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IFRS and US GAAP: similarities and differences

2015

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Other primary contributors that contributed to the content or served as technical reviewers of this publication include Edward Abahoonie, John Althoff, Chris Barello, Catherine Benjamin, Lawrence Dodyk, Gina Klein, Yoo-Bi Lee, Kirsten Schofield, Jay Seliber, Chad Soares, and Simon Whitehead.

Other contributors include Mercedes Bano, Yelena Belokovyyenko, Derek Carmichael, Ernesto Mendez, Richard Davis, Fiona Hackett, Robert Kianos, Gabriela Martinez, Dr. Holger Meurer, Ruth Preedy, Irina Sedelnikova, Jessica Taurae, and Hugo Van Den Ende.

Preface

This publication is designed to alert companies, investors, and other capital market participants to the major differences between IFRS and US GAAP as they exist today, and to the timing and scope of accounting changes that the standard setting agenda's of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) (collectively, the Boards) will bring.

It would appear that the use of IFRS in the United States by public companies will not be required for the foreseeable future. However, as discussed in Chapter 1, knowing both accounting frameworks, being financially bilingual, is increasingly important for US capital market participants.

Each topical chapter consists of the following:

- A conceptual discussion of the current IFRS and US GAAP similarities and differences
- A more detailed analysis of current differences between the frameworks, including an assessment of the impact embodied within the differences
- Commentary and insight with respect to recent/proposed guidance

In addition, this publication also includes an overview of IFRS for small and medium-sized entities.

This publication is not all-encompassing. It focuses on those differences that we generally consider to be the most significant or most common. When applying the individual accounting frameworks, companies should consult all of the relevant accounting standards and, where applicable, national law.

Guidance date

This publication considers authoritative pronouncements and other developments under IFRS and US GAAP through June 1, 2015. Future editions will be released to keep pace with significant developments. In addition, this publication supersedes all previously issued editions.

Other information

The appendices to this guide include a FASB/IASB project summary exhibit, noteworthy updates since the previous edition, and an index.

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Chapter 1:
Importance of being
financially bilingual

1.1 Overview

Many of the world's capital markets now require IFRS, or some form thereof, for financial statements of public-interest entities. For specific country data, see our publication IFRS adoption by country (<http://www.pwc.com/us/en/issues/ifrs-reporting/publications/ifrs-status-country.jhtml>), and for additional information, see the IASB's jurisdictional profiles (<http://www.ifrs.org/Use-around-the-world/Pages/Jurisdiction-profiles.aspx>).

The remaining major capital markets without an IFRS mandate are:

- The US, with no current plans to change
- Japan, where voluntary adoption is allowed, but no mandatory transition date has been established
- India, which announced in January 2015 its final roadmap requiring the use over the next several years of Indian accounting standards that are significantly converged with IFRS
- China, which intends to fully converge at some undefined future date

Continued global adoption affects US businesses, as additional countries permit or require IFRS for statutory reporting purposes and public filings. IFRS requirements elsewhere in the world also impact US companies through cross-border, merger and acquisition (M&A) activity, and the IFRS reporting demands of non-US stakeholders. Accordingly, it is clear from a preparer perspective that being financially bilingual in the US is increasingly important.

From an investor perspective, the need to understand IFRS is arguably even greater. US investors keep looking overseas for investment opportunities. Recent estimates suggest that over \$9 trillion of US capital is invested in foreign securities. The US markets also remain open to non-US companies that prepare their financial statements using IFRS. There are currently over 500 non-US filers with market capitalization in the multiple of trillions of US dollars who use IFRS without reconciliation to US GAAP.

To assist investors and preparers in obtaining this bilingual skill, this publication provides a broad understanding of the major differences between IFRS and US GAAP as they exist today, as well as an appreciation for the level of change on the horizon. While this publication does not cover every difference between IFRS and US GAAP, it focuses on those differences we generally consider to be the most significant or most common.

1.2 IFRS and the SEC

The discussion about the use of IFRS in the US continues. In a speech in May 2014, SEC Chair Mary Jo White stated that considering whether to incorporate IFRS into the US financial reporting system continues to be a priority and she “hopes to be able

to say more in the relatively near future.” In recent public speeches, Chief Accountant of the SEC’s Office of the Chief Accountant, James Schnurr, discussed the potential for further incorporating IFRS into the US capital markets by allowing domestic issuers to provide IFRS-based information as a supplement to US GAAP financial statements without requiring reconciliation. He also noted that the SEC staff is currently developing a recommendation for the Commission that is intended to provide clarity to investors.

Although Schnurr acknowledged that there is continued support for the objective of a single set of high-quality, globally accepted accounting standards, he indicated that there is little support for the SEC to provide an option allowing domestic companies to prepare their financial statements under IFRS, and there is virtually no support to have the SEC mandate IFRS for all companies.

Finally, Schnurr indicated that he believed that, for the foreseeable future, continued collaboration among the IASB, the FASB, the IFRS Foundation (the trustees of the IASB), and the Financial Accounting Foundation (the trustees of the FASB) is the only realistic path to further the objective of a single set of high-quality, global accounting standards. Accordingly, he stated that how these entities decide to interact in the future is critical to this objective.

1.3 IFRS affects US businesses in multiple ways

While use of IFRS in the United States by public companies will not be required in the foreseeable future, IFRS remains or is becoming increasingly relevant to many US businesses. Companies will be affected by IFRS at different times and to a different degree, depending on factors such as size, industry, geographic makeup, M&A activity, and global expansion plans. The following discussion expands on these impacts.

1.3.1 Mergers and acquisitions and capital-raising

Global M&A transactions are on the rise. As more companies look outside their borders for potential buyers, targets, and capital, knowledge and understanding of IFRS becomes increasingly important. Despite the Boards’ recent standard-setting coordination, significant differences in both bottom-line impact and disclosure requirements will remain. Understanding these differences and their impact on key deal metrics, as well as on both short- and long-term financial-reporting requirements, will lead to a more informed decision-making process and help minimize late surprises that could significantly impact deal value or completion.

1.3.2 Non-US stakeholders

As our marketplace becomes increasing global, more US companies begin to have non-US stakeholders. These stakeholders may require IFRS financial information, audited IFRS financial statements, and budgets and management information prepared under IFRS.

1.3.3 *Non-US subsidiaries*

Many countries currently require or permit IFRS for statutory financial reporting purposes, while other countries have incorporated IFRS into their local accounting framework used for statutory reporting. As a result, multinational companies should, at a minimum, monitor the IFRS activity of their non-US subsidiaries. Complex transactions, new IFRS standards, and changes in accounting policies may have an impact on an organization beyond that of a specific subsidiary.

1.3.4 *US reporting*

Although the era of convergence is coming to a close, the impacts of the accounting changes resulting from the Boards' joint efforts have been significant, and the two accounting frameworks have moved closer together during this time (e.g., the new revenue guidance). Although the Boards are no longer formally working together in most areas, differences between the two frameworks continue to be removed. A recent example is the US GAAP change relating to the reporting of discontinued operations. The new guidance is now substantially aligned with IFRS.

1.4 *Our point of view*

In conclusion, we continue to believe in the long-term vision of a single set of consistently applied, high-quality, globally accepted accounting standards. However, acceptance of an outright move to international standards is off the table, at least for now. In the meantime, the FASB and IASB should continue to focus on improving the quality of their standards while, if possible, reducing differences between IFRS and US GAAP.

Chapter 2: ***IFRS first-time adoption***

2.1 *IFRS first-time adoption*

IFRS 1, *First-Time Adoption of International Financial Reporting Standards*, is the standard that is applied during preparation of a company's first IFRS-based financial statements. IFRS 1 was created to help companies transition to IFRS and provides practical accommodations intended to make first-time adoption cost-effective. It also provides application guidance for addressing difficult conversion topics.

2.1.1 *What does IFRS 1 require?*

The key principle of IFRS 1 is full retrospective application of all IFRS standards that are effective as of the closing balance sheet or reporting date of the first IFRS financial statements. Full retrospective adoption can be very challenging and burdensome. To ease this burden, IFRS 1 gives certain optional exemptions and certain mandatory exceptions from retrospective application.

IFRS 1 requires companies to:

- Identify the first IFRS financial statements
- Prepare an opening balance sheet at the date of transition to IFRS
- Select accounting policies that comply with IFRS effective at the end of the first IFRS reporting period and apply those policies retrospectively to all periods presented in the first IFRS financial statements
- Consider whether to apply any of the optional exemptions from retrospective application
- Apply the seven mandatory exceptions from retrospective application. Two exceptions regarding classification and measurement periods of financial assets and embedded derivatives relate to amendments to IFRS 9, which is effective for annual reporting periods beginning on or after January 1, 2018
- Make extensive disclosures to explain the transition to IFRS

IFRS 1 is regularly updated to address first-time adoption issues. There are currently twenty-one long-term optional exemptions (nineteen of which are effective) to ease the burden of retrospective application. These exemptions are available to all first-time adopters, regardless of their date of transition. Additionally, the standard provides for short-term exemptions, which are temporarily available to users and often address transition issues related to new standards. There are currently four such short-term exemptions. As referenced above, the exemptions provide limited relief for first-time adopters, mainly in areas where the information needed to apply IFRS retrospectively might be particularly challenging to obtain. There are, however, no exemptions from the disclosure requirements of IFRS, and companies may experience challenges in collecting new information and data for retrospective footnote disclosures.

Many companies will need to make significant changes to existing accounting policies to comply with IFRS, including in such key areas as revenue recognition, inventory accounting, financial instruments and hedging, employee benefit plans, impairment testing, provisions, and stock-based compensation.

2.1.2 *When to apply IFRS 1*

Companies will apply IFRS 1 when they prepare their first IFRS financial statements, including when they transition from their previous GAAP to IFRS. These are the first financial statements to contain an explicit and unreserved statement of compliance with IFRS.

2.1.3 *The opening IFRS balance sheet*

The opening IFRS balance sheet is the starting point for all subsequent accounting under IFRS and is prepared at the date of transition, which is the beginning of the earliest period for which full comparative information is presented in accordance with IFRS. For example, preparing IFRS financial statements for the three years ending December 31, 2016, would have a transition date of January 1, 2014. That would also be the date of the opening IFRS balance sheet.

IFRS 1 requires that the opening IFRS balance sheet:

- Include all of the assets and liabilities that IFRS requires
- Exclude any assets and liabilities that IFRS does not permit
- Classify all assets, liabilities, and equity in accordance with IFRS
- Measure all items in accordance with IFRS
- Be prepared and presented within an entity's first IFRS financial statements

These general principles are followed unless one of the optional exemptions or mandatory exceptions does not require or permit recognition, classification, and measurement in line with the above.

2.1.4 *Important takeaways*

The transition to IFRS can be a long and complicated process with many technical and accounting challenges to consider. Experience with conversions in Europe and Asia indicates there are some challenges that are consistently underestimated by companies making the change to IFRS, including:

Consideration of data gaps—Preparation of the opening IFRS balance sheet may require the calculation or collection of information that was not previously required under US GAAP. Companies should plan their transition and identify the differences between IFRS and US GAAP early so that all of the information required can be collected and verified in a timely manner. Likewise, companies should identify differences between local regulatory requirements and IFRS. This could impact the

amount of information-gathering necessary. For example, certain information required by the SEC but not by IFRS (e.g., a summary of historical data) can still be presented, in part, under US GAAP but must be clearly labeled as such, and the nature of the main adjustments to comply with IFRS must be discussed. Other incremental information required by a regulator might need to be presented in accordance with IFRS. For example, the SEC in certain instances requires two years of comparative IFRS financial statements, whereas IFRS would require only one.

Consolidation of additional entities—IFRS consolidation principles differ from those of US GAAP in certain respects and those differences might cause some companies either to deconsolidate entities or to consolidate entities that were not consolidated under US GAAP. Subsidiaries that previously were excluded from the consolidated financial statements are to be consolidated as if they were first-time adopters on the same date as the parent. Companies also will have to consider the potential data gaps of investees to comply with IFRS informational and disclosure requirements.

Consideration of accounting policy choices—A number of IFRS standards allow companies to choose between alternative policies. Companies should select carefully the accounting policies to be applied to the opening balance sheet and have a full understanding of the implications to current and future periods. Companies should take this opportunity to evaluate their IFRS accounting policies with a “clean sheet of paper” mind-set. Although many accounting requirements are similar between US GAAP and IFRS, companies should not overlook the opportunity to explore alternative IFRS accounting policies that might better reflect the economic substance of their transactions and enhance their communications with investors.

Chapter 3: ***Revenue recognition***

3.1 Revenue recognition

In May 2014, the FASB and IASB issued their long-awaited converged standard on revenue recognition, *Revenue from Contracts with Customers*. The revenue standard was originally issued with effective dates for calendar year-end companies in 2017 (2018 for non-public entities following US GAAP); however, as noted in SD 3.11.1.7, both boards have proposals to defer the effective date by a year. Refer to SD 3.11.1.7 for further discussion. The new model is expected to impact revenue recognition under both US GAAP and IFRS, and will eliminate many of the existing differences in accounting for revenue between the two frameworks. Many industries having contracts in the scope of the new standard will be affected, and some will see pervasive changes. Refer to the Recent/proposed guidance section of this chapter for a further discussion of the new revenue standard.

Until the new revenue standard is effective for all entities, existing differences between the two frameworks remain. US GAAP revenue recognition guidance is extensive and includes a significant number of standards issued by the Financial Accounting Standards Board (FASB), the Emerging Issues Task Force (EITF), the American Institute of Certified Public Accountants (AICPA), and the US Securities and Exchange Commission (SEC). The guidance tends to be highly detailed and is often industry-specific. While the FASB's codification has put authoritative US GAAP in one place, it has not impacted the volume and/or nature of the guidance. IFRS has two primary revenue standards and four revenue-focused interpretations. The broad principles laid out in IFRS are generally applied without further guidance or exceptions for specific industries.

A detailed discussion of industry-specific differences is beyond the scope of this publication. However, the following examples illustrate industry-specific US GAAP guidance and how that guidance can create differences between US GAAP and IFRS and produce conflicting results for economically similar transactions.

- US GAAP guidance on software revenue recognition requires the use of vendor-specific objective evidence (VSOE) of fair value in determining an estimate of the selling price. IFRS does not have an equivalent requirement.
- Activation services provided by telecommunications providers are often economically similar to connection services provided by cable television companies. The US GAAP guidance governing the accounting for these transactions, however, differs. As a result, the timing of revenue recognition for these economically similar transactions also varies.

As noted above, IFRS contains minimal industry-specific guidance. Rather, the broad principles-based approach of IFRS is to be applied across all entities and industries. A few of the more significant, broad-based differences are highlighted below:

Contingent pricing and how it factors into the revenue recognition models vary between US GAAP and IFRS. Under US GAAP, revenue recognition is based on fixed or determinable pricing criterion, which results in contingent amounts generally not being recorded as revenue until the contingency is resolved. IFRS looks to the

probability of economic benefits associated with the transaction flowing to the entity and the ability to reliably measure the revenue in question, including any contingent revenue. This could lead to differences in the timing of revenue recognition, with revenue potentially being recognized earlier under IFRS.

Two of the most common revenue recognition issues relate to (1) the determination of when transactions with multiple deliverables should be separated into components and (2) the method by which revenue gets allocated to the different components. US GAAP requires arrangement consideration to be allocated to elements of a transaction based on relative selling prices. A hierarchy is in place which requires VSOE of fair value to be used in all circumstances in which it is available. When VSOE is not available, third-party evidence (TPE) may be used. Lastly, a best estimate of selling price may be used for transactions in which VSOE or TPE does not exist. The residual method of allocating arrangement consideration is no longer permitted under US GAAP (except under software industry guidance), but continues to be an option under IFRS. Under US GAAP and IFRS, estimated selling prices may be derived in a variety of ways, including cost plus a reasonable margin.

The accounting for customer loyalty programs may drive fundamentally different results. The IFRS requirement to treat customer loyalty programs as multiple-element arrangements, in which consideration is allocated to the goods or services and the award credits based on fair value through the eyes of the customer, would be acceptable for US GAAP purposes. US GAAP reporting companies, however, may use the incremental cost model, which is different from the multiple-element approach required under IFRS. In this instance, IFRS generally results in the deferral of more revenue.

