Miles CPA Review: FAR - 2017 Updates

Summary of updates:

- **"New version" CPA exam structure (w.e.f. April 2017)**
- **FAR-1.13 (III) – Personal F/S and FAR-1.13 (IV) – Liquidation Basis of Accounting** - No longer tested on the CPA exams [to be deleted]
- **FAR-2.3 (III) – Inventory Valuation** [ASU 2015-11]
- **FAR-3.1 (IB) – Equity Method** [ASU 2016-07]
- **FAR-5.1 (III) – Deferred Taxes – Temporary Differences** [ASU 2015-17]
- **FAR-6.1– Business Combinations & Consolidation – Accounting for Acquisitions** [ASU 2015-16]

"New version" CPA exam structure (w.e.f. April 2017):

MCQ testlets

50% weightage
Recommended time:

- **Testlet #1: 50 mins**
- **Testlet #2: 50 mins**

TBS/WCT testlets

50% weightage
Recommended time:

- **Testlet #3: 30 mins**
- **Testlet #4: 50 mins**
- **Testlet #5: 60 mins**

FAR	Testlet #1 33 MCQs	Testlet #2 33 MCQs	Testlet #3 2 TBSs	Break: 15 min	Testlet #4 3 TBSs	Testlet #5 3 TBSs
AUD	Testlet #1 36 MCQs	Testlet #2 36 MCQs	Testlet #3 2 TBSs	Break: 15 min	Testlet #4 3 TBSs	Testlet #5 3 TBSs
REG	Testlet #1 38 MCQs	Testlet #2 38 MCQs	Testlet #3 2 TBSs	Break: 15 min	Testlet #4 3 TBSs	Testlet #5 3 TBSs
BEC	Testlet #1 31 MCQs	Testlet #2 31 MCQs	Testlet #3 2 TBSs	Break: 15 min	Testlet #4 2 TBSs	Testlet #5 3 WCTs

Old version vs. New version:

	CPA exams (2011 – March 2017)	CPA exams w.e.f. April 2017
Skill-level tested	• Remembering & Understanding • Application	• Remembering & Understanding • Application • **Analysis** • **Evaluation** (for AUD only)
Exam structure & scoring weights	**FAR:** 90 MCQs (60%), 7 TBSs (40%) **AUD:** 90 MCQs (60%), 7 TBSs (40%) **REG:** 72 MCQs (60%), 6 TBSs (40%) **BEC:** 72 MCQs (85%), 3 WCTs (15%)	**FAR:** 66 MCQs (50%), 8 TBSs (50%) **AUD:** 72 MCQs (50%), 8 TBSs (50%) **REG:** 76 MCQs (50%), 8 TBSs (50%) **BEC:** 62 MCQs (50%), 4 TBSs (35%), 3 WCTs (15%)
# of Testlets	**4 testlets:** 3 MCQ testlets + 1 TBS/WCT testlet	**5 testlets:** 2 MCQ testlets + 3 TBS/WCT testlets
Time Allotment	**FAR:** 4 hours **AUD:** 4 hours **REG:** 3 hours **BEC:** 3 hours	**FAR:** 4 hours **AUD:** 4 hours **REG:** 4 hours **BEC:** 4 hours
Break	Optional breaks (count against time)	**15-min Standard break** (after Testlet #3) + Optional breaks (count against time)

*** MCQ - Multiple Choice Question | TBS - Task Based Simulation | WCT - Written Communication Task**

FAR-2.3 (III) – Inventory Valuation [ASU 2015-11]

- FASB issued Accounting Standards Update 2015-11 simplifying the measurement of inventories by replacing "Lower of Cost or Market" test with a "Lower of Cost or NRV" test. However, the new guidance applies only to inventories for which cost is determined by methods other than LIFO and retail inventory method - i.e., entities using LIFO or retail inventory methods continue with "Lower of Cost or Market" [IFRS always required "Lower of Cost or NRV"]
    - The Board released the new guidance as part of its simplification initiative, which, as explained in the ASU, is intended to "identify, evaluate, and improve areas of US GAAP for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to the users of financial statements"
    - Effective Dec 15, 2016, for public companies, and Dec 15, 2017, for non-public companies
- Earlier: US GAAP required "Lower of Cost or Market" for all methods

Example for Inventory Valuation:

Part 1:

LCM Co. determines that as of 12/31/2010 the replacement cost of its inventory is $100,000. Estimated selling price is $140,000 which includes selling expenses of $20,000 and a normal profit margin of $30,000. Cost of inventory is calculated to be $110,000 (assume same cost under both LIFO and FIFO). Calculate the value of inventory as of 12/31/2010 under LIFO and FIFO methods (both under US GAAP).

