation of financial statements (17 to 23 percent)
2. Financial statement accounts: recognition, measurement, valuation, calculation, presentation, and disclosures (27 to 33 percent)
3. Specific transactions, events and disclosures: recognition, measurement, valuation, calculation, presentation, and disclosures (27 to 33 percent)
4. Governmental accounting and reporting (8 to 12 percent)
5. Not-for-profit (nongovernmental) accounting and reporting (8 to 12 percent)

I. ACCOUNTING STANDARDS AND CONCEPTUAL FRAMEWORKS

A. In the United States, the SEC has the legal authority to establish U.S. GAAP. In most instances, the SEC has allowed the accounting profession to establish GAAP and to self-regulate. The FASB is the current standard-setting body in the United States. The FASB Accounting Standards Codification (ASC) is the single source of authoritative nongovernmental U.S. GAAP.

B. The Financial Accounting Foundation (FAF) created the Private Company Council (PCC) to improve standard setting for privately held companies in the U.S. The goal of the PCC is to establish alternatives to U.S. GAAP, where appropriate, to make private company financial statements more relevant, less complex, and cost-beneficial. Accounting alternatives for private companies are incorporated into the relevant sections of the Accounting Standards Codification (ASC).

C. The IASB and the FASB began working together toward the international convergence of accounting standards in 2002. The FASB and IASB cooperated for several years to improve both U.S. GAAP and IFRS and to eliminate the differences between them. Recently, the scope of the overall convergence project has evolved. Many projects have been discontinued as joint projects, and each board is pursuing its own agenda.

D. The FASB conceptual framework (set forth in pronouncements called Statements of Financial Accounting Concepts, or SFAC) serves as a basis for all FASB pronouncements. The SFAC are not GAAP, but they provide a basis for financial accounting concepts for business and nonbusiness enterprises. As phases of this project become completed, the FASB will issue each component of the conceptual framework as a chapter in Statement of Financial Accounting Concepts No. 8, Conceptual Framework for Financial Reporting.

The IASB is developing the Conceptual Framework for Financial Reporting (Conceptual Framework), which describes the basic concepts that underlie the preparation and presentation of financial statements for external users. The conceptual framework assists the IASB in developing future IFRSs, evaluating existing IFRSs, and reducing the number of alternative accounting treatments permitted by IFRSs. The conceptual framework is not an IFRS.

The IASB conceptual framework is very similar to the FASB conceptual framework. Originally, the two boards were pursuing a joint project to develop the conceptual frameworks. Now, they are working independently. (Differences between the two are described in the F1 lecture.)

E. Terminology is key here—know the fundamental qualitative characteristics (relevance and faithful representation) and the enhancing qualitative characteristics (comparability, verifiability, timeliness, and understandability).

II. INCOME STATEMENT

A. Income Statement

Know the IDA mnemonic:

I: Income from continuing operations

D: Income from discontinued operations

A: Accounting principle changes (to retained earnings)

B. Discontinued Operations

Accounting for discontinued operations can consist of gain/loss on current operations, gain/loss on sale, and impairment loss. Discontinued operations are shown net of tax. Any of these must be reported as part of discontinued operations in the year incurred. If the operations are "held for sale," they are treated as discontinued. The disposal must represent a strategic shift that has or will have a major effect on an entity's operations and financial results to be reported as a discontinued operation.
C. Accounting Changes
   1. Accounting changes appear in three varieties: estimate, principle, and entity.
      a. Changes in estimates, such as the useful life of a plant asset, are incorporated into
         the accounting records for the current and future periods (prospectively). No adjustment
         of prior financial statements is required. A change in depreciation method is a change in
         accounting principle that is inseparable from a change in estimate and is accounted for as a change in
         estimate.
      b. Changes in principle (or method) involve switching from one acceptable method to another. The cumulative
effect is the change in retained earnings that results from restating prior years from the "old" method to the "new"
method at the beginning of the earliest year presented. The cumulative effect is reported as an adjustment to
beginning retained earnings, net of tax, in the statement of retained earnings.
         (1) Changes in Principle—Exception:
               When it is impracticable to estimate the change in retained earnings that would result from
measuring the asset or liability at fair value, the change in method is not applied prospectively (like changes
in estimate). In this case, no restatement of prior years occurs and there is no cumulative effect reported in
the statement of retained earnings (e.g., changing to U.S. GAAP LIFO from any other inventory method).
      c. Changes in entity require restatement of prior year's financial statements to
         conform with the new accounting entity when the prior financials are presented
         comparatively. IFRS does not include the concept of a change in entity.