US GAAP prohibits use of the cost-to-cost percentage-of-completion method for service transactions (unless the transaction explicitly qualifies as a particular type of construction or production contract). Most service transactions that do not qualify for these types of construction or production contracts are accounted for under a proportional-performance model. IFRS requires use of the percentage-of-completion method in recognizing revenue in service arrangements unless progress toward completion cannot be estimated reliably (in which case a zero-profit approach is used) or a specific act is much more significant than any other (in which case revenue recognition is postponed until the significant act is executed). Prohibition of the use of the completed contract method under IFRS and diversity in application of the percentage-of-completion method might also result in differences.

Due to the significant differences in the overall volume of revenue-related guidance, a detailed analysis of specific fact patterns is normally necessary to identify and evaluate the potential differences between the accounting frameworks.

Technical references

US GAAP

ASC 605-20-25-1 through 25-6, ASC 605-20-25-14 through 25-18, ASC 605-25, ASC 605-35, ASC 605-50, ASC 985-605, CON 5, SAB Topic 13

IFRS

IAS 11, IAS 18, IFRIC 13, IFRIC 15, IFRIC 18, SIC 31

Note

The following discussion captures a number of the more significant GAAP differences. It is important to note that the discussion is not inclusive of all GAAP differences in this area.

3.2 Revenue recognition—general

The concept of IFRS being principles-based, and US GAAP being principles-based but also rules-laden, is perhaps nowhere more evident than in the area of revenue recognition.

This fundamental difference requires a detailed, transaction-based analysis to identify potential GAAP differences.

Differences may be affected by the way companies operate, including, for example, how they bundle various products and services in the marketplace.

US GAAP

Revenue recognition guidance is extensive and includes a significant volume of literature issued by various US standard setters.

Generally, the guidance focuses on revenue being (1) either realized or realizable and (2) earned. Revenue recognition is considered to involve an exchange transaction; that is, revenue should not be recognized until an exchange transaction has occurred.

These rather straightforward concepts are augmented with detailed rules.

IFRS

Two primary revenue standards capture all revenue transactions within one of four broad categories:

- Sale of goods
- Rendering of services
- Others' use of an entity's assets (yielding interest, royalties, etc.)
- Construction contracts

Revenue recognition criteria for each of these categories include the probability that the economic benefits associated with the transaction will flow to the entity and that the revenue and costs can be measured reliably. Additional recognition criteria apply within each broad category.

The principles laid out within each of the categories are generally to be applied without significant further rules and/or exceptions.

US GAAP

A detailed discussion of industry-specific differences is beyond the scope of this publication. For illustrative purposes only, we note that highly specialized guidance exists for software revenue recognition. One aspect of that guidance focuses on the need to demonstrate VSOE of fair value in order to separate different software elements in a contract. This requirement goes beyond the general fair value requirement of US GAAP.

IFRS

The concept of VSOE of fair value does not exist under IFRS, thereby resulting in more elements likely meeting the separation criteria under IFRS.

Although the price that is regularly charged by an entity when an item is sold separately is the best evidence of the item's fair value, IFRS acknowledges that reasonable estimates of fair value (such as cost plus a reasonable margin) may, in certain circumstances, be acceptable alternatives.

3.3 *Contingent consideration—general*

Revenue may be recognized earlier under IFRS when there are contingencies associated with the price/level of consideration.

US GAAP

General guidance associated with contingencies around consideration is addressed within SEC Staff Accounting Bulletin (SAB) Topic 13 and the concept of the seller's price to the buyer being fixed or determinable.

Even when delivery clearly has occurred (or services clearly have been rendered), the SEC has emphasized that revenue related to contingent consideration should not be recognized until the contingency is resolved. It would not be appropriate to recognize revenue based upon the probability of a factor being achieved.

IFRS

For the sale of goods, one looks to the general recognition criteria as follows:

- The entity has transferred to the buyer the significant risks and rewards of ownership;
- The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- The amount of revenue can be measured reliably;
- It is probable that the economic benefits associated with the transaction will flow to the entity; and
- The costs incurred or to be incurred with respect to the transaction can be measured reliably.

US GAAP**IFRS**

IFRS specifically calls for consideration of the probability of the benefits flowing to the entity as well as the ability to reliably measure the associated revenue. If it were probable that the economic benefits would flow to the entity and the amount of revenue could be reliably measured, contingent consideration would be recognized assuming that the other revenue recognition criteria are met. If either of these criteria were not met, revenue would be postponed until all of the criteria are met.

3.4 Multiple-element arrangements—general

While the guidance often results in the same treatment under the two frameworks, careful consideration is required, as there is the potential for significant differences.

US GAAP**IFRS**

Revenue arrangements with multiple deliverables are separated into different units of accounting if the deliverables in the arrangement meet all of the specified criteria outlined in the guidance. Revenue recognition is then evaluated independently for each separate unit of accounting.

US GAAP includes a hierarchy for determining the selling price of a deliverable. The hierarchy requires the selling price to be based on VSOE if available, third-party evidence (TPE) if VSOE is not available, or estimated selling price if neither VSOE nor TPE is available. An entity must make its best estimate of selling price (BESP) in a manner consistent with that used to determine the price to sell the deliverable on a standalone basis. No estimation methods are prescribed; however, examples include the use of cost plus a reasonable margin.

The revenue recognition criteria usually are applied separately to each transaction. In certain circumstances, however, it is necessary to separate a transaction into identifiable components to reflect the substance of the transaction.

At the same time, two or more transactions may need to be grouped together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.

The price that is regularly charged when an item is sold separately is the best evidence of the item's fair value. At the same time, under certain circumstances, a cost-plus-reasonable-margin approach to estimating fair value would be appropriate under IFRS. The use of the residual method and, under rare circumstances, the reverse residual method may be acceptable to allocate arrangement consideration.

US GAAP**IFRS**

Given the requirement to use BESP if neither VSOE nor TPE is available, arrangement consideration will be allocated at the inception of the arrangement to all deliverables using the relative selling price method.

The residual method is precluded.

The reverse-residual method (when objective and reliable evidence of the fair value of an undelivered item or items does not exist) is also precluded unless other US GAAP guidance specifically requires the delivered unit of accounting to be recorded at fair value and marked to market each reporting period thereafter.

3.4.1 Multiple-element arrangements—contingencies

In situations where the amount allocable to a delivered item includes an amount that is contingent on the delivery of additional items, differences in the frameworks may result in recognizing a portion of revenue sooner under IFRS.

US GAAP**IFRS**

The guidance includes a strict limitation on the amount of revenue otherwise allocable to the delivered element in a multiple-element arrangement.

Specifically, the amount allocable to a delivered item is limited to the amount that is not contingent on the delivery of additional items. That is, the amount allocable to the delivered item or items is the lesser of the amount otherwise allocable in accordance with the guidance or the noncontingent amount.

IFRS maintains its general principles and would look to key concepts including, but not limited to, the following:

- Revenue should not be recognized before it is probable that economic benefits would flow to the entity
- The amount of revenue can be measured reliably

When a portion of the amount allocable to a delivered item is contingent on the delivery of additional items, IFRS might not impose a limitation on the amount allocated to the first item. A thorough consideration of all factors would be necessary so as to draw an appropriate conclusion. Factors to consider would include the extent to which fulfillment of the undelivered item is within the control of, and is a normal/customary deliverable for, the selling party, as well as the ability and intent of the selling party to enforce the terms of the arrangement. In practice, the potential limitation is often overcome.

3.4.2 *Multiple-element arrangements—customer loyalty programs*

Entities that grant award credits as part of sales transactions, including awards that can be redeemed for goods and services not supplied by the entity, may encounter differences that impact both the timing and total value of revenue to be recognized.

Where differences exist, revenue recognition is likely to be delayed under IFRS.

US GAAP

Currently, divergence exists under US GAAP in the accounting for customer loyalty programs. Two very different models generally are employed.

Some companies utilize a multiple-element accounting model, wherein revenue is allocated to the award credits based on relative fair value. Other companies utilize an incremental cost model, wherein the cost of fulfillment is treated as an expense and accrued for as a “cost to fulfill,” as opposed to deferred based on relative fair value.

The two models can result in significantly different accounting.

IFRS

IFRS requires that award, loyalty, or similar programs, whereby a customer earns credits based on the purchase of goods or services, be accounted for as multiple-element arrangements. As such, IFRS requires that the fair value of the award credits (otherwise attributed in accordance with the multiple-element guidance) be deferred and recognized separately upon achieving all applicable criteria for revenue recognition.

The above-outlined guidance applies whether the credits can be redeemed for goods or services supplied by the entity or whether the credits can be redeemed for goods or services supplied by a different entity. In situations where the credits can be redeemed through a different entity, a company also should consider the timing of recognition and appropriate presentation of each portion of the consideration received, given the entity’s potential role as an agent versus a principal in each aspect of the transaction.

3.4.3 *Multiple-element arrangements—loss on delivered element only*

The timing of revenue and cost recognition in situations with multiple element arrangements and losses on the first element may vary under the two frameworks.

US GAAP

When there is a loss on the first element of a two-element arrangement (within the scope of the general/non-industry-specific, multiple-element revenue recognition guidance), an accounting policy choice with respect to how the loss is treated may exist.

IFRS

When there is an apparent loss on the first element of a two-element arrangement, an accounting policy choice may exist as of the date the parties entered into the contract.

US GAAP

When there is a loss on the first element but a profit on the second element (and the overall arrangement is profitable), a company has an accounting policy choice if performance of the undelivered element is both probable and in the company's control. Specifically, there are two acceptable ways of treating the loss incurred in relation to the delivered unit of accounting. The company may (1) recognize costs in an amount equal to the revenue allocated to the delivered unit of accounting and defer the remaining costs until delivery of the second element, or (2) recognize all costs associated with the delivered element (i.e., recognize the loss) upon delivery of that element.

IFRS

When there is a loss on the first element but a profit on the second element (and the overall arrangement is profitable), a company may choose between two acceptable alternatives if performance of the undelivered element is both probable and in the company's control. The company may (1) determine that revenue is more appropriately allocated based on cost plus a reasonable margin, thereby removing the loss on the first element, or (2) recognize all costs associated with the delivered element (i.e., recognize the loss) upon delivery of that element.

Once the initial allocation of revenue has been made, it is not revisited. That is, if the loss on the first element becomes apparent only after the initial revenue allocation, the revenue allocation is not revisited.

There is not, under IFRS, support for deferring the loss on the first element akin to the US GAAP approach.

3.5 Sales of services—general

A fundamental difference in the guidance surrounding how service revenue should be recognized has the potential to significantly impact the timing of revenue recognition.

US GAAP

US GAAP prohibits the use of the cost-to-cost revenue recognition method for service arrangements unless the contract is within the scope of specific guidance for construction or certain production-type contracts.

IFRS

IFRS requires that service transactions be accounted for by reference to the stage of completion of the transaction (the percentage-of-completion method). The stage of completion may be determined by a variety of methods, including the cost-to-cost method. Revenue may be recognized on a straight-line basis if the services are performed by an indeterminate number of acts over a specified period and no other method better represents the stage of completion.

US GAAP

Generally, companies would apply the proportional-performance model or the completed-performance model. In circumstances where output measures do not exist, input measures (other than cost-to-cost), which approximate progression toward completion, may be used. Revenue is recognized based on a discernible pattern and, if none exists, then the straight-line approach may be appropriate.

Revenue is deferred if a service transaction cannot be measured reliably.

IFRS

When the outcome of a service transaction cannot be measured reliably, revenue may be recognized to the extent of recoverable expenses incurred. That is, a zero-profit model would be utilized, as opposed to a completed-performance model. If the outcome of the transaction is so uncertain that recovery of costs is not probable, revenue would need to be deferred until a more accurate estimate could be made.

Revenue may have to be deferred in instances where a specific act is much more significant than any other acts.

3.5.1 Sales of services—right of refund

Differences within IFRS and US GAAP provide the potential for revenue to be recognized earlier under IFRS when services-based transactions include a right of refund.

US GAAP

A right of refund may preclude recognition of revenue from a service arrangement until the right of refund expires.

In certain circumstances, companies may be able to recognize revenue over the service period—net of an allowance—if certain criteria within the guidance are satisfied.

IFRS

Service arrangements that contain a right of refund must be considered to determine whether the outcome of the contract can be estimated reliably and whether it is probable that the company would receive the economic benefit related to the services provided.

When reliable estimation is not possible, revenue is recognized only to the extent of the costs incurred that are probable of recovery.

3.6 Construction contracts

There are a variety of differences between the two frameworks with potentially far-reaching consequences.

Differences ranging from the transactions scoped into the construction contract accounting guidance to the application of the models may have significant impacts.

US GAAP

The guidance generally applies to accounting for performance of contracts for which specifications are provided by the customer for the construction of facilities, the production of goods, or the provision of related services.

The scope of this guidance generally has been limited to specific industries and types of contracts.

Completed-contract method

Although the percentage-of-completion method is preferred, the completed-contract method is required in certain situations, such as when management is unable to make reliable estimates.

For circumstances in which reliable estimates cannot be made, but there is an assurance that no loss will be incurred on a contract (e.g., when the scope of the contract is ill-defined but the contractor is protected from an overall loss), the percentage-of-completion method based on a zero-profit margin, rather than the completed-contract method, is used until more-precise estimates can be made.

IFRS

The guidance applies to contracts specifically negotiated for the construction of a single asset or a combination of assets that are interrelated or interdependent in terms of their design, technology, and function, or their ultimate purpose or use. The guidance is not limited to certain industries and includes fixed-price and cost-plus construction contracts.

Assessing whether a contract is within the scope of the construction contract standard or the broader revenue standard continues to be an area of focus. A buyer's ability to specify the major structural elements of the design (either before and/or during construction) is a key indicator (although not, in and of itself, determinative) of construction contract accounting.

Construction accounting guidance is generally not applied to the recurring production of goods.

Completed-contract method

The completed-contract method is prohibited.

US GAAP	IFRS
<p>Percentage-of-completion method</p> <p>Within the percentage-of-completion model there are two acceptable approaches: the revenue approach and the gross-profit approach.</p>	<p>Percentage-of-completion method</p> <p>IFRS utilizes a revenue approach to percentage of completion. When the final outcome cannot be estimated reliably, a zero-profit method is used (wherein revenue is recognized to the extent of costs incurred if those costs are expected to be recovered). The gross-profit approach is not allowed.</p>
<p>Combining and segmenting contracts</p> <p>Combining and segmenting contracts is permitted, provided certain criteria are met, but it is not required so long as the underlying economics of the transaction are reflected fairly.</p>	<p>Combining and segmenting contracts</p> <p>Combining and segmenting contracts is required when certain criteria are met.</p>

3.7 *Sale of goods—continuous transfer*

Outside of construction accounting under IFRS, some agreements for the sale of goods will qualify for revenue recognition by reference to the stage of completion.

US GAAP	IFRS
<p>Other than construction accounting, US GAAP does not have a separate model equivalent to the continuous transfer model for sale of goods.</p>	<p>When an agreement is for the sale of goods and is outside the scope of construction accounting, an entity considers whether all of the sale of goods revenue recognition criteria are met continuously as the contract progresses. When all of the sale of goods criteria are met continuously, an entity recognizes revenue by reference to the stage of completion using the percentage-of-completion method.</p> <p>The requirements of the construction contracts guidance are generally applicable to the recognition of revenue and the associated expenses for such continuous transfer transactions.</p> <p>Meeting the revenue recognition criteria continuously as the contract progresses for the sale of goods is expected to be relatively rare in practice.</p>

3.8 Barter transactions

The two frameworks generally require different methods for determining the value ascribed to barter transactions.

