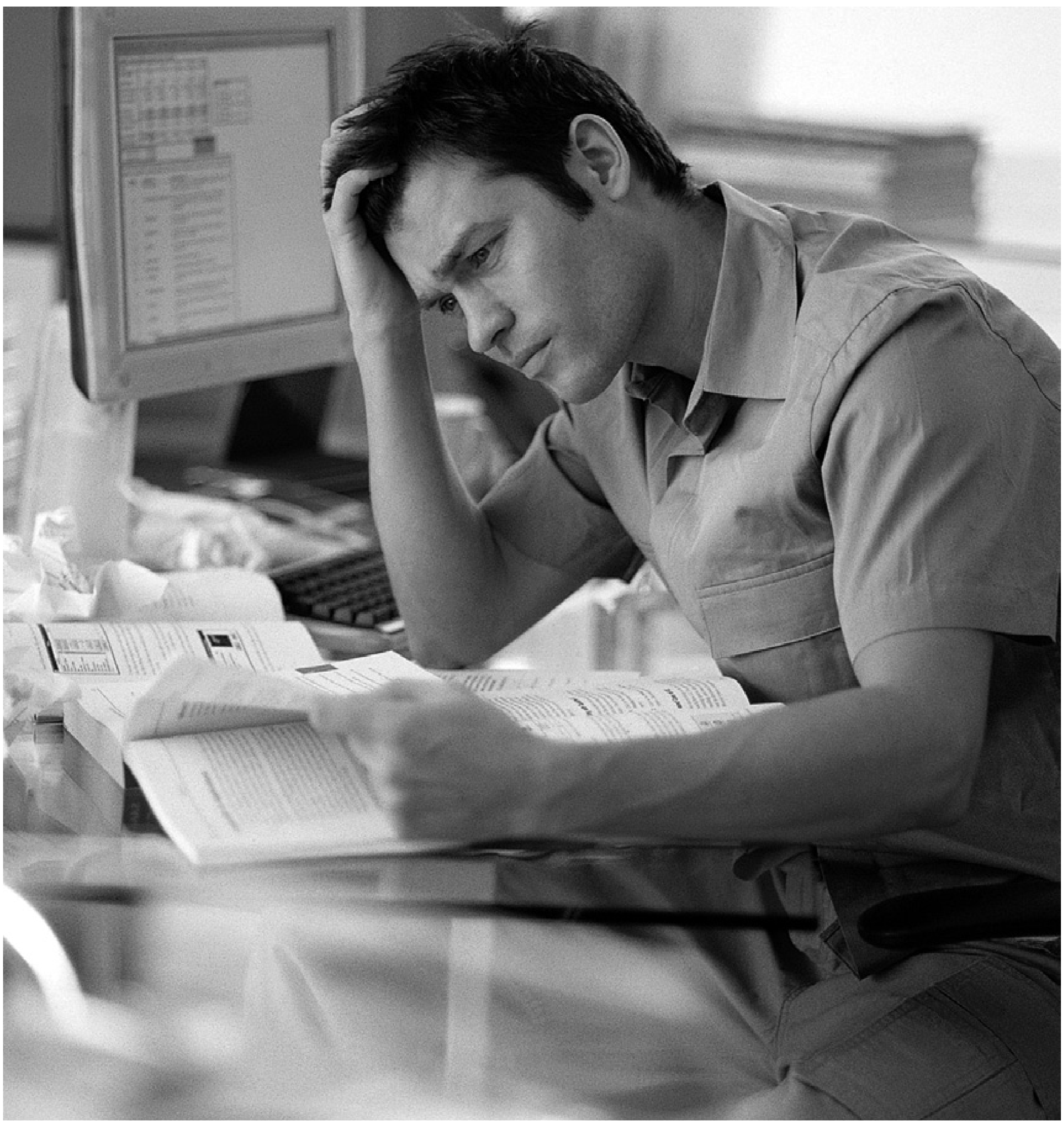

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New IFRS standards will change the face of financial statements, but should also make them easier to understand.