Part 2:

If replacement cost is re-calculated to be $80,000, what would be the new value of inventory

Solution - Part 1 of 2:

INVENTORY @COST	INVENTORY @MARKET
$110,000	Ceiling (NRV) = $140,000 - $20,000 = $120,000
	Floor (NRV - profit) = $120,000 - $30,000 = $90,000
	Replacement = $100,000

US GAAP - LIFO:

Market (Middle of the 3) = Replacement cost of $100,000

∴ **Lower of Cost ($110,000) or Market ($100,000) = $100,000**

US GAAP - FIFO *(same calculation for IFRS)*:

NRV = $120,000

∴ **Lower of Cost ($110,000) or NRV ($120,000) = $110,000**

Solution - Part 2 of 2:

INVENTORY @COST	INVENTORY @MARKET
$110,000	Ceiling (NRV) = $140,000 - $20,000 = $120,000
	Floor (NRV - profit) = $120,000 - $30,000 = $90,000
	Replacement = $80,000

US GAAP - LIFO:

Market (Middle of the 3) = Floor of $90,000

∴ **Lower of Cost ($110,000) or Market ($90,000) = $90,000**

US GAAP - FIFO *(same calculation for IFRS)*:

NRV = $120,000

∴ **Lower of Cost ($110,000) or NRV ($120,000) = $110,000**

FAR-3.1 (IB) – Equity Method [ASU 2016-07]

- **Changes in ownership percentages** - Apply the new method **prospectively** (i.e., going forward)
  - Equity to Cost (e.g., ownership changes from 30% to 15%) - Apply cost method prospectively
  - Cost to Equity (e.g., ownership changes from 15% to 30%) - Apply equity method prospectively
    - ✓ Note: If an AFS (available for sale) security is to be accounted for using the equity method, any unrealized holding gain/loss in Accumulated OCI is to be recognized as earnings

Note:

- FASB issued Accounting Standards Update 2016-07 which eliminates the requirement that when an investment qualifies for use of the equity method (as a result of an increase in ownership/influence), the investor must adjust retroactively as if the equity method had been in effect during all previous periods that the investment had been held
  - The Board released the new guidance as part of its simplification initiative, which, as explained in the ASU, is intended to "identify, evaluate, and improve areas of US GAAP for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to the users of financial statements"
  - Effective Dec 15, 2016
- Earlier: "To equity method" (e.g., cost to equity method) required retrospective treatment

Example on Change from Cost Method → Equity Method:

On 1/1/2008, Giant Co. makes a 15% investment in Dwarf Co., and then purchased an additional 15% at the beginning of 2009 gaining significant influence as a result of the second purchase. Also assume the following information about the investee:

	2008	2009
Net income	300,000	400,000
Dividends	50,000	60,000

Pass the 2009 Journal entries for Giant Co. (ignore tax effects)

Solution:

In 2008, Giant Co. used cost method, and recorded \$50,000 x 15% = \$7,500 of dividend income

In 2009, Giant Co. used equity method, and recorded \$400,000 x 30% = \$120,000 of equity in earnings in Dwarf Co. Entries for current year are:

12/31/2009: Entry for current income:

	Dr	Cr
Investment	120,000	
Equity in Earnings		120,000

12/31/2009: Entry for current dividend:

	Dr	Cr
Cash	18,000	
Investment		18,000

FAR-5.1 (III) – Deferred Taxes – Temporary Differences [ASU 2015-17]

- **B/S presentation:**
  - **Always classify deferred tax assets & liabilities as non-current**

> Note:
> - FASB issued Accounting Standards Update 2015-17 requiring companies to **classify <u>all</u> deferred tax assets and liabilities as noncurrent on B/S** [IFRS always had this requirement]
>   - The Board released the new guidance as part of its simplification initiative, which, as explained in the ASU, is intended to "identify, evaluate, and improve areas of US GAAP for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to the users of financial statements"
>   - Effective Dec 15, 2016, for public companies, and Dec 15, 2017, for non-public companies
> - <u>Earlier:</u> Deferred tax assets & liabilities were segregated into current and noncurrent amounts

- **Netting of deferred tax assets and liabilities:**
  - ✓ GAAP allows separate netting of deferred tax assets & liabilities resulting in a single non-current amount to be reported on the B/S

    E.g., Assume Net Co. has the following temporary differences:
    (i) Deferred Tax Asset (Non-current) = $300,
    (ii) Deferred Tax Liability (Non-current) = $200

    On the B/S, following amount would be reported:
    - **Non-current Asset:** Deferred Tax Asset = $300 - $200 = $100

  - ✓ ***Under IFRS, allowed to net non-current deferred tax assets & liabilities only if the amounts relate to the same taxing authority (e.g., same country)*** *and they have a legal right to offset the amounts*

FAR-6.1– Business Combinations & Consolidation – Accounting for Acquisitions [ASU 2015-16]

- Acquisition date = date on which the Parent obtains control of the Sub
  - ✓ Measurement period = one year from acquisition date when the Parent is allowed to revise the fair values of assets/liabilities acquired during the combination
    - ⇒ If the values change in the 2nd year after the acquisition or later, change is accounted for prospectively per FASB Accounting Standards Update 2015-16; this new guidance is part of FASB's simplification initiative (<u>earlier:</u> if the values changed in the 2nd year after the acquisition or later, retrospective change was required)