US GAAP	IFRS
<p>US GAAP generally requires companies to use the fair value of goods or services surrendered as the starting point for measuring a barter transaction.</p>	<p>IFRS generally requires companies to use the fair value of goods or services received as the starting point for measuring a barter transaction.</p>
<p>Non-advertising-barter transactions</p>	<p>Non-advertising-barter transactions</p>
<p>The fair value of goods or services received can be used if the value surrendered is not clearly evident.</p>	<p>When the fair value of items received is not reliably determinable, the fair value of goods or services surrendered can be used to measure the transaction.</p>
<p>Accounting for advertising-barter transactions</p>	<p>Accounting for advertising-barter transactions</p>
<p>If the fair value of assets surrendered in an advertising-barter transaction is not determinable, the transaction should be recorded based on the carrying amount of advertising surrendered, which likely will be zero.</p>	<p>Revenue from a barter transaction involving advertising cannot be measured reliably at the fair value of advertising services received. However, a seller can reliably measure revenue at the fair value of the advertising services it provides if certain criteria are met.</p>
<p>Accounting for barter-credit transactions</p>	<p>Accounting for barter-credit transactions</p>
<p>It should be presumed that the fair value of the nonmonetary asset exchanged is more clearly evident than the fair value of the barter credits received.</p>	<p>There is no further/specific guidance for barter-credit transactions. The broad principles outlined above should be applied.</p>
<p>However, it is also presumed that the fair value of the nonmonetary asset does not exceed its carrying amount unless there is persuasive evidence supporting a higher value. In rare instances, the fair value of the barter credits may be utilized (e.g., if the entity can convert the barter credits into cash in the near term, as evidenced by historical practice).</p>	

3.9 *Extended warranties*

The IFRS requirement to separately allocate a portion of the consideration to each component of an arrangement on a relative fair value basis has the potential to impact the timing of revenue recognition for arrangements that include a separately priced extended warranty or maintenance contract.

US GAAP	IFRS
<p>Revenue associated with separately priced extended warranty or product maintenance contracts generally should be deferred and recognized as income on a straight-line basis over the contract life. An exception exists where experience indicates that the cost of performing services is incurred on an other-than-straight-line basis.</p> <p>The revenue related to separately priced extended warranties is determined by reference to the separately stated price for maintenance contracts that are sold separately from the product. There is no relative fair market value allocation in this instance.</p>	<p>If an entity sells an extended warranty, the revenue from the sale of the extended warranty should be deferred and recognized over the period covered by the warranty.</p> <p>In instances where the extended warranty is an integral component of the sale (i.e., bundled into a single transaction), an entity should attribute consideration based on relative fair value to each component of the bundle.</p>

3.10 *Discounting of revenues*

Discounting of revenue (to present value) is more broadly required under IFRS than under US GAAP.

This may result in lower revenue under IFRS because the time value portion of the ultimate receivable is recognized as finance/interest income.

US GAAP	IFRS
<p>The discounting of revenue is required in only limited situations, including receivables with payment terms greater than one year and certain industry-specific situations, such as retail land sales or license agreements for motion pictures or television programs.</p>	<p>Discounting of revenue to present value is required in instances where the inflow of cash or cash equivalents is deferred.</p>

US GAAP**IFRS**

When discounting is required, the interest component should be computed based on the stated rate of interest in the instrument or a market rate of interest if the stated rate is considered unreasonable.

In such instances, an imputed interest rate should be used for determining the amount of revenue to be recognized as well as the separate interest income component to be recorded over time.

3.11 Recent/proposed guidance

3.11.1 Joint FASB/IASB Revenue Recognition Project

In May 2014, the FASB and IASB issued their long-awaited converged standard on revenue recognition—ASC 606 and IFRS 15, *Revenue from Contracts with Customers*. The standard contains principles that an entity will apply to report useful information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from its contracts to provide goods or services to customers. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration it expects to be entitled to in exchange for those goods or services. The standard could significantly change how many entities recognize revenue, especially those that currently apply industry-specific guidance. The standard will also result in a significant increase in the volume of disclosures related to revenue.

The standard sets forth a five-step model for recognizing revenue from contracts with customers:

- Identify the contract with a customer.
- Identify the performance obligations in the contract.
- Determine the transaction price.
- Allocate the transaction price to the performance obligations.
- Recognize revenue when (or as) each performance obligation is satisfied.

3.11.1.1 Identify the contract with a customer

The model starts with identifying the contract with the customer and whether an entity should combine, for accounting purposes, two or more contracts (including contract modifications), to properly reflect the economics of the underlying transaction. An entity will need to conclude that it is “probable,” at the inception of the contract, that the entity will collect the consideration to which it will ultimately be entitled in exchange for the goods or services that are transferred to the customer in order for a contract to be in the scope of the revenue standard. The term “probable” has a different meaning under US GAAP (where it is generally interpreted as 75 percent – 80 percent likelihood) and IFRS (where it means more likely than not—that

is, greater than 50 percent likelihood). This could result in a difference in the accounting for a contract if there is a likelihood of non-payment at inception. For example, assuming all other criteria were met, an IFRS preparer would be following the revenue guidance for a contract that is 70% certain of collection, whereas a US GAAP preparer would not be permitted to apply the revenue standard.

Two or more contracts (including contracts with different customers) should be combined if the contracts are entered into at or near the same time and the contracts are negotiated with a single commercial objective, the amount of consideration in one contract depends on the other contract, or the goods or services in the contracts are interrelated. A contract modification is treated as a separate contract only if it results in the addition of a separate performance obligation and the price reflects the stand-alone selling price (that is, the price the good or service would be sold for if sold on a stand-alone basis) of the additional performance obligation. The modification is otherwise accounted for as an adjustment to the original contract either through a cumulative catch-up adjustment to revenue or a prospective adjustment to revenue when future performance obligations are satisfied, depending on whether the remaining goods and services are distinct. While aspects of this model are similar to existing literature, careful consideration will be needed to ensure the model is applied to the appropriate unit of account.

3.11.1.2 *Identify the performance obligations in the contract*

An entity will be required to identify all performance obligations in a contract. Performance obligations are promises to transfer goods or services to a customer and are similar to what we know today as “elements” or “deliverables.” Performance obligations might be explicitly stated in the contract but might also arise in other ways. Legal or statutory requirements to deliver a good or perform a service might create performance obligations even though such obligations are not explicit in the contract. A performance obligation may also be created through customary business practices, such as an entity’s practice of providing customer support, or by published policies or specific company statements. This could result in an increased number of performance obligations within an arrangement, possibly changing the timing of revenue recognition.

An entity accounts for each promised good or service as a separate performance obligation if the good or service is distinct (i.e., the customer can benefit from the good or service either on its own or together with other resources readily available to the customer); and is distinct within the context of the contract (i.e., the good or service is separately identifiable from other promises in the contract).

Sales-type incentives such as free products or customer loyalty programs, for example, are currently recognized as marketing expense under US GAAP in some circumstances. These incentives might be performance obligations under the new model; if so, revenue will be deferred until such obligations are satisfied, such as when a customer redeems loyalty points. Other potential changes in this area include accounting for return rights, licenses, and options.

3.11.1.3 Determine the transaction price

Once an entity identifies the performance obligations in a contract, the obligations will be measured by reference to the transaction price. The transaction price reflects the amount of consideration that an entity expects to be entitled to in exchange for goods or services delivered. This amount is measured using either a probability-weighted or most-likely-amount approach; whichever is most predictive. The amount of expected consideration captures: (1) variable consideration if it is “probable” (US GAAP) or “highly probable” (IFRS) that the amount will not result in a significant revenue reversal if estimates change, (2) an assessment of time value of money (as a practical expedient, an entity need not make this assessment when the period between payment and the transfer of goods or services is less than one year), (3) noncash consideration, generally at fair value, and (4) consideration paid to customers. While the standards use different words in measuring variable consideration (“probable” under US GAAP and “highly probable” under IFRS), the intent of the boards is that the terminology should lead to the same accounting treatment under both frameworks.

Inclusion of variable consideration in the initial measurement of the transaction price might result in a significant change in the timing of revenue recognition. Such consideration is recognized as the entity satisfies its related performance obligations, provided (1) the entity has relevant experience with similar performance obligations (or other valid evidence) that allows it to estimate the cumulative amount of revenue for a satisfied performance obligation, and (2) based on that experience, the entity does not expect a significant reversal in future periods in the cumulative amount of revenue recognized for that performance obligation. Revenue may therefore be recognized earlier than under existing guidance if an entity meets the conditions to include variable consideration in the transaction price. Judgment will be needed to assess whether the entity has predictive experience about the outcome of a contract. The following indicators might suggest the entity’s experience is not predictive of the outcome of a contract: (1) the amount of consideration is highly susceptible to factors outside the influence of the entity, (2) the uncertainty about the amount of consideration is not expected to be resolved for a long period of time, (3) the entity’s experience with similar types of contracts is limited, and (4) the contract has a large number and broad range of possible consideration amounts.

3.11.1.4 Allocate the transaction price to the performance obligations

For contracts with multiple performance obligations, the performance obligations should be separately accounted for to the extent that the pattern of transfer of goods and services is different. Once an entity identifies and determines whether to separately account for all the performance obligations in a contract, the transaction price is allocated to these separate performance obligations based on relative standalone selling prices.

The best evidence of standalone selling price is the observable price of a good or service when the entity sells that good or service separately. The selling price is estimated if a standalone selling price is not available. Some possible estimation methods include (1) cost plus a reasonable margin or (2) evaluation of standalone sales prices of the same or similar products, if available. If the standalone selling price is highly variable or uncertain, entities may use a residual approach to aid in

estimating the standalone selling price (i.e., total transaction price less the standalone selling prices of other goods or services in the contract). An entity may also allocate discounts and variable amounts entirely to one (or more) performance obligations if certain conditions are met.

3.11.1.5 *Recognize revenue when each performance obligation is satisfied*

Revenue should be recognized when a promised good or service is transferred to the customer. This occurs when the customer obtains control of that good or service. Control can transfer at a point in time or continuously over time. Determining when control transfers will require a significant amount of judgment. An entity satisfies a performance obligation over time if: (1) the customer is receiving and consuming the benefits of the entity's performance as the entity performs (i.e., another entity would not need to substantially re-perform the work completed to date); (2) the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or (3) the entity's performance does not create an asset with an alternative use to the entity, the entity has a right to payment for performance completed to date, and it expects to fulfill the contract. A good or service not satisfied over time is satisfied at a point in time. Indicators to consider in determining when the customer obtains control of a promised asset include: (1) the customer has an unconditional obligation to pay, (2) the customer has legal title, (3) the customer has physical possession, (4) the customer has the risks and rewards of ownership of the good, and (5) the customer has accepted the asset. These indicators are not a checklist, nor are they all-inclusive. All relevant factors should be considered to determine whether the customer has obtained control of a good.

If control is transferred continuously over time, an entity may use output methods (e.g., units delivered) or input methods (e.g., costs incurred or passage of time) to measure the amount of revenue to be recognized. The method that best depicts the transfer of goods or services to the customer should be applied consistently throughout the contract and to similar contracts with customers. The notion of an earnings process is no longer applicable.

3.11.1.6 *Contract cost guidance*

The new model also includes guidance related to contract costs. Costs relating to satisfied performance obligations and costs related to inefficiencies should be expensed as incurred. Incremental costs of obtaining a contract (e.g., a sales commission) should be recognized as an asset if they are expected to be recovered. An entity can expense the cost of obtaining a contract if the amortization period would be less than one year. Entities should evaluate whether direct costs incurred in fulfilling a contract are in the scope of other standards (e.g., inventory, intangibles, or fixed assets). If so, the entity should account for such costs in accordance with those standards. If not, the entity should capitalize those costs only if the costs relate directly to a contract, relate to future performance, and are expected to be recovered under a contract. An example of such costs may be certain mobilization, design, or testing costs. These costs would then be amortized as control of the goods or services to which the asset relates is transferred to the customer. The amortization period may extend beyond the length of the contract when the economic benefit will be received

over a longer period. An example might include set-up costs related to contracts likely to be renewed.

3.11.1.7 Summary observations and anticipated timing

The above commentary is not all-inclusive. The effect of the new revenue recognition guidance will be extensive, and all industries may be affected. Some will see pervasive changes as the new model will replace all existing US GAAP and IFRS revenue recognition guidance, including industry-specific guidance with limited exceptions (for example, certain guidance on rate-regulated activities in US GAAP).

The US GAAP standard was originally going to be effective (1) for public entities, for annual reporting periods, and interim periods therein, beginning after December 15, 2016 and (2) for non-public entities, for annual reporting periods beginning after December 15, 2017, and for interim periods within annual periods beginning after December 15, 2018. Under IFRS, the final standard was originally going to be effective for the first interim period within annual reporting periods beginning on or after January 1, 2017. In spring 2015, both boards issued exposure drafts deferring the proposed effective dates by a year. The IASB has retained the option for entities to early adopt the standard, and the FASB's proposal will permit entities to adopt the standard as of the original effective date.

The IASB and FASB discussed several implementation issues related to the new revenue standard at joint board meetings in 2015. The boards were aligned on the need to address stakeholder feedback on licenses, performance obligations, and certain practical expedients upon transition, but did not agree on the approach. The IASB is expected to recommend more limited clarifications while the FASB changes are expected to be more extensive. The FASB has also decided to propose changes in other areas—for example, guidance on collectibility and noncash consideration, and new practical expedients for shipping and handling services and presentation of sales taxes collected from customers. The joint discussions are expected to continue in the coming months.

Entities should continue to evaluate how the model might affect current business activities, including contract negotiations, key metrics (including debt covenants and compensation arrangements), budgeting, controls and processes, information technology requirements, and accounting. The new standard will permit an entity to either apply it (i) retrospectively to all existing contracts, using any combination of several optional practical expedients, or (ii) through use of a modified retrospective transition method (whereby the cumulative effect of initially applying the guidance is recognized as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) in the period of initial application). This modified retrospective approach must be supplemented by additional disclosures.

For further details on the new revenue standard, refer to PwC's accounting and financial reporting guide for *Revenue from contracts with customers - 2014 global edition*. For current developments of the new revenue standard, refer to PwC's *In transition* publications, available on CFODirect.com.

Chapter 4:
Expense recognition—
share-based payments

4.1 Expense recognition—share-based payments

Although the US GAAP and IFRS guidance in this area is similar at a macro conceptual level, many significant differences exist at the detailed application level.

The broader scope of share-based payments guidance under IFRS leads to differences associated with awards made to nonemployees, impacting both the measurement date and total value of expense to be recognized.

Differences within the two frameworks may result in differing grant dates and/or different classifications of an award as a component of equity or as a liability. Once an award is classified as a liability, it needs to be remeasured to fair value at each period through earnings, which introduces earnings volatility while also impacting balance sheet metrics and ratios. Certain types of awards (e.g., puttable awards and awards with vesting conditions outside of service, performance, or market conditions) are likely to have different equity-versus-liability classification conclusions under the two frameworks.

In addition, companies that issue awards with graded vesting (e.g., awards that vest ratably over time, such as 25 percent per year over a four-year period) may encounter accelerated expense recognition and potentially a different total value to be expensed (for a given award) under IFRS. The impact in this area could lead some companies to consider redesigning the structure of their share-based payment plans. By changing the vesting pattern to cliff vesting (from graded vesting), companies can avoid a front-loading of share-based compensation expense, which may be desirable to some organizations.

The deferred income tax accounting requirements for share-based payments under IFRS vary significantly from US GAAP. Companies can expect to experience greater variability in their effective tax rate over the lifetime of share-based payment awards under IFRS. This variability will be linked with the issuing company's stock price. For example, as a company's stock price increases, a greater income statement tax benefit will occur, to a point, under IFRS. Once a benefit has been recorded, subsequent decreases to a company's stock price may increase income tax expense within certain limits.

Technical references

US GAAP

ASC 480, ASC 505-50, ASC 718, SAB Topic 14

IFRS

IFRS 2

Note

The following discussion captures a number of the more significant GAAP differences. It is important to note that the discussion is not inclusive of all GAAP differences in this area.

4.2 Scope

Under IFRS, companies apply a single standard to all share-based payment arrangements, regardless of whether the counterparty is a nonemployee. Under US GAAP, there is a separate standard for non-employee awards.

Some awards categorized as nonemployee instruments under US GAAP will be treated as employee awards under IFRS. The measurement date and expense will be different for awards that are categorized as nonemployee instruments under US GAAP but employee awards under IFRS.