ACCOUNTING

Accounting for new financial statements

IFRS CHANGES

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After years of figuring out how balance sheets and income statements work, non-financial executives are in for a big surprise. When International Financial Reporting Standards (IFRS) come to Canada in January, 2011, the look and feel of the financial statements as we know them are likely to change substantially.

IFRS is a standardized set of accounting principles sweeping across the world. The globalized norms gained a lot of prominence in 2005 when the European Union, Australia and New Zealand adopted IFRS. When Canada adopts IFRS in 2011, these international standards will replace our current accounting rules, called Generally Accepted Accounting Principles (GAAP), for all publicly accountable enterprises. The United States will not adopt IFRS before 2014, but it will still adopt the new financial statements in 2011.

The financial statements' proposed new format would become the boldest accounting change business professionals have witnessed in decades. These changes are under consideration by two major global accounting regulators, the International Accounting Standards Board (IASB) in Europe and the Financial Accounting Standards Board (FASB) in the United States. While it is true that accounting regulators constantly fine-tune accounting standards to improve financial information transparency, most business people don't care about the intricate details of how the numbers are calculated. They browse through statements to understand the financial highlights and leave it to their accountants to understand the details behind the numbers.

Throughout all the accounting scandals of the past century, the general structure of the financial statements remained the same: An income statement calculates profit (or loss), and a balance sheet shows an organization's assets, liabilities and equity, and splits these up into short-term and long-term sub-categories. Many non-financial business people have attended courses or hired executive coaches to help them understand how to sort through these numbers. For all these people who derive comfort from the fact that balance sheets "balance," that comfort level is about to disappear.

Business professionals look at a balance sheet today and quickly see that total assets equal liabilities plus equity. Under IFRS, instead of being split into the traditional categories of assets, liabilities and equity, the new balance sheet will be structured in five categories — operating, financing, investing, taxes and discontinued operations. (The statements on this page illustrate the changes — see chart at right.) Assets and liabilities will be scattered in each section while equity will remain intact.

At first glance, it looks like the balance sheet doesn't even balance. Of course the balance sheet still balances, but it just isn't as obvious.

Companies won't be required to show a total for assets or liabilities on the new balance sheet as long as these totals are included somewhere in the financial statement notes. The same holds true for subtotals related to short-term or long-term assets and liabilities. Unfortunately, financial statement notes can be quite lengthy — from 10 pages to more than 200 pages — and they are written in technical accounting language. Most people don't even look at the notes. Hopefully, organizations will disclose the totals directly on the new balance sheets, which they are allowed but not required to do. After all, the idea behind the new format is to make it easier for financial statement readers to find the information they are looking for.

> "There will be two formats floating around in 2011

The income statement and cash-flow statement will also be split into the operating, financing and investing categories, and will be much more detailed than they are now.

For some people, this will be a positive change since it will mean all the financial statements will have the same look and feel. For others, however, this change means the income statement becomes more complicated.

A welcome change with IFRS is the new cash-flow statement, which will show clearly and concisely the sources and uses of cash in the organization. Current cash-flow statements are supposed to accomplish this but they are usually more confusing than helpful to non-financial professionals because they don't show cash flows directly. Instead, readers calculate cash flow by making a number of adjustments to net income. Without taking a few accounting courses, it's very difficult to look at a cash-flow statement and see how much cash is coming from customers or being spent on suppliers. The new format will solve this problem and be much easier for the non-financial professional to understand.

On the other hand, financial professionals who love today's cash-flow statement will appreciate a new schedule in the notes to the financial statements that will reconcile net income to cash flow, similar to the current cash flow statement, but with much more detail.

If all of this wasn't confusing enough, IFRS won't even be used by all organizations. In 2011, IFRS will become mandatory for publicly accountable companies in Canada. Private companies and not-for-profit organizations will be able to continue following existing Canadian accounting standards.

This means that there will be two financial statement formats floating around and people wanting to improve their financial skills will have twice as much work to do to learn about both types of formats.