D. Error Corrections
   Reported net of tax in the statement of retained earnings.

III. COMPREHENSIVE INCOME
   A. Comprehensive income includes all changes in owners’ equity other than transactions with
owners. The formula shows that comprehensive income must include net income plus/minus other
changes in owners’ equity not resulting from transactions with owners. These other changes are known as
other comprehensive income items.
   B. Other comprehensive income items are revenues, expense, gains, or losses that are
   included in comprehensive income but excluded from net income under U.S. GAAP
   and/or IFRS.
   C. The mnemonic PUFER represents the five commonly tested sources of other
      comprehensive income.
         1. Pension adjustments; covered in F6.
         2. Unrealized gains and losses on AFS securities; covered in F3.
         3. Foreign currency translation items; covered in F2.
4. Effective portion of cash flows hedges; covered in F7.
5. Revaluation surpluses (gains) recognized when intangible assets and fixed assets are revalued under IFRS; covered in F2 and F4.

D. Accumulated other comprehensive income is the cumulative sum of all of the individual components of other comprehensive income. Accumulated other comprehensive income is an owners' equity item.

E. Both U.S. GAAP and IFRS allow the statement of comprehensive income to be presented using the one-statement approach (statement of income and comprehensive income) or the two-statement approach (statement of income immediately followed by a separate statement of comprehensive income).

IV. BALANCE SHEET AND DISCLOSURES OVERVIEW
A. Review the terminology and be able to recognize a classified balance sheet.
B. The Summary of Significant Accounting Policies reflects the methods and policies employed by the firm.
C. IFRS requires an explicit and unreserved statement of compliance with IFRS in the notes to the financial statements. An entity cannot describe financial statements as complying with IFRS unless they comply with all IFRS requirements. U.S. GAAP does not have a similar requirement.
D. Understand the related party disclosure requirements and the disclosure of risks and uncertainties.

V. GOING CONCERN
A. An entity is considered to be a going concern if it is reasonably expected to remain in existence and to be able to settle all its obligations for the foreseeable future.
B. Under U.S. GAAP, preparation of financial statements presumes that the reporting entity will continue as a going concern. Under this presumption, financial statements are prepared under the going concern basis of accounting.
C. Management is required to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time not to exceed one year beyond the date of the financial statements.
D. U.S. GAAP and IFRS both emphasize management’s responsibility to evaluate the entity’s ability to continue as a going concern and provide relevant disclosures when necessary.

VI. INTERIM FINANCIAL REPORTING
Interim financial reports use the same IFRS/U.S. GAAP principles and practices as do annual financial reports, although U.S. GAAP allows certain principles and practices to be modified when preparing interim financial statements. Timeliness is emphasized over reliability and income taxes are estimated each quarter based on the estimated average tax rate for the whole year.
VII. SEGMENT REPORTING

A. A reportable segment exists if it meets one of three tests:
   1. Ten percent of combined revenues to internal and external parties.
   2. Ten percent of the greater of reported profit or loss (as an absolute amount). You should be familiar with the definition of operating profit: Segment revenues from sales to internal and external customers less directly traceable costs and also less reasonably allocated costs equals segment operating profit (loss).
   3. Ten percent of the combined assets of all operating segments.

B. The "75 percent reporting sufficiency test" is a "catch all" requirement that may require identification of additional segments to attain the 75 percent level. This test requires that reportable segments total at least 75 percent of revenue from external parties.

C. Under U.S. GAAP, entities must disclose segment profit or loss, segment assets, and certain other related items. Under IFRS, entities must disclose segment profit or loss, segment assets, segment liabilities (if such a measure is provided to the chief operating decision maker), and certain other related items. U.S. GAAP does not require a disclosure of segment liabilities.

VIII. SEC REPORTING REQUIREMENTS

A. Form 10-K must be filed annually by U.S. registered companies (issuers). The filing deadline for Form 10-K is 60 days after the end of the fiscal year for large accelerated filers, 75 days after the end of the fiscal year for accelerated filers, and 90 days after the end of the fiscal year for all other registrants. This form contains financial disclosures, including a summary of financial data, management's discussion and analysis (MD&A), and audited financial statements prepared using U.S. GAAP.

B. Form 10-Q must be filed quarterly by U.S. registered companies (issuers). The filing deadline for Form 10-Q is 40 days after the end of the fiscal quarter for large accelerated filers and accelerated filers, and 45 days after the end of the fiscal quarter for all other registrants. This form contains unaudited financial statements prepared using U.S. GAAP, interim period MD&A, and certain disclosures.

C. Regulation S-X outlines the form and content of and requirements for interim and annual financial statements to be filed with the SEC.