US GAAP	IFRS
<p>ASC 718, <i>Compensation—Stock Compensation</i>, applies to awards granted to employees and through Employee Stock Ownership Plans. ASC 505-50 applies to grants to nonemployees.</p> <p>The guidance focuses on the legal definition of an employee with certain specific exceptions.</p>	<p>IFRS 2, <i>Share-based payments</i>, includes accounting for all employee and nonemployee arrangements. Furthermore, under IFRS, the definition of an employee is broader than the US GAAP definition.</p> <p>IFRS focuses on the nature of the services provided and treats awards to employees and others providing employee-type services similarly. Awards for goods from vendors or nonemployee-type services are treated differently.</p>

4.3 Measurement of awards granted to employees by nonpublic companies

IFRS does not permit alternatives in choosing a measurement method.

US GAAP	IFRS
<p>Equity-classified</p> <p>The guidance allows nonpublic companies to measure stock-based compensation awards by using the fair value method (preferred) or the calculated-value method.</p>	<p>IFRS does not include such alternatives for nonpublic companies and requires the use of the fair-value method in all circumstances.</p>

US GAAP**IFRS****Liability-classified**

The guidance allows nonpublic companies to make an accounting policy decision on how to measure stock-based compensation awards that are classified as liabilities. Such companies may use the fair value method, calculated-value method, or intrinsic-value method.

4.4 Measurement of awards granted to nonemployees

Both the measurement date and the measurement methodology may vary for awards granted to nonemployees.

US GAAP**IFRS**

ASC 505-50 states that the fair value of an equity instrument issued to a nonemployee should be measured as of the date at which either (1) a commitment for performance by the counterparty has been reached, or (2) the counterparty's performance is complete.

Nonemployee transactions should be measured based on the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable.

Transactions with parties other than employees (or those providing employee-type services) should be measured at the date(s) on which the goods are received or the date(s) on which the services are rendered. The guidance does not include a performance commitment concept.

Nonemployee transactions are generally measured at the fair value of the goods or services received, since it is presumed that it will be possible to reliably measure the fair value of the consideration received. If an entity is not able to reliably measure the fair value of the goods or services received (i.e., if the presumption is overcome), the fair value of the award should be measured indirectly by reference to the fair value of the equity instrument granted as consideration.

When the presumption is not overcome, an entity is also required to account for any unidentifiable goods or services received or to be received. This would be the case if the fair value of the equity instruments granted exceeds the fair value of the identifiable goods or services received and to be received.

4.5 *Classification of certain instruments as liabilities or equity*

Although ASC 718 and IFRS 2 contain a similar principle for classification of stock-based compensation awards, certain awards will be classified differently under the two standards. In some instances, awards will be classified as equity under US GAAP and a liability under IFRS, while in other instances awards will be classified as a liability under US GAAP and equity under IFRS.

US GAAP	IFRS
<p>ASC 718 contains guidance on determining whether to classify an award as equity or a liability. ASC 718 also references the guidance in ASC 480, <i>Distinguishing Liabilities from Equity</i>, when assessing classification of an award.</p> <p>In certain situations, puttable shares may be classified as equity awards, as long as the recipient bears the risks and rewards normally associated with equity share ownership for a reasonable period of time (defined as 6 months).</p> <p>Liability classification is required when an award is based on a fixed monetary amount settled in a variable number of shares.</p>	<p>IFRS 2 follows a similar principle of equity/liability classification as ASC 718. However, while IAS 32 has similar guidance to ASC 480, arrangements subject to IFRS 2 are out of the scope of IAS 32. Therefore, equity/liability classification for share-based awards is determined wholly on whether the awards are ultimately settled in equity or cash, respectively.</p> <p>Puttable shares are always classified as liabilities, even if the put cannot be exercised for an extended period of time.</p> <p>Share-settled awards are classified as equity awards even if there is variability in the number of shares due to a fixed monetary value to be achieved.</p>

4.6 *Awards with conditions other than service, performance, or market conditions*

Certain awards classified as liabilities under US GAAP may be classified as equity under IFRS.

US GAAP	IFRS
<p>If an award contains conditions other than service, performance, or market conditions (referred to as “other” conditions), it is classified as a liability award.</p>	<p>If an award of equity instruments contains conditions other than service or performance (which can include market vesting conditions), it can still be classified as an equity-settled award. Such conditions may be nonvesting conditions. Nonvesting conditions are taken into account when determining the grant date fair value of the award.</p>

4.7 *Awards with a performance target met after the requisite service period is completed*

Under IFRS, this is a non-vesting condition that is reflected in the measurement of the grant date fair value.

US GAAP

A performance target that may be met after the requisite service period is complete is a performance vesting condition, and cost should be recognized only if the performance condition is probable of being achieved.

IFRS

A performance target that may be met after the requisite service period is a non-vesting condition and is reflected in the measurement of the grant date fair value of an award.

4.8 *Service-inception date, grant date, and requisite service*

Because of the differences in the definitions, there may be differences in the grant date and the period over which compensation cost is recognized.

US GAAP

The guidance provides specific definitions of service-inception date, grant date, and requisite service, which, when applied, will determine the beginning and end of the period over which compensation cost will be recognized. Additionally, the grant date definition includes a requirement that the employee begins to be affected by the risks and rewards of equity ownership at that date.

IFRS

IFRS does not include the same detailed definitions. The difference in the grant date definition is that IFRS does not have the requirement that the employee begins to be affected by the risks and rewards of equity ownership.

4.9 *Attribution—awards with service conditions and graded-vesting features*

The alternatives included under US GAAP provide for differences in both the measurement and attribution of compensation costs when compared with the requirements under IFRS for awards with graded vesting (i.e., tranches).

US GAAP

Companies are permitted to make an accounting policy election regarding the attribution method for awards with service-only conditions and graded-vesting features. The choice in attribution method (straight-line or accelerated tranche by tranche) is not linked to the valuation method that the company uses. For awards with graded vesting and performance or market conditions, the accelerated graded-vesting attribution approach is required.

IFRS

Companies are not permitted to choose how the valuation or attribution method is applied to awards with graded-vesting features. Companies should treat each installment of the award as a separate grant. This means that each installment would be separately measured and attributed to expense over the related vesting period.

4.10 *Certain aspects of modification accounting*

Differences between the two standards for improbable to probable modifications may result in differences in the compensation costs that are recognized.

US GAAP

An improbable to probable “Type III” modification can result in recognition of compensation cost that is more or less than the fair value of the award on the original grant date. When a modification makes it probable that a vesting condition will be achieved, and the company does not expect the original vesting conditions to be achieved, a new measurement date is established. The grant-date fair value of the award would not be a floor for the amount of compensation cost recognized.

IFRS

Under IFRS, if the vesting conditions of an award are modified in a manner that is beneficial to the employee, this would be accounted for as a change in only the number of awards that are expected to vest (from zero to a new amount), and the award’s full original grant-date fair value would be recognized for the awards over the remainder of the service period. That result is the same as if the modified vesting condition had been in effect on the grant date.

4.11 *Cash-settled awards with a performance condition*

For a cash-settled award where the performance condition is not probable, liability and expense recognition may occur earlier under IFRS.

US GAAP

For cash-settled awards with a performance condition, where the performance condition is not probable, there may be no liability recognized under US GAAP.

IFRS

For cash settled awards, even where the performance condition is not probable (i.e., greater than zero but less than 50 percent probability), a liability may be recognized under IFRS based on the fair value of the instrument (considering the likelihood of earning the award).

4.12 *Derived service period*

For an award containing a market condition that is fully vested and deep out of the money at grant date, expense recognition may occur earlier under IFRS.

US GAAP

US GAAP contains the concept of a derived service period. Where an award is fully vested and deep out of the money at the grant date but allows employees only a limited amount of time to exercise their awards in the event of termination, US GAAP presumes that employees must provide some period of service to earn value from the award. Because there is no explicit service period stated in the award, a derived service period must be determined by reference to a valuation technique. The expense for the award would be recognized over the derived service period and reversed if the employee does not complete the requisite service period.

IFRS

IFRS does not define a derived service period for fully vested, deep-out-of-the-money awards. Therefore, the related expense for such an award would be recognized in full at the grant date because the award is fully vested at that date.

4.13 *Tax withholding arrangements—impact to classification*

There could be a difference in award classification as a result of tax withholding arrangements.

US GAAP

An award containing a net settled tax withholding clause could be equity-classified so long as the arrangement limits tax withholding to the company's minimum statutory rate. If tax withholding is permitted at some higher rate, then the whole award would be classified as a liability.

IFRS

IFRS does not contain a similar exception. When an employee can net settle a tax withholding liability in cash, the award is bifurcated between a cash-settled portion and an equity-settled portion. The portion of the award relating to the estimated tax payment is treated as a cash-settled award and marked to market each period until settlement of the actual tax liability. The remaining portion is treated as an equity settled award.

4.14 Accounting for income tax effects

Companies reporting under IFRS generally will have greater volatility in their deferred tax accounts over the life of the awards due to the related adjustments for stock price movements in each reporting period.

Companies reporting under US GAAP could have greater volatility upon exercise arising from the variation between the estimated deferred taxes recognized and the actual tax deductions realized.

There are also differences in the presentation of the cash flows associated with an award's tax benefits.

US GAAP

The US GAAP model for accounting for income taxes requires companies to record deferred taxes as compensation cost is recognized, as long as a tax deduction is allowed for that particular type of instrument. The measurement of the deferred tax asset is based on the amount of compensation cost recognized for book purposes. Changes in the stock price do not impact the deferred tax asset or result in any adjustments prior to settlement or expiration. Although they do not impact deferred tax assets, future changes in the stock price will nonetheless affect the actual future tax deduction (if any).

Excess tax benefits (“windfalls”) upon settlement of an award are recorded in equity. “Shortfalls” are recorded as a reduction of equity to the extent the company has accumulated windfalls in its pool of windfall tax benefits. If the company does not have accumulated windfalls, shortfalls are recorded to income tax expense.

In addition, the excess tax benefits upon settlement of an award would be reported as cash inflows from financing activities.

IFRS

The measurement of the deferred tax asset in each period is based on an estimate of the future tax deduction, if any, for the award measured at the end of each reporting period (based on the current stock price if the tax deduction is based on the future stock price).

When the expected tax benefits from equity awards exceed the recorded cumulative recognized expense multiplied by the tax rate, the tax benefit up to the amount of the tax effect of the cumulative book compensation expense is recorded in the income statement; the excess is recorded in equity.

When the expected tax benefit is less than the tax effect of the cumulative amount of recognized expense, the entire tax benefit is recorded in the income statement. IFRS 2 does not include the concept of a pool of windfall tax benefits to offset shortfalls.

In addition, all tax benefits or shortfalls upon settlement of an award generally are reported as operating cash flows.

4.15 Recognition of social charges (e.g., payroll taxes)

The timing of recognition of social charges generally will be earlier under IFRS than US GAAP.

US GAAP**IFRS**

A liability for employee payroll taxes on employee stock-based compensation should be recognized on the date of the event triggering the measurement and payment of the tax (generally the exercise date for a nonqualified option or the vesting date for a restricted stock award).

Social charges, such as payroll taxes levied on the employer in connection with stock-based compensation plans, are expensed in the income statement when the related share-based compensation expense is recognized. The guidance in IFRS for cash-settled share-based payments would be followed in recognizing an expense for such charges.

4.16 Valuation—SAB Topic 14 guidance on expected volatility and expected term

Companies that report under US GAAP may place greater reliance on implied short-term volatility to estimate volatility. Companies that report under IFRS do not have the option of using the “simplified method” of calculating expected term provided by SAB Topic 14. As a result, there could be differences in estimated fair values.

US GAAP**IFRS**

SAB Topic 14 includes guidance on expected volatility and expected term, which includes (1) guidelines for reliance on implied volatility and (2) the “simplified method” for calculating the expected term for qualifying awards.

IFRS does not include comparable guidance.

4.17 Employee stock purchase plans (ESPP)

ESPPs generally will be deemed compensatory more often under IFRS than under US GAAP.

US GAAP**IFRS**

ESPPs are compensatory if terms of the plan:

- Either (1) are more favorable than those available to all shareholders, or (2) include a discount from the market price that exceeds the percentage of stock issuance costs avoided (discount of 5 percent or less is a safe harbor);
- Do not allow all eligible employees to participate on an equitable basis; or
- Include any option features (e.g., look-backs).

ESPPs are always compensatory and treated like any other equity-settled share-based payment arrangement. IFRS does not allow any safe-harbor discount for ESPPs.

US GAAP**IFRS**

In practice, most ESPPs are compensatory; however, plans that do not meet any of the above criteria are non-compensatory.

4.18 *Group share-based payment transactions*

Under US GAAP, push-down accounting of the expense recognized at the parent level generally would apply. Under IFRS, the reporting entity's obligation will determine the appropriate accounting.

US GAAP**IFRS**

Generally, push-down accounting of the expense recognized at the parent level would apply to the separate financial statements of the subsidiary.

For liability-classified awards settled by the parent company, the mark to market expense impact of these awards should be pushed down to the subsidiary's books each period, generally as a capital contribution from the parent. However, liability accounting at the subsidiary may be appropriate, depending on the facts and circumstances.

For the separate financial statements of the subsidiary, equity or liability classification is determined based on the nature of the obligation each entity has in settling the awards, even if the award is settled in parent equity.

The accounting for a group cash-settled share-based payment transaction in the separate financial statements of the entity receiving the related goods or services when that entity has no obligation to settle the transaction would be as an equity-settled share-based payment. The group entity settling the transaction would account for the share-based payment as cash-settled.

The accounting for a group equity-settled share-based payment transaction is dependent on which entity has the obligation to settle the award.

US GAAP**IFRS**

For the entity that settles the obligation, a requirement to deliver anything other than its own equity instruments (equity instruments of a subsidiary would be “own equity” but equity instruments of a parent would not) would result in cash-settled (liability) treatment. Therefore, a subsidiary that is obligated to issue its parent’s equity would treat the arrangement as a liability, even though in the consolidated financial statements the arrangement would be accounted for as an equity-settled share-based payment. Conversely, if the parent is obligated to issue the shares directly to employees of the subsidiary, then the arrangement should be accounted for as equity-settled in both the consolidated financial statements and the separate standalone financial statements of the subsidiary.

Hence, measurement could vary between the two sets of accounts.

4.19 Recent/proposed guidance

4.19.1 IASB exposure draft and research project

The IASB issued an exposure draft in November 2014 on issues discussed with the Interpretations Committee. The proposal addresses the following issues:

- Measurement of cash-settled share-based payment transactions that include a performance condition
- Classification of share-based payments settled net of tax withholdings
- Modifications of share-based payment transaction from cash-settled to equity-settled

The IASB also has a research project on its agenda exploring the most common areas of complexity in the application of IFRS 2 and their causes.

4.19.1.1 Measurement of cash-settled share-based payment transactions that include a performance condition

The IASB proposed clarifying the measurement model for cash-settled awards that include a performance condition to indicate that the measurement model should be consistent with the measurement of an equity-settled award (i.e., the value should only be recognized if the achievement of a non-market performance condition is considered probable).

If the proposed amendment is adopted, we believe US GAAP and IFRS accounting will be consistent for these awards.

4.19.1.2 *Classification of share-based payments settled net of tax withholdings*

The IASB proposed amending IFRS 2 to add guidance that specifies that in a share-based payment transaction where the entity settles the share-based payment arrangement by withholding a specified portion of the equity instruments to meet its minimum statutory tax withholding requirements, the award would be classified as equity-settled in its entirety, if the entire award would otherwise be classified as equity-settled without the net settlement feature.

If adopted, the proposed amendment would eliminate the difference between current US GAAP and IFRS for withholding up to the statutory minimum. However, there would still be a difference if the minimum is exceeded. Additionally, the FASB has also proposed amending its guidance, which would create a further difference. Refer to 4.19.2.2 below on the FASB's exposure draft.

4.19.1.3 *Modifications of a share-based payment transaction from cash-settled to equity-settled*

The IASB proposed amending IFRS 2 to address a modification of a share-based payment transaction that changes its classification from cash-settled to equity-settled, as follows:

- The new equity-settled award should be measured by reference to the modification-date fair value of the equity-settled award, because the modification-date should be viewed as the grant date of the new award;
- The liability recorded for the original cash-settled award should be derecognized upon the modification and the equity-settled replacement award should be recognized to the extent that service has been rendered up to the modification date; and
- The difference between the carrying amount of the liability and the amount recognized in equity as of the modification date should be recorded in profit or loss immediately in order to show that the liability has been remeasured to its fair value at the settlement date.