The new format of the financial statements makes sense, giving a common look and feel to the different financial statements so that it is easier to make linkages between statements. That being said, people are creatures of habit and after years of struggling to decipher financials in one format, there is no doubt that it will be challenging for most people to switch over to the new format. In fact, it almost means relearning about finance all over again.

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FINANCIAL STATEMENTS

BEFORE IFRS

	2011	2010
ASSETS		
Current assets		
Cash	57,200	37,600
Accounts receivable, net	26,400	21,200
Inventory	10,400	8,000
Available-for-sale financial assets	800	1,200
Held-for-sale financial assets	8,000	8,800
Other current assets	7,600	9,600
Total current assets	**110,400**	**86,400**
Property, plant and equipment, net	10,000	7,200
Investments accounted for using equity method	2,400	2,000
Goodwill and other intangible assets	32,400	37,200
Deferred tax assets	4,200	5,400
Total fixed assets	**49,000**	**51,800**
TOTAL ASSETS	**159,400**	**138,200**
LIABILITIES AND EQUITY		
Current liabilities		
Borrowings	5,600	400
Accounts payable, trade	7,600	6,400
Other current liabilities	26,800	35,600
Total current liabilities	**40,000**	**42,400**
Borrowings	31,600	22,800
Other non- current liabilities	2,000	1,200
Long term liabilities	33,600	24,000
Total liabilities	**73,600**	**66,400**
SHAREHOLDER'S EQUITY		
Share capital	18,000	18,400
Retained earnings	64,100	50,000
Accumulated other comprehensive income	3,700	3,400
Total equity	**85,800**	**71,800**
TOTAL EQUITY AND LIABILITIES	**159,400**	**138,200**

AFTER IFRS

	2011	2010
BUSINESS		
Operating		
Receivables	27,200	21,600
Less: allowance for bad debt	(800)	(400)
Inventory	10,400	8,000
Prepaid expenses	7,600	9,600
Short-term assets	44,400	38,800
Property, plant and equipment	13,600	9,600
Less: accumulated depreciation	(3,600)	(2,400)
Goodwill	8,000	10,000
Intangibles (net)	24,400	27,200
Long-term assets	42,400	44,400
Accounts payable	(7,600)	(6,400)
Accrued liabilities	(22,400)	(29,600)
Short-term liabilities	(30,000)	(36,000)
Accrued long-term liabilities	(2,000)	(1,200)
Long-term liabilities	(2,000)	(1,200)
Net operating assets	**54,800**	**46,000**
Investing	-	-
Available for sale assets (short-term)	800	1,200
Investment in sub (long-term)	2,400	2,000
Total investing assets	**3,200**	**3,200**
NET BUSINESS ASSETS	**58,000**	**49,200**
FINANCING		
Financing assets	-	-
Cash	57,200	37,600
Total financing assets	**57,200**	**37,600**
Financing liabilities	-	-
Dividends payable	(1,200)	(1,200)
Short-term debt	(5,600)	(400)
Short-term financing liabilities	(6,800)	(1,600)
Long -term debt	(28,400)	(19,600)
Total financing liabilities	**(35,200)**	**(21,200)**
NET FINANCING ASSETS	**22,000**	**16,400**
INCOME TAXES		
Short-term	-	-
Income tax payable	(3,200)	(4,800)
Long-term	-	-
Deferred tax assets	4,200	5,400
NET INCOME TAX ASSET	**1,000**	**600**
DISCONTINUED OPERATIONS		
Assets held for sale	8,000	8,800
Liabilities related to assets held for sale	(3,200)	(3,200)
NET ASSETS HELD FOR SALE	**4,800**	**5,600**
NET ASSETS	**85,800**	**71,800**
EQUITY		
Share capital	(18,000)	(18,400)
Retained earnings	(64,100)	(50,000)
Accumulated other comprehensive income	(3,700)	(3,400)
TOTAL EQUITY	**(85,800)**	**(71,800)**

SOURCE: KNOWLEDGE PLUS CORP. NATIONAL POST