If the proposed amendment is adopted, we believe US GAAP and IFRS accounting will be consistent for these types of modifications.

4.19.2 *FASB exposure draft and research projects*

The FASB issued an exposure draft in June 2015 intended to simplify the accounting for share-based payment awards issued to employees. The proposal addressed the following issues:

- Income tax effects of share-based payments

- Minimum statutory tax withholding requirements
- Accounting for forfeitures
- Classification of share-based payment awards with repurchase features
- Specific proposals for nonpublic companies

The FASB also added two research projects to its agenda:

- Nonemployee share-based payment accounting, and
- Measuring nonpublic company awards at intrinsic value

4.19.2.1 *Income tax effects of share-based payments*

The FASB proposed changing the accounting for the income tax effects of share-based payment awards to record all tax effects through the income statement, as opposed to recording certain amounts in Additional Paid-in Capital (APIC). This proposal would eliminate the complications of tracking a “windfall pool” to determine the amounts to record in APIC. However, it would also increase the volatility of income tax expense. The FASB also proposed presenting all tax effects as an operating activity in the statement of cash flows, as opposed to presenting gross windfall tax benefits as a financing activity.

If the proposed amendments are adopted, US GAAP and IFRS will continue to differ, both in periods prior to settlement as well as in the treatment of windfall tax benefits.

4.19.2.2 *Minimum statutory tax withholding requirements*

The FASB proposed revising the current guidance that allows an entity to withhold shares upon vesting or exercise of an award to satisfy its cash tax withholding requirement and remit the cash to the taxing authority on the employee’s behalf, without resulting in liability classification of the award. Currently, the amount that can be withheld is strictly limited to the employer’s minimum statutory tax withholding requirement, which creates administrative challenges for many companies. The FASB’s proposal would allow entities to withhold an amount up to the highest marginal tax rate applicable to employees in the relevant jurisdiction, without causing liability classification of the award. The FASB also proposed clarifying that when withholding shares for tax withholding purposes, the cash paid to the taxing authority would be classified as a financing activity.

If the proposed amendments are adopted, US GAAP and IFRS will continue to diverge. However, the IASB has proposed amending its guidance to align it with current US GAAP. Refer to 4.19.1.2 above on the IASB’s exposure draft.

4.19.2.3 *Accounting for forfeitures*

The FASB proposal would provide companies with an option to make an entity-wide accounting policy election to account for award forfeitures as they occur instead of estimating expected forfeitures as compensation cost is recognized.

If the proposed amendment is adopted, companies that elect to account for forfeitures as they occur will diverge from IFRS.

4.19.2.4 *Classification of share-based payment awards with repurchase features*

The FASB proposal would align the classification guidance for put and call rights that are contingent upon a future event that is within the employee's control. Such features would only be incorporated in the analysis of liability classification when the event is considered probable of occurring before the employee bears the risks and rewards of stock ownership for a reasonable period of time.

If the proposed amendment is adopted, US GAAP and IFRS will continue to diverge.

4.19.2.5 *Specific proposals for nonpublic companies*

The FASB proposal includes two proposals for nonpublic companies:

- A one-time election to change the measurement of liability-classified awards from fair value to intrinsic value, and
- A practical expedient for estimating the expected term of an award, allowing a short-cut method to be used, based on whether the award has either service or performance conditions.

If the proposed amendments are adopted, US GAAP and IFRS will continue to diverge.

4.19.2.6 *FASB research projects*

Nonemployee share-based payment accounting

The FASB added a separate research project to its agenda to further research potential improvements to the accounting for nonemployee share-based payment awards, which will include the scope of the nonemployee award guidance and the accounting for awards with unresolved performance conditions.

Measuring nonpublic company awards at intrinsic value

The FASB added a separate research project to evaluate an alternative that would permit a nonpublic company to classify all share-based-payment awards as liabilities and to measure those awards at their intrinsic value.

Chapter 5:
Expense recognition—
employee benefits

5.1 *Expense recognition—employee benefits*

There are a number of significant differences between US GAAP and IFRS in the area of accounting for pension and other postretirement and postemployment benefits. Some differences will result in less earnings volatility, while others will result in greater earnings volatility. The net effect depends on the individual facts and circumstances for a given employer. Further differences could have a significant impact on presentation, operating metrics, and key ratios.

While there are few differences with respect to the measurement of defined benefit plans, there are key differences with regards to cost recognition and presentation. Under IFRS, the effects of remeasurements (which include actuarial gains/losses) are recognized immediately in other comprehensive income (OCI) and are not subsequently recycled through the income statement. Under US GAAP, these gains/losses are recognized in the income statement either immediately or in the future.

Under IFRS, all prior service costs (positive or negative) are recognized in profit or loss when the employee benefit plan is amended and are not allowed to be spread over any future service period, which may create volatility in profit or loss. This is different from US GAAP, under which prior service cost is recognized in OCI at the date the plan amendment is adopted and then amortized into income over the participants' remaining years of service, service to full eligibility date, or life expectancy, depending on the facts and circumstances.

In addition, US GAAP requires an independent calculation of interest cost (based on the application of a discount rate to the projected benefit obligation) and expected return on assets (based on the application of an expected rate of return on assets to the calculated asset value), while IFRS applies the discount rate to the net benefit obligation to calculate a single net interest cost or income.

Under IFRS, there is no requirement to present the various components of pension cost as a net amount. As such, companies have flexibility to present components of net benefit cost within different line items on the income statement. Components recognized in determining net income (i.e., service and finance costs, but not actuarial gains and losses) may be presented as (1) a single net amount (similar to US GAAP) or (2) those components may be separately displayed.

Differences between US GAAP and IFRS also can result in different classifications of a plan as a defined benefit or a defined contribution plan. It is possible that a benefit arrangement that is classified as a defined benefit plan under US GAAP may be classified as a defined contribution plan under IFRS and vice versa. Classification differences would result in changes to the expense recognition model as well as to the balance sheet presentation.

Note that the FASB and the IASB use the term postemployment differently. The IASB uses the term postemployment to include pension, postretirement, and other postemployment benefits, whereas the FASB uses the term postretirement benefits (OPEB) to include postretirement benefits other than pensions (such as retiree

medical) and the term postemployment benefits to include benefits before retirement (such as disability or termination benefits).

For simplicity, discussion of benefit cost in the remainder of this chapter refers to recognition in income. However, a portion of the benefit cost may be capitalized into inventory, fixed assets, or other balance sheet accounts when associated with employees whose compensation costs are capitalized.

Technical references

US GAAP

ASC 420, ASC 710, ASC 712, ASC 715, ASC 820

IFRS

IAS 19, IAS 37, IFRS 13, IFRIC 14

Note

The following discussion captures a number of the more significant GAAP differences. It is important to note that the discussion is not inclusive of all GAAP differences in this area.

5.2 Expense recognition—gains/losses

Under IFRS, remeasurement effects are recognized immediately in other comprehensive income and are not subsequently recorded within profit or loss, while US GAAP permits two options for recognition of gains and losses, with ultimate recognition in profit or loss.

Note: Gains and losses as referenced under US GAAP include (1) the differences between actual and expected return on assets and (2) changes in the measurement of the benefit obligation. Remeasurements under IFRS, as referenced, include (1) actuarial gains and losses, (2) the difference between actual return on assets and the amount included in the calculation of net interest cost, and (3) changes in the effect of the asset ceiling.

US GAAP

The guidance permits companies to either (1) record expense for gains/losses in the period incurred within the statement of operations or (2) defer gains/losses through the use of the corridor approach (or any systematic method that results in faster recognition than the corridor approach).

IFRS

Remeasurements are recognized immediately in OCI. There is no option to recognize gains/losses in profit or loss. In addition, the “corridor and spreading” option—which allows delayed recognition of gains and losses—is prohibited.

US GAAP

Whether gains/losses are recognized immediately or amortized in a systematic fashion, they are ultimately recorded within the statement of operations as components of net periodic benefit cost.

IFRS

Once recognized in OCI, gains/losses are not subsequently recorded within profit or loss. The standard no longer requires that the amounts recognized in OCI be immediately taken to retained earnings; they can also remain in a specific reserve or 'other' reserves within equity.

5.3 *Expense recognition—prior service costs and credits*

IFRS requires immediate recognition in income for the effects of plan amendments that create an increase (or decrease) to the benefit obligation (i.e., prior service cost).

IFRS requirements are significantly different from US GAAP, which requires prior service costs, including costs related to vested benefits, to be initially recognized in OCI and then amortized through net income over future periods.

US GAAP

Prior service cost (whether for vested or unvested benefits) should be recognized in other comprehensive income at the date of the adoption of the plan amendment and then amortized into income over one of the following:

- The participants' remaining years of service (for pension plans, except where all or almost all plan participants are inactive)
- The participants' remaining years of service to full eligibility date (for other postretirement benefit plans, except where all or almost all plan participants are inactive)
- The participants' life expectancy (for plans that have all or almost all inactive participants)

Negative prior service cost should be recognized as a prior service credit in other comprehensive income and used first to reduce any remaining positive prior service cost included in accumulated other comprehensive income. Any remaining prior service credits should then be amortized over the same periods as described above.

IFRS

Recognition of all past service costs is required at the earlier of when a plan amendment occurs or when the entity recognizes related restructuring costs (in the event of a curtailment). Unvested past service cost may not be spread over a future service period. Curtailments that reduce benefits are no longer disclosed separately, but are considered as part of the past service costs.

5.4 *Expense recognition—expected return on plan assets*

Under IFRS, companies calculate a net interest cost (income) by applying the discount rate to the defined benefit liability (asset). US GAAP uses an expected rate of return on plan assets and permits companies to use a calculated value of plan assets (reflecting changes in fair value over a period of up to five years) in determining the expected return on plan assets and in accounting for gains and losses.

US GAAP

Expected return is based on an expected rate of return on assets.

Plan assets should be measured at fair value for balance sheet recognition and for disclosure purposes. However, for purposes of determining the expected return on plan assets and the related accounting for gains and losses, plan assets can be measured by using either fair value or a calculated value that recognizes changes in fair value over a period of not more than five years.

IFRS

Net interest cost or income is calculated by applying the discount rate (as described below) to the defined benefit liability or asset of the plan. The defined benefit asset or liability is the surplus or deficit (i.e., the net amount of the defined benefit obligation less plan assets) which is recognized on the balance sheet after considering the asset ceiling test.

Plan assets should always be measured at fair value.

5.5 *Income statement classification*

Under IFRS, companies have the option to present different components of net benefit cost within different line items on the income statement.

This could result in companies recording interest cost within financing.

US GAAP

All components of net benefit cost must be aggregated and presented as a net amount in the income statement.

Although it is appropriate to allocate a portion of net benefit cost to different line items (such as cost of goods sold or general and administrative expenses, based on which line items other employee costs are included), disaggregating the components of net benefit cost is not permitted.

IFRS

Employers have flexibility to either (1) present all components recognized in determining net income (i.e., service and net interest cost but not gains and losses) as a single net amount (similar to US GAAP) or (2) present those components separately within the income statement.

5.6 *Measurement frequency*

IFRS requires interim remeasurements in more circumstances than US GAAP.

US GAAP	IFRS
The measurement of plan assets and benefit obligations is required as of the employer's fiscal year-end balance sheet date, unless the plan is sponsored by a consolidated subsidiary or equity method investee with a different fiscal period. Interim remeasurements generally occur only if there is a significant event, such as a plan amendment, curtailment, or settlement.	Employers typically remeasure the benefit obligation and plan assets at each interim period to determine the balance sheet and OCI component, but that will not lead to a change in service cost or interest cost (unless there was a plan amendment, curtailment, or settlement).

5.7 *Substantive commitment to provide pension or other postretirement benefits*

Differences in the manner in which a substantive commitment to increase future pension or other postretirement benefits is determined may result in an increased benefit obligation under IFRS.

US GAAP	IFRS
The determination of whether a substantive commitment exists to provide pension benefits beyond the written terms of a given plan's formula requires careful consideration. Although actions taken by an employer can demonstrate the existence of a substantive commitment, a history of retroactive plan amendments is not sufficient on its own. However, in postretirement benefit plans other than pensions, the substantive plan should be the basis for determining the obligation. This may consider an employer's past practice or communication of intended changes, for example in the area of setting caps on cost-sharing levels.	In certain circumstances, a history of regular increases may indicate a present commitment to make future plan amendments. In such cases, a constructive obligation (to increase benefits) is the basis for determining the obligation.

5.8 *Defined benefit versus defined contribution plan classification*

Certain plans currently accounted for as defined benefit plans under US GAAP may be accounted for as defined contribution plans under IFRS and vice versa. Classification

differences would result in differences to expense recognition as well as to balance sheet presentation.

US GAAP

IFRS

A defined contribution plan is any arrangement that provides benefits in return for services rendered, establishes an individual account for each participant, and is based on contributions by the employer or employee to the individual's account and the related investment experience.

An arrangement qualifies as a defined contribution plan if an employer's legal or constructive obligation is limited to the amount it contributes to a separate entity (generally, a fund or an insurance company). There is no requirement for individual participant accounts.

Multiemployer plans are treated similar to defined contribution plans. A pension plan to which two or more unrelated employers contribute is generally considered to be a multiemployer plan. A common characteristic of a multiemployer plan is that there is commingling of assets contributed by the participating employers.

For multiemployer plans, the accounting treatment used is based on the substance of the terms of the plan. If the plan is a defined benefit plan in substance, it should be accounted for as such, and the participating employer should record its proportionate share of all relevant amounts in the plan. However, defined benefit accounting may not be required if the company cannot obtain sufficient information.

Subsidiaries whose employees participate in a plan sponsored by a parent company also follow multiemployer plan accounting in their separate stand-alone financial statements.

Subsidiaries that participate in parent-sponsored plans are not multiemployer plans. The accounting by the subsidiary will depend on the specific facts and circumstances.

5.9 Curtailments

A number of differences exist in relation to how curtailments are defined, how both curtailment gains and losses are calculated, and when such gains should be recorded. Losses are typically recorded in the same period, when the loss is probable.

When a curtailment is caused by a plan amendment (e.g., a plan freeze), the timing of recognizing a gain or loss is the same under US GAAP or IFRS.

There are additional differences in the timing of the recognition of gains or losses related to plan amendments, curtailments, and termination benefits that occur in connection with a restructuring.

US GAAP

A curtailment is defined as an event that significantly reduces the expected years of future service of present employees or eliminates for a significant number of employees the accrual of defined benefits for some or all of their future service.

Curtailment gains are recognized when realized (i.e., once the terminations have occurred or the plan amendment is adopted). The guidance permits certain offsets of unamortized gains/losses in a curtailment but does not permit pro rata recognition of the remaining unamortized gains/losses.

IFRS

The definition of a curtailment is limited to “a significant reduction by the entity in the number of employees covered by a plan.”

Curtailment gains and losses should be recorded when the curtailment occurs.

IFRS requires the gain or loss related to plan amendments, curtailments, and termination benefits that occur in connection with a restructuring to be recognized when the related restructuring cost is recognized, if that is earlier than the normal IAS 19 recognition date.

5.10 Settlements

Fewer settlements may be recognized under US GAAP (because of an accounting policy choice that is available under US GAAP but not IFRS).

US GAAP

A settlement gain or loss normally is recognized in earnings when the settlement occurs. However, an employer may elect an accounting policy whereby settlement gain or loss recognition is not required if the cost of all settlements within a plan year does not exceed the sum of the service and interest cost components of net benefit cost for that period.

IFRS

A settlement gain or loss is recognized when the settlement occurs. If the settlements are due to lump sum elections by employees as part of the normal operating procedures of the plan, settlement accounting does not apply.

Different definitions of partial settlements may lead to more settlements being recognized under IFRS.

US GAAP

A partial settlement of any one participant’s obligation is generally not allowed. If a portion of the obligation for vested benefits to plan participants is satisfied and the employer remains liable for the balance of those participants’ vested benefits, the amount that is satisfied is not considered settled.

IFRS

A partial settlement occurs if a transaction eliminates all further legal or constructive obligations for part of the benefits provided under a defined benefit plan.

Varying settlement calculation methodologies can result in differing amounts being recognized in income and other comprehensive income.

US GAAP	IFRS
Settlement accounting requires complex calculations unique to US GAAP to determine how much of the gains and losses is recognized in current period earnings.	Settlement accounting requires complex calculations unique to IFRS to determine how much is recognized in current period earnings as compared to other comprehensive income.

5.11 *Asset ceiling*

Under IFRS, there is a limitation on the value of the net pension asset that can be recorded on the balance sheet. Territory-specific regulations may determine limits on refunds or reductions in future contributions that may impact the asset ceiling test.

US GAAP	IFRS
There is no limitation on the size of the net pension asset that can be recorded on the balance sheet.	<p>An asset ceiling test limits the amount of the net pension asset that can be recognized to the lower of (1) the amount of the net pension asset or (2) the present value of any economic benefits available in the form of refunds or reductions in future contributions to the plan. IFRIC 14 clarifies that prepayments are required to be recognized as assets in certain circumstances.</p> <p>The guidance also governs the treatment and disclosure of amounts, if any, in excess of the asset ceiling. In addition, the limitation on the asset often will create an additional liability because contributions may be required that would lead to or increase an irrecoverable surplus.</p>

5.12 *Measurement of defined benefit obligation when both employers and employees contribute*

The accounting for plans where an employer's exposure may be limited by employee contributions may differ. The benefit obligation may be smaller under IFRS than US GAAP.

US GAAP

The measurement of plan obligations does not reflect a reduction when the employer's exposure is limited or where the employer can increase contributions from employees from current levels to help meet a deficit.

IFRS

The measurement of plan obligations where risks associated with the benefit are shared between employers and employees should reflect the substance of the arrangements where the employer's exposure is limited or where the employer can increase contributions from employees to help meet a deficit.

IFRS allows contributions that are linked to service, and do not vary with the length of employee service, to be deducted from the cost of benefits earned in the period that the service is provided rather than spreading them over the employees' working lives.

Contributions that are linked to service, and vary according to the length of employee service, must be spread over the service period using the same attribution method that is applied to the benefits; either in accordance with the formula in the pension plan, or, where the plan provides a materially higher level of benefit for service in later years, on a straight line basis.

5.13 *Plan asset valuation*

Although both models are measured at fair value, US GAAP reduces fair value for the cost to sell and IFRS does not.

US GAAP

Plan assets should be measured at fair value less cost to sell. Under US GAAP, contracts with insurance companies (other than purchases of annuity contracts) should be accounted for as investments and measured at fair value. In some cases, the contract value may be the best available evidence of fair value unless the contract has a determinable cash surrender value or conversion value, which would provide better evidence of the fair value.

IFRS

Plan assets should be measured at fair value, which is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

US GAAP**IFRS**

Under IFRS, the fair value of insurance policies should be estimated using, for example, a discounted cash flow model with a discount rate that reflects the associated risk and the expected maturity date or expected disposal date of the assets. Qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan are measured at the present value of the related obligations. Under IFRS, the use of the cash surrender value is generally inappropriate.

5.14 *Discount rates*

Differences in the selection criteria for discount rates could lead companies to establish different discount rates under IFRS and US GAAP.

US GAAP**IFRS**

The discount rate is based on the rate at which the benefit obligation could be effectively settled. Companies may look to the rate of return on high-quality, fixed-income investments with similar durations to those of the benefit obligation to establish the discount rate. The SEC has stated that the term “high quality” means that a bond has received one of the two highest ratings given by a recognized ratings agency (e.g., Aa or higher by Moody’s).

The guidance does not specifically address circumstances in which a deep market in high-quality corporate bonds does not exist (such as in certain foreign jurisdictions). However, in practice, a hypothetical high-quality corporate bond yield is determined based on a spread added to representative government bond yields.

The discount rate should be determined by reference to market yields on high-quality corporate bonds in the same currency as the benefits to be paid with durations that are similar to those of the benefit obligation.

Where a deep market of high-quality corporate bonds does not exist, companies are required to look to the yield on government bonds when selecting the discount rate. A synthetically constructed bond yield designed to mimic a high-quality corporate bond may not be used to determine the discount rate.

5.15 *Accounting for termination indemnities*

US GAAP allows for more options in accounting for termination indemnity programs.

US GAAP

When accounting for termination indemnities, there are two acceptable alternatives to account for the obligation: (1) full defined benefit plan accounting or (2) if higher, mark-to-market accounting (i.e., basing the liability on the amount that the company would pay out if the employee left the company as of the balance sheet date).

IFRS

Defined benefit accounting is required for termination indemnities.

5.16 *Deferred compensation arrangements—employment benefits*

The accounting for these arrangements, which include individual senior executive employment arrangements, varies under the two frameworks. IFRS provides less flexibility than US GAAP with respect to the expense attribution and measurement methodology.

US GAAP

Individual deferred compensation arrangements that are not considered, in the aggregate, to be a “plan” do not follow the pension accounting standard. Deferred compensation liabilities are measured at the present value of the benefits expected to be provided in exchange for an employee’s service to date. If expected benefits are attributed to more than one individual year of service, the costs should be accrued in a systematic and rational manner over the relevant years of service in which the employee earns the right to the benefit (to the full eligibility date).

A number of acceptable attribution models are used in practice, including the sinking-fund model and the straight-line model. Gains and losses are recognized immediately in the income statement.

IFRS

IFRS does not distinguish between individual senior executive employment arrangements and a “plan” in the way that US GAAP does. Whether a postemployment benefit is provided for one employee or all employees the accounting is the same under IFRS. Deferred compensation accounting relates to benefits that are normally paid while in service but more than 12 months after the end of the accounting period in which they are earned.

The liability associated with deferred compensation contracts classified as other long-term benefits under IAS 19 is measured by the projected-unit-credit method (equivalent to postemployment-defined benefits). All prior service costs and gains and losses are recognized immediately in profit or loss.

5.17 Accounting for taxes

The timing of recognition for taxes related to benefit plans differs.

US GAAP	IFRS
A contribution tax should be recognized as a component of net benefit cost in the period in which the contribution is made.	Taxes related to benefit plans should be included either in the return on assets or the calculation of the benefit obligation, depending on their nature. For example, taxes payable by the plan on contributions are included in actuarial assumptions for the calculation of the benefit obligation.

5.18 Recent/proposed guidance

5.18.1 IASB exposure draft and research project

The IASB issued an exposure draft in June 2015 to address issues discussed with the Interpretations Committee. The proposal addresses the following issues:

- Remeasurements at a significant event
- Availability of refunds from a defined benefit plan managed by an independent trustee

The IASB also has a research project on its agenda to explore the accounting for hybrid plans.

5.18.1.1 Remeasurements at a significant event

The IASB proposed clarifying the accounting related to the remeasurement of the net defined benefit liability (asset) in the event of a plan amendment, curtailment, or settlement such that the calculations of current service cost and net interest cost in the post-event period should be remeasured consistent with the net defined benefit liability. This would include using updated assumptions and the remeasured defined benefit liability when remeasuring the current service cost and net interest cost.

If the proposed amendment is adopted, we believe US GAAP and IFRS accounting will be consistent.

5.18.1.2 Availability of refunds from a defined benefit plan managed by an independent trustee

The IASB proposed clarifying whether a trustee's power can affect a company's unconditional right to a refund and restrict the recognition of an asset. It clarified that amounts of a surplus that a company recognizes as an asset on the basis of a future refund should not include amounts that another party can unilaterally use for other

purposes. It also distinguishes between the power to make investment decisions and the power to wind up a plan or the power to use a surplus to enhance benefits. Also, when determining the availability of a refund or reduction in future contributions, a company should consider statutory requirements, contractual agreements, and any constructive obligation. The proposal further clarified that upon a remeasurement for a significant event, the asset ceiling would need to be reassessed and any adjustment to the asset ceiling would be recognized in other comprehensive income.

If the proposed amendment is adopted, the current US GAAP and IFRS difference with regard to the asset ceiling described in SD 5.11 will remain.

5.18.2 *FASB Accounting Standards Update No. 2015-04, Compensation—Retirement Benefits (Topic 715): Practical Expedient for the Measurement Date of an Employer’s Defined Benefit Obligation and Plan Assets*

As part of its overall simplification efforts, the FASB issued new guidance in April 2015 that provides a practical expedient for companies that have a fiscal year-end that does not coincide with a calendar month-end. The guidance permits a company to elect as an accounting policy the use of the calendar month-end closest to the fiscal year-end for measuring plan assets and obligations. The funded status would be adjusted for contributions and other significant events that occur between the alternative measurement date and the fiscal year-end. A similar practical expedient can also be used for interim remeasurements of significant events that occur on other than calendar month-end dates. This guidance is effective for fiscal years beginning after December 15, 2015 for public companies, and a year later for nonpublic companies. Early adoption is permitted, and transition would be prospective.

IFRS does not provide for a practical expedient, and therefore this guidance creates a difference between the two accounting standards.

Chapter 6:
Assets–nonfinancial
assets

6.1 *Assets—nonfinancial assets*

The guidance under US GAAP and IFRS as it relates to nonfinancial assets (e.g., intangibles; property, plant, and equipment, including leased assets; inventory; and investment property) contains some significant differences with potentially far-reaching implications. These differences primarily relate to differences in impairment indicators, asset unit of account, impairment measurement and subsequent recoveries of previously impaired assets. Overall, differences for long-lived assets held for use could result in earlier impairment recognition under IFRS as compared to US GAAP.

In the area of inventory, IFRS prohibits the use of the last in, first out (LIFO) costing methodology, which is an allowable option under US GAAP. As a result, a company that adopts IFRS and utilizes the LIFO method under US GAAP would have to move to an allowable costing methodology, such as first in, first out (FIFO) or weighted-average cost. For US-based operations, differences in costing methodologies could have a significant impact on reported operating results as well as on current income taxes payable, given the Internal Revenue Service (IRS) book/tax LIFO conformity rules.

IFRS provides criteria for lease classification that are similar to US GAAP criteria. However, the IFRS criteria do not override the basic principle that classification is based on whether the lease transfers substantially all of the risks and rewards of ownership to the lessee. This could result in varying lease classifications for similar leases under the two frameworks. Other key differences involve areas such as sale-leaseback accounting, build-to-suit leases, leveraged leases, and real estate transactions.

As further discussed in the Recent/proposed guidance section, the FASB and IASB are carrying out a joint project on leases and re-exposed the proposals in May 2013. The proposed changes are expected to impact almost all entities and would significantly change lease accounting.

Technical references

US GAAP

ASC 205, ASC 250, ASC 330, ASC 360-10, ASC 360-20, ASC 410-20, ASC 410-20-25, ASC 835-20, ASC 840, ASC 840-40, ASC 908-30, ASC 976

IFRS

IAS 2, IAS 16, IAS 17, IAS 23, IAS 36, IAS 37, IAS 40, IAS 41, IFRS 5, IFRS 13, IFRIC 4, IFRIC 17, SIC 15

Note

The following discussion captures a number of the more significant GAAP differences. It is important to note that the discussion is not inclusive of all GAAP differences in this area.

Long-lived assets

6.2 Impairment of long-lived assets held for use—general

The IFRS-based impairment model might lead to the recognition of impairments of long-lived assets held for use earlier than would be required under US GAAP.

There are also differences related to such matters as what qualifies as an impairment indicator and how recoveries in previously impaired assets get treated.

US GAAP	IFRS
<p>US GAAP requires a two-step impairment test and measurement model as follows:</p> <p>Step 1—The carrying amount is first compared with the undiscounted cash flows. If the carrying amount is lower than the undiscounted cash flows, no impairment loss is recognized, although it might be necessary to review depreciation (or amortization) estimates and methods for the related asset.</p> <p>Step 2—If the carrying amount is higher than the undiscounted cash flows, an impairment loss is measured as the difference between the carrying amount and fair value. Fair value is defined as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date (an exit price). Fair value should be based on the assumptions of market participants and not those of the reporting entity.</p>	<p>IFRS uses a one-step impairment test. The carrying amount of an asset is compared with the recoverable amount. The recoverable amount is the higher of (1) the asset's fair value less costs of disposal or (2) the asset's value in use.</p> <p>In practice, individual assets do not usually meet the definition of a CGU. As a result, assets are rarely tested for impairment individually but are tested within a group of assets.</p> <p>Fair value less costs of disposal represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date less costs of disposal.</p> <p>Value in use represents entity-specific or CGU-specific future pretax cash flows discounted to present value by using a pretax, market-determined rate that reflects the current assessment of the time value of money and the risks specific to the asset or CGU for which the cash flow estimates have not been adjusted.</p>
<p>Changes in market interest rates are not considered impairment indicators.</p>	<p>Changes in market interest rates can potentially trigger impairment and, hence, are impairment indicators.</p>

US GAAP

The reversal of impairments is prohibited.

IFRS

If certain criteria are met, the reversal of impairments, other than those of goodwill, is permitted.

For noncurrent, nonfinancial assets (excluding investment properties and biological assets) carried at fair value instead of depreciated cost, impairment losses related to the revaluation are recorded in other comprehensive income to the extent of prior upward revaluations, with any further losses being reflected in the income statement.

Application of valuation

techniques—The calculation of fair value no longer will default to a present value technique. Although present value techniques might be appropriate, the reporting entity must consider all appropriate valuation techniques in the circumstances.

If the asset is recoverable based on undiscounted cash flows, the discounting or fair value type determinations are not applicable.

6.2.1 Impairment of long-lived assets—cash flow estimates

As noted above, impairment testing under US GAAP starts with undiscounted cash flows, whereas the starting point under IFRS is discounted cash flows. Aside from that difference, IFRS is more prescriptive with respect to how the cash flows themselves are identified for purposes of calculating value in use.

US GAAP

Future cash flow estimates used in an impairment analysis should include:

- All cash inflows expected from the use of the long-lived asset (asset group) over its remaining useful life, based on its existing service potential
- Any cash outflows necessary to obtain those cash inflows, including future expenditures to maintain (but not improve) the long-lived asset (asset group)

IFRS

Cash flow estimates used to calculate value in use under IFRS should include:

- Cash inflows from the continuing use of the asset or the activities of the CGU
- Cash outflows necessarily incurred to generate the cash inflows from continuing use of the asset or CGU (including cash outflows to prepare the asset for use) and that are directly attributable to the asset or CGU

US GAAP

- Cash flows associated with the eventual disposition, including selling costs, of the long-lived asset (asset group)

US GAAP specifies that the remaining useful life of a group of assets over which cash flows may be considered should be based on the remaining useful life of the “primary” asset of the group.

Cash flows are from the perspective of the entity itself. Expected future cash flows should represent management’s best estimate and should be based on reasonable and supportable assumptions consistent with other assumptions made in the preparation of the financial statements and other information used by the entity for comparable periods.

IFRS

- Cash outflows that are indirectly attributable (such as those relating to central overheads) but that can be allocated on a reasonable and consistent basis to the asset or CGU
- Cash flows expected to be received (or paid) for the disposal of assets or CGUs at the end of their useful lives
- Cash outflows to maintain the operating capacity of existing assets, including, for example, cash flows for day-to-day servicing

Cash flow projections used to measure value in use should be based on reasonable and supportable assumptions of economic conditions that will exist over the asset’s remaining useful life. Cash flows expected to arise from future restructurings or from improving or enhancing the asset’s performance should be excluded.

Cash flows are from the perspective of the entity itself. Projections based on management’s budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified. Estimates of cash flow projections beyond the period covered by the most recent budgets/forecasts should extrapolate the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate shall not exceed the long-term average growth rate for the products, industries, or country in which the entity operates, or for the market in which the asset is used unless a higher rate can be justified.

6.2.2 *Impairment of long-lived assets—asset groupings*

Determination of asset groupings is a matter of judgment and could result in differences between IFRS and US GAAP.

US GAAP

For purposes of recognition and measurement of an impairment loss, a long-lived asset or asset group should represent the lowest level for which an entity can separately identify cash flows that are largely independent of the cash flows of other assets and liabilities.

In limited circumstances, a long-lived asset (e.g., corporate asset) might not have identifiable cash flows that are largely independent of the cash flows of other assets and liabilities and of other asset groups. In those circumstances, the asset group for that long-lived asset shall include all assets and liabilities of the entity.

IFRS

A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. It can be a single asset. Identification of an entity's CGUs involves judgment. If an active market (as defined by IFRS 13) exists for the output produced by an asset or group of assets, that asset or group should be identified as a CGU, even if some or all of the output is used internally.

6.3 *Carrying basis*

The ability to revalue assets (to fair value) under IFRS might create significant differences in the carrying value of assets as compared with US GAAP.

US GAAP

US GAAP generally utilizes historical cost and prohibits revaluations except for certain categories of financial instruments, which are carried at fair value.

IFRS

Historical cost is the primary basis of accounting. However, IFRS permits the revaluation to fair value of some intangible assets; property, plant, and equipment; and investment property and inventories in certain industries (e.g., commodity broker/dealer).

IFRS also requires that biological assets be reported at fair value.

Intangible assets¹

6.4 Internally developed intangibles

US GAAP prohibits, with limited exceptions, the capitalization of development costs. Development costs are capitalized under IFRS if certain criteria are met.

Further differences might exist in such areas as software development costs, where US GAAP provides specific detailed guidance depending on whether the software is for internal use or for sale. The principles surrounding capitalization under IFRS, by comparison, are the same, whether the internally generated intangible is being developed for internal use or for sale.

US GAAP

In general, both research costs and development costs are expensed as incurred, making the recognition of internally generated intangible assets rare.

However, separate, specific rules apply in certain areas. For example, there is distinct guidance governing the treatment of costs associated with the development of software for sale to third parties. Separate guidance governs the treatment of costs associated with the development of software for internal use.

The guidance for the two types of software varies in a number of significant ways. There are, for example, different thresholds for when capitalization commences, and there are also different parameters for what types of costs are permitted to be capitalized.

IFRS

Costs associated with the creation of intangible assets are classified into research phase costs and development phase costs. Costs in the research phase are always expensed. Costs in the development phase are capitalized, if all of the following six criteria are demonstrated:

- The technical feasibility of completing the intangible asset
- The intention to complete the intangible asset
- The ability to use or sell the intangible asset
- How the intangible asset will generate probable future economic benefits (the entity should demonstrate the existence of a market or, if for internal use, the usefulness of the intangible asset)
- The availability of adequate resources to complete the development and to use or sell it
- The ability to measure reliably the expenditure attributable to the intangible asset during its development

¹ Excluding goodwill which is covered in the Business Combinations section of this guide.

US GAAP**IFRS**

Expenditures on internally generated brands, mastheads, publishing titles, customer lists, and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognized as intangible assets.

Development costs initially recognized as expenses cannot be capitalized in a subsequent period.

6.5 *Acquired research and development assets*

Under US GAAP, capitalization depends on both the type of acquisition (asset acquisition or business combination) as well as whether the asset has an alternative future use.

Under IFRS, acquired research and development assets are capitalized if it is probable that they will have future economic benefits.

US GAAP**IFRS**

Research and development intangible assets acquired in an asset acquisition are capitalized only if they have an alternative future use. For an asset to have alternative future use, it must be reasonably expected (greater than a 50% chance) that an entity will achieve economic benefit from such alternative use and further development is not needed at the acquisition date to use the asset.

The price paid reflects expectations about the probability that the future economic benefits of the asset will flow to the entity. The probability recognition criterion is always assumed to be met for separately acquired intangible assets.

6.6 *Indefinite-lived intangible assets—level of assessment for impairment testing*

Under US GAAP, the assessment is performed at the asset level. Under IFRS, the assessment may be performed at a higher level (i.e., the CGU level). The varying assessment levels can result in different conclusions as to whether an impairment exists.

US GAAP**IFRS**

Separately recorded indefinite-lived intangible assets, whether acquired or internally developed, shall be combined into a single unit of accounting for purposes of testing impairment if they are operated as a single asset and, as such, are essentially inseparable from one another.

Indefinite-lived intangible assets may be combined only with other indefinite-lived intangible assets; they may not be tested in combination with goodwill or with a finite-lived asset.

US GAAP literature provides a number of indicators that an entity should consider in making a determination of whether to combine intangible assets.

As most indefinite-lived intangible assets (e.g., brand name) do not generate cash flows independently of other assets, it might not be possible to calculate the value in use for such an asset on a standalone basis. Therefore, it is necessary to determine the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets, (known as a CGU), in order to perform the test.

6.6.1 Indefinite-lived intangible assets—impairment testing

Under US GAAP, an entity can choose to first assess qualitative factors in determining if further impairment testing is necessary. This option does not exist Under IFRS.

US GAAP**IFRS**

ASC 350, *Intangibles-Goodwill and Other*, requires an indefinite-lived intangible asset to be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired.

An entity may first assess qualitative factors to determine if a quantitative impairment test is necessary. Further testing is only required if the entity determines, based on the qualitative assessment, that it is more likely than not that a indefinite-lived intangible asset's fair value is less than its carrying amount. Otherwise, no further impairment testing is required.

IAS 36, *Impairment of Assets*, requires an entity to test an indefinite-lived intangible asset for impairment annually. It also requires an impairment test in between annual tests whenever there is an indication of impairment.

US GAAP

An entity can choose to perform the qualitative assessment on none, some, or all of its indefinite lived intangible assets. An entity can bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to the quantitative impairment test and then choose to perform the qualitative assessment in any subsequent period.

IFRS

IAS 36 allows an entity to carry forward the most recent detailed calculation of an asset's recoverable amount when performing its current period impairment test, provided the following criteria are met: (i) the asset is assessed for impairment as a single asset (that is it generates cash flows independently of other assets and is not reviewed for impairment as part of a CGU), (ii) the most recent impairment test resulted in an amount that exceeded the asset's carrying amount by a substantial margin; and (iii) an analysis of events that have occurred and changes in circumstances since the last review indicate that the likelihood that the asset's current recoverable amount would be less than its carrying amount is remote.

6.6.2 Indefinite-lived intangible assets—impairment charge measurement

Even when there is an impairment under both frameworks, the amount of the impairment charge may differ.

US GAAP

Impairments of indefinite-lived intangible assets are measured by comparing fair value to carrying amount.

IFRS

Indefinite-lived intangible asset impairments are calculated by comparing the recoverable amount to the carrying amount (see above for determination of level of assessment). The recoverable amount is the higher of fair value less costs of disposal or value in use. The value in use calculation uses the present value of future cash flows.

6.7 Impairments of software costs to be sold, leased, or otherwise marketed

Impairment measurement model and timing of recognition of impairment are different under US GAAP and IFRS.

US GAAP

When assessing potential impairment, at least at each balance sheet date, the unamortized capitalized costs for each product must be compared with the net realizable value of the software product. The amount by which the unamortized capitalized costs of a software product exceed the net realizable value of that asset shall be written off. The net realizable value is the estimated future gross revenue from that product reduced by the estimated future costs of completing and disposing of that product.

The net realizable value calculation does not utilize discounted cash flows.

IFRS

Under IFRS, intangible assets not yet available for use are tested annually for impairment because they are not being amortized. Once such assets are brought into use, amortization commences and the assets are tested for impairment when there is an impairment indicator.

The impairment is calculated by comparing the recoverable amount (the higher of either (1) fair value less costs of disposal or (2) value in use) to the carrying amount. The value in use calculation uses the present value of future cash flows.

6.8 Advertising costs

Under IFRS, advertising costs may need to be expensed sooner.

US GAAP

The costs of other than direct response advertising should be either expensed as incurred or deferred and then expensed the first time the advertising takes place. This is an accounting policy decision and should be applied consistently to similar types of advertising activities.

Certain direct response advertising costs are eligible for capitalization if, among other requirements, probable future economic benefits exist. Direct response advertising costs that have been capitalized are then amortized over the period of future benefits (subject to impairment considerations).

Aside from direct response advertising-related costs, sales materials such as brochures and catalogs may be accounted for as prepaid supplies until they no longer are owned or expected to be used, in which case their cost would be a cost of advertising.

IFRS

Costs of advertising are expensed as incurred. The guidance does not provide for deferrals until the first time the advertising takes place, nor is there an exception related to the capitalization of direct response advertising costs or programs.

Prepayment for advertising may be recorded as an asset only when payment for the goods or services is made in advance of the entity's having the right to access the goods or receive the services.

The cost of materials, such as sales brochures and catalogues, is recognized as an expense when the entity has the right to access those goods.

Property, plant and equipment

6.9 Depreciation

Under IFRS, differences in asset componentization guidance might result in the need to track and account for property, plant, and equipment at a more disaggregated level.

US GAAP	IFRS
<p>US GAAP generally does not require the component approach for depreciation.</p> <p>While it would generally be expected that the appropriateness of significant assumptions within the financial statements would be reassessed each reporting period, there is no explicit requirement for an annual review of residual values.</p>	<p>IFRS requires that separate significant components of property, plant, and equipment with different economic lives be recorded and depreciated separately.</p> <p>The guidance includes a requirement to review residual values and useful lives at each balance sheet date.</p>

6.10 Overhaul costs

US GAAP may result in earlier expense recognition when portions of a larger asset group are replaced.

US GAAP	IFRS
<p>US GAAP permits alternative accounting methods for recognizing the costs of a major overhaul. Costs representing a replacement of an identified component can be (1) expensed as incurred, (2) accounted for as a separate component asset, or (3) capitalized and amortized over the period benefited by the overhaul.</p>	<p>IFRS requires capitalization of the costs of a major overhaul representing a replacement of an identified component.</p> <p>Consistent with the componentization model, the guidance requires that the carrying amount of parts or components that are replaced be derecognized.</p>

6.11 Asset retirement obligations

Initial measurement might vary because US GAAP specifies a fair value measure and IFRS does not. IFRS results in greater variability, as obligations in subsequent periods get adjusted and accreted based on current market-based discount rates.

US GAAP

Asset retirement obligations (AROs) are recorded at fair value and are based upon the legal obligation that arises as a result of the acquisition, construction, or development of a long-lived asset.

The use of a credit-adjusted, risk-free rate is required for discounting purposes when an expected present-value technique is used for estimating the fair value of the liability.

The guidance also requires an entity to measure changes in the liability for an ARO due to passage of time by applying an interest method of allocation to the amount of the liability at the beginning of the period. The interest rate used for measuring that change would be the credit-adjusted, risk-free rate that existed when the liability, or portion thereof, was initially measured.

In addition, changes to the undiscounted cash flows are recognized as an increase or a decrease in both the liability for an ARO and the related asset retirement cost. Upward revisions are discounted by using the current credit-adjusted, risk-free rate. Downward revisions are discounted by using the credit-adjusted, risk-free rate that existed when the original liability was recognized. If an entity cannot identify the prior period to which the downward revision relates, it may use a weighted-average, credit-adjusted, risk-free rate to discount the downward revision to estimated future cash flows.

IFRS

IFRS requires that management's best estimate of the costs of dismantling and removing the item or restoring the site on which it is located be recorded when an obligation exists. The estimate is to be based on a present obligation (legal or constructive) that arises as a result of the acquisition, construction, or development of a fixed asset. If it is not clear whether a present obligation exists, the entity may evaluate the evidence under a more-likely-than-not threshold. This threshold is evaluated in relation to the likelihood of settling the obligation.

The guidance uses a pretax discount rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Changes in the measurement of an existing decommissioning, restoration, or similar liability that result from changes in the estimated timing or amount of the cash outflows or other resources, or a change in the discount rate, adjust the carrying value of the related asset under the cost model. Adjustments may result in an increase of the carrying amount of an asset beyond its recoverable amount. An impairment loss would result in such circumstances. Adjustments may not reduce the carrying amount of an asset to a negative value. Once the carrying value reaches zero, further reductions are recorded in profit and loss. The periodic unwinding of the discount is recognized in profit or loss as a finance cost as it occurs.

6.12 *Borrowing costs*

Borrowing costs under IFRS are broader and can include more components than interest costs under US GAAP.

US GAAP allows for more judgment in the determination of the capitalization rate, which could lead to differences in the amount of costs capitalized.

IFRS does not permit the capitalization of borrowing costs in relation to equity-method investments, whereas US GAAP may allow capitalization in certain circumstances.

US GAAP

Capitalization of interest costs is required while a qualifying asset is being prepared for its intended use.

The guidance does not require that all borrowings be included in the determination of a weighted-average capitalization rate. Instead, the requirement is to capitalize a reasonable measure of cost for financing the asset's acquisition in terms of the interest cost incurred that otherwise could have been avoided.

Eligible borrowing costs do not include exchange rate differences from foreign currency borrowings. Also, generally, interest earned on invested borrowed funds cannot offset interest costs incurred during the period.

An investment accounted for by using the equity method meets the criteria for a qualifying asset while the investee has activities in progress necessary to commence its planned principal operations, provided that the investee's activities include the use of funds to acquire qualifying assets for its operations.

IFRS

Borrowing costs directly attributable to the acquisition, construction, or production of a qualifying asset are required to be capitalized as part of the cost of that asset.

The guidance acknowledges that determining the amount of borrowing costs directly attributable to an otherwise qualifying asset might require professional judgment. Having said that, the guidance first requires the consideration of any specific borrowings and then requires consideration of all general borrowings outstanding during the period.

In broad terms, a qualifying asset is one that necessarily takes a substantial period of time to get ready for its intended use or sale. Investments accounted for under the equity method would not meet the criteria for a qualifying asset.

Eligible borrowing costs include exchange rate differences from foreign currency borrowings.

Leases**6.13 Lease scope**

IFRS is broader in scope and may be applied to certain leases of intangible assets.

US GAAP

The guidance for leases (ASC 840, *Leases*) applies only to property, plant, and equipment.

Although the guidance is restricted to tangible assets, entities can analogize to the lease guidance for leases of software.

IFRS

The scope of IFRS lease guidance (IAS 17, *Leases*) is not restricted to property, plant, and equipment. Accordingly, it may be applied more broadly (for example, to some intangible assets and inventory).

US GAAP

Specifically, ASC 985-20 addresses the accounting by lessors for leases of computer equipment and software. ASC 350-40-25-16 specifies that a company acquiring software under a licensing or leasing agreement should account for the transaction by analogy to ASC 840.

IFRS

However, the standard cannot be applied to leases of biological assets, licensing agreements, or leases to explore for or use minerals, oil, natural gas, and similar non-regenerative resources.

6.14 *Lease classification—general*

Leases might be classified differently under IFRS than under US GAAP. Different classification can have a profound effect on how a lease is reflected within the financial statements.

US GAAP

The guidance under ASC 840 contains four specific criteria for determining whether a lease should be classified as an operating lease or a capital lease by a lessee. The criteria for capital lease classification broadly address the following matters:

- Ownership transfer of the property to the lessee
- Bargain purchase option
- Lease term in relation to economic life of the asset
- Present value of minimum lease payments in relation to fair value of the leased asset

IFRS

The guidance under IAS 17 focuses on the overall substance of the transaction. Lease classification as an operating lease or a finance lease (i.e., the equivalent of a capital lease under US GAAP) depends on whether the lease transfers substantially all of the risks and rewards of ownership to the lessee.

Although similar lease classification criteria identified in US GAAP are considered in the classification of a lease under IFRS, there are no quantitative breakpoints or bright lines to apply (e.g., 90 percent). IFRS also lacks guidance similar to ASC 840-10-25-14 with respect to default remedies.

US GAAP

The criteria contain certain specific quantified thresholds such as whether the lease term equals or exceeds 75% of the economic life of the leased asset (“75% test”) or the present value of the minimum lease payments equals or exceeds 90 percent of the fair value of the leased property (“90% test”).

Events of default must be evaluated pursuant to ASC 840-10-25-14 to assess whether remedies payable upon default are minimum lease payments for purposes of applying the 90% test.

The guidance indicates that the maximum amount of potential payments under all non-performance events of default must be included in the lease classification 90% test unless each of the following 4 criteria are met: (i) the covenant is customary, (ii) predefined criteria relating solely to the lessee and its operations have been established for the determination of the event of default, (iii) the occurrence of the event of default is objectively determinable; and (iv) it is reasonable to assume at lease inception that an event of default will not occur.

For a lessor to classify a lease as a direct financing or sales-type lease under the guidance, two additional criteria must be met.

IFRS

Under IFRS there are additional indicators/potential indicators that may result in a lease being classified as a finance lease. For example, a lease of special-purpose assets that only the lessee can use without major modification generally would be classified as a finance lease. This would also be the case for any lease that does not subject the lessor to significant risk with respect to the residual value of the leased property.

There are no incremental criteria for a lessor to consider in classifying a lease under IFRS. Accordingly, lease classification by the lessor and the lessee typically should be symmetrical.

6.15 *Sale-leaseback arrangements*

Differences in the frameworks might lead to differences in the timing of gain recognition in sale-leaseback transactions. Where differences exist, IFRS might lead to earlier gain recognition.

US GAAP

The gain on a sale-leaseback transaction generally is deferred and amortized over the lease term. Immediate recognition of the full gain is normally appropriate only when the leaseback is considered minor, as defined.

IFRS

When a sale-leaseback transaction results in a lease classified as an operating lease, the full gain on the sale normally would be recognized immediately if the sale was executed at the fair value of the asset. It is not necessary for the leaseback to be minor.

US GAAP**IFRS**

If the leaseback is more than minor but less than substantially all of the asset life, a gain is only recognized immediately to the extent that the gain exceeds (a) the present value of the minimum lease payments if the leaseback is classified as an operating lease; (b) the recorded amount of the leased asset if the leaseback is classified as a capital lease.

If the lessee provides a residual value guarantee, the gain corresponding to the gross amount of the guarantee is deferred until the end of the lease; such amount is not amortized during the lease term.

When a sale-leaseback transaction involves the leaseback of the entire property sold and the leaseback is a capital lease, then under ASC 840-40-25-4, the substance of the transaction is a financing and the profit should be deferred until the sale is recognized.

There are onerous rules for determining when sale-leaseback accounting is appropriate for transactions involving real estate (including integral equipment). If the rules are not met, the sale leaseback will be accounted for as a financing. As such, the real estate will remain on the seller-lessee's balance sheet, and the sales proceeds will be reflected as debt. Thereafter, the property will continue to depreciate, and the rent payments will be re-characterized as debt service.

If the sale price is below fair value, any profit or loss should be recognized immediately, except that if there is a loss compensated by below-market rentals during the lease term the loss should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortized over the period for which the asset is expected to be used.

When a sale-leaseback transaction results in a finance lease, the gain is amortized over the lease term, irrespective of whether the lessee will reacquire the leased property.

There are no real estate-specific rules equivalent to the US guidance. Accordingly, almost all sale-leaseback transactions result in sale-leaseback accounting. The property sold would be removed from the balance sheet, and if the leaseback is classified as an operating lease, the property would not come back onto the seller-lessee's balance sheet.

6.16 *Leases involving land and buildings*

More frequent bifurcation under IFRS might result in differences in the classification of and accounting for leases involving land and buildings. In addition, accounting for land leases under IFRS might result in more frequent recordings of finance leases.

US GAAP

Under ASC 840, land and building elements generally are accounted for as a single unit of account, unless the land represents 25 percent or more of the total fair value of the leased property.

When considering the classification of land that is considered its own unit of account, ASC 840 would require the lease to be classified as an operating lease unless either the transfer-of-ownership criterion or the bargain-purchase-option criterion is met. In those cases the lessee should account for the land lease as a capital lease.

IFRS

Under IAS 17, land and building elements must be considered separately, unless the land element is not material. This means that nearly all leases involving land and buildings should be bifurcated into two components, with separate classification considerations and accounting for each component.

The lease of the land element should be classified based on a consideration of all of the risks and rewards indicators that apply to leases of other assets. Accordingly, a land lease would be classified as a finance lease if the lease term were long enough to cause the present value of the minimum lease payments to be at least substantially all of the fair value of the land.

In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life.

6.17 Lease—other

The exercise of renewal/extension options within leases might result in a new lease classification under US GAAP, but not under IFRS.

US GAAP

The renewal or extension of a lease beyond the original lease term, including those based on existing provisions of the lease arrangement, normally triggers accounting for the arrangement as a new lease.

IFRS

If the period covered by the renewal option was not considered to be part of the initial lease term but the option is ultimately exercised based on the contractually stated terms of the lease, the original lease classification under the guidance continues into the extended term of the lease; it is not revisited.

Leveraged lease accounting is not available under IFRS, potentially resulting in delayed income recognition and gross balance sheet presentation.

US GAAP**IFRS**

The lessor can classify leases that would otherwise be classified as direct-financing leases as leveraged leases if certain additional criteria are met. Financial lessors sometimes prefer leveraged lease accounting because it often results in faster income recognition. It also permits the lessor to net the related nonrecourse debt against the leveraged lease investment on the balance sheet.

The guidance does not permit leveraged lease accounting. Leases that would qualify as leveraged leases under US GAAP typically would be classified as finance leases under IFRS. Any nonrecourse debt would be reflected gross on the balance sheet.

Immediate income recognition by lessors on leases of real estate is more likely under IFRS.

US GAAP**IFRS**

Under the guidance, income recognition for an outright sale of real estate is appropriate only if certain requirements are met. By extension, such requirements also apply to a lease of real estate. Accordingly, a lessor is not permitted to classify a lease of real estate as a sales-type lease unless ownership of the underlying property automatically transfers to the lessee at the end of the lease term, in which case the lessor must apply the guidance appropriate for an outright sale.

IFRS does not have specific requirements similar to US GAAP with respect to the classification of a lease of real estate. Accordingly, a lessor of real estate (e.g., a dealer) will recognize income immediately if a lease is classified as a finance lease (i.e., if it transfers substantially all the risks and rewards of ownership to the lessee).

Additional consideration is required under US GAAP when the lessee is involved with the construction of an asset that will be leased to the lessee when construction of the asset is completed.

US GAAP**IFRS**

Lessee involvement in the construction of an asset to be leased upon construction completion is subject to specific detailed guidance to determine whether the lessee should be considered the owner of the asset during construction. If the lessee has substantially all of the construction period risks, as determined by specific criterion included in ASC 840-40-55, the lessee must account for construction in progress as if it were the legal owner and recognize landlord financed construction costs as debt. Once construction is complete, the arrangement is evaluated as a sale-leaseback.

No specific guidance relating to lessee involvement in the construction of an asset exists under IFRS.

US GAAP**IFRS**

ASC 840 provides guidance with respect to accounting for a “construction project” and can be applied not only to new construction but also to the renovation or re-development of an existing asset.

Other

6.18 Distributions of nonmonetary assets to owners

Spin-off transactions under IFRS can result in gain recognition as nonmonetary assets are distributed at fair value. Under US GAAP, nonmonetary assets are distributed at their recorded amount, and no gains are recognized.

US GAAP**IFRS**

Accounting for the distribution of nonmonetary assets to owners of an enterprise should be based on the recorded amount (after reduction, if appropriate, for an indicated impairment of value) of the nonmonetary assets distributed. Upon distribution, those amounts are reflected as a reduction of owner’s equity.

Accounting for the distribution of nonmonetary assets to owners of an entity should be based on the fair value of the nonmonetary assets to be distributed. A dividend payable is measured at the fair value of the nonmonetary assets to be distributed. Upon settlement of a dividend payable, an entity will recognize any differences between the carrying amount of the assets to be distributed and the carrying amount of the dividend payable in profit or loss.

6.19 Inventory costing

Companies that utilize the LIFO costing methodology under US GAAP might experience significantly different operating results as well as cash flows under IFRS.

Furthermore, regardless of the inventory costing model utilized, under IFRS companies might experience greater earnings volatility in relation to recoveries in values previously written down.

US GAAP**IFRS**

A variety of inventory costing methodologies such as LIFO, FIFO, and/or weighted-average cost are permitted.

A number of costing methodologies such as FIFO or weighted-average costing are permitted. The use of LIFO, however, is precluded.

US GAAP**IFRS**

For companies using LIFO for US income tax purposes, the book/tax conformity rules also require the use of LIFO for book accounting/reporting purposes.

Reversals of write-downs are prohibited.

Reversals of inventory write-downs (limited to the amount of the original write-down) are required for subsequent recoveries.

6.20 *Inventory measurement*

The measurement of inventory might vary when cost is greater than market (US GAAP) or net realizable value (IFRS).

US GAAP**IFRS**

Inventory is measured at the lower of cost or market. Market is the current replacement cost; however, the replacement cost cannot be greater than the net realizable value or less than net realizable value reduced by a normal sales margin. Net realizable value is estimated selling price less costs of completion and sale.

Inventory is measured at the lower of cost and net realizable value. Net realizable value is estimated selling price less costs of completion and sale.

6.21 *Biological assets—fair value versus historical cost*

Companies whose operations include management of the transformation of living animals or plants into items for sale, agricultural produce, or additional biological assets have the potential for fundamental changes to their basis of accounting (because IFRS requires fair value-based measurement).

US GAAP**IFRS**

Biological assets are generally measured at historical cost. These assets are tested for impairment in the same manner as other long-lived assets.

Under IAS 41, biological assets are measured at fair value less costs to sell for initial recognition and at each subsequent reporting date, except when the measurement of fair value is unreliable. All changes in fair value are recognized in the income statement in the period in which they arise.

US GAAP**IFRS**

An amendment was made in June 2014 which excluded bearer plants from the scope of IAS 41 and included them in the scope of IAS 16, *Property, Plant and Equipment*. The amendment is effective for annual periods beginning on or after 1 January 2016. The produce growing on bearer plants will remain within the scope of IAS 41.

6.22 *Investment property*

Alternative methods or options of accounting for investment property under IFRS could result in significantly different asset carrying values (fair value) and earnings.

US GAAP**IFRS**

There is no specific definition of investment property.

The historical-cost model is used for most real estate companies and operating companies holding investment-type property.

Investor entities—such as many investment companies, insurance companies' separate accounts, bank-sponsored real estate trusts, and employee benefit plans that invest in real estate—carry their investments at fair value.

The fair value alternative for leased property does not exist.

Investment property is separately defined as property (land and/or buildings) held in order to earn rentals and/or for capital appreciation. The definition does not include owner-occupied property, property held for sale in the ordinary course of business, or property being constructed or developed for such sale. Properties under construction or development for future use as investment properties are within the scope of investment properties.

The acquisition of an investment property may either be an acquisition of an asset or a group of assets or a business combination within the scope of IFRS 3, *Business Combinations*.

Investment property is initially measured at cost (transaction costs are included). Thereafter, it may be accounted for on a historical-cost basis or on a fair value basis as an accounting policy choice.² When fair value is applied, the gain or loss arising from a change in the fair value is recognized in the income statement. The carrying amount is not depreciated.

The election to account for investment property at fair value may also be applied to leased property.

² An entity that chooses the cost model would need to disclose the fair value of its investment property.

6.23 *Recent/proposed guidance*

6.23.1 *Leases—Joint Project of the FASB and IASB*

The FASB and IASB each issued a revised Leases Exposure Draft in May 2013 that attracted significant comments from stakeholders, and which prompted the Boards to reconsider key elements of the proposed standard. Although some aspects of the initial proposal have changed, and convergence between the FASB and IASB appears unlikely, the key objective, to bring most leases on the lessee balance sheet, has been met.

As redeliberations draw to a close, the FASB has retained a dual income statement model with classification of different types of leases similar to today. The IASB, on the other hand, has decided to require lessees to reflect all leases as financings. Over the past two years, there have also been other changes to the initial proposals related to classification, measurement, transition, and disclosure.

6.23.1.1 *Key provisions*

For lessees, the Boards have continued to support balance sheet recognition for most leases and have retained, but clarified, previous proposals regarding how to determine whether an arrangement is (or contains) a lease. Although in agreement on how to identify a lease, the Boards have been unable to arrive at a converged proposal regarding classification, with each Board voting for different changes to the guidance proposed in their respective exposure drafts.

The FASB has continued to support a dual approach for classifying leases based on criteria similar to current US GAAP—rejecting classification based on the nature of the underlying asset, as had been proposed in the 2013 revised ED. The FASB will require a lease to be presented as a financing (similar to capital leases today) in the income statement (referred to as a Type A lease) when (1) payments represent substantially all of the fair value of the asset, (2) the lease term is for a major portion of the asset's economic life, (3) purchase of the asset is considered a bargain, or (4) title transfer is automatic at the end of the lease. The fair value and economic life tests are expected to be similar to the 90 percent and 75 percent tests under existing US GAAP guidance, albeit without the bright lines.

All other leases would be classified as Type B, with costs presented as lease expense and recognized on a straight-line basis in the income statement over the lease term. This would produce an expense recognition pattern that is similar to operating leases under current US GAAP.

In contrast, the IASB has decided to require all leases to be presented as financings for lessees, given their belief that this approach is conceptually superior and that a single model will be easier to apply than a dual approach.

Regardless of how the differences in lease classification will impact the income statement, the Boards agree that on the balance sheet, lessees should initially recognize a right-to-use asset and lease liability based on the discounted payments

required by the lease. The Boards agreed to an exemption to this presentation for short-term leases (i.e., a term of one year or less), which would not be recognized on a lessee's balance sheet. The IASB decided on an additional exemption for leases of small assets.

For lessors, in light of significant stakeholder concerns, the Boards voted to eliminate the “receivable and residual” approach proposed in the revised ED. This would have treated all leases as a sale, resulting in de-recognition of the leased asset. Real estate lessors in particular voiced concern about the resulting complexity when applied to the lease of a portion of an asset (e.g., a floor of a building being leased to a single tenant). Instead, the Boards agree that lessors with Type B leases should continue to reflect the underlying asset subject to the lease arrangement on the balance sheet similar to the classification of leases previously accounted for as operating leases. For financing arrangements (Type A leases) or sales, the balance sheet should reflect the lessor's investment in the lease, which consists of the receivable and the lessor's residual interest in the underlying asset.

With respect to the income statement, the FASB and IASB agree that an arrangement that is effectively a sale should result in recognition of a day-one profit. The FASB, however, believes that when the lessee does not obtain control of the underlying asset, the profit should be deferred and recognized over the lease term, even if the lease is classified as a Type A lease. This could occur when a lessor purchases residual value insurance—thereby transferring the risks and rewards, but not control, of the underlying asset, to the lessee.

Lessors would consider all other leases to be Type B, with income statement and balance sheet treatment similar to today's operating leases.

For both lessees and lessors, it is critical to determine which payments should be included in the calculation of their respective assets and, in the case of a lessee, the lease liability. Previous proposals prompted significant debate. The Boards voted to include all fixed lease payments in the measurement of the lessor and lessee's assets and the lessee's lease liability. For variable payments (e.g., increases in rent based on CPI), the Boards voted to include rents on the basis of the rate or index at lease commencement. The FASB decided that lease payments used to measure the right-to-use asset and lease liability would not be revisited if the rate or index changes unless the lease obligation was required to be remeasured for other reasons. In contrast, the IASB decided to require remeasurement whenever a change in the reference rate results in a change in cash flows. Variable payments related to the use of the asset (e.g., percentage rent on sales) would be recognized as incurred. Lessors should not reassess variable lease payments.

6.23.1.2 Transition

The 2013 Exposure Draft proposed a requirement to apply either a full retrospective transition approach, or a modified approach, for lessors and lessees. In their February 2015 meeting, the FASB voted against full retrospective transition, in favor of retaining only a modified retrospective approach. The IASB elected to retain both full retrospective and modified retrospective transition approaches for lessees, which should be applied consistently across the entire portfolio of former operating leases.

The IASB further tentatively decided to require lessors to continue to apply existing lease accounting for leases in effect at the date of initial application (except for intermediate lessors in a sublease).

Currently, the Boards expect that lessees and lessors will compute lease assets and liabilities based on the remaining payments for leases existing at, or entered into after the date of initial application (if the IASB full retrospective approach is not applied). The Boards will provide transition guidance for different types of lease arrangements, and will include provisions to simplify the initial application of the proposed standard. In some cases, these provisions are not converged.

In addition, the IASB decided to permit an entity to grandfather the definition of a lease for all contracts that are ongoing at the date of initial application of the new standard. An entity that chooses to grandfather the definition of a lease should do so for all contracts that are ongoing at the date of initial application. The entity should disclose that fact.

6.23.1.3 *What's next*

The Boards have nearly completed their redeliberations and are working on drafting the final standard, which could differ in some respects from the tentative decisions discussed to date. The Boards have indicated that they will not issue another exposure draft and hope to issue a final standard in the second half of 2015. The Boards have not yet proposed an effective date.

Adoption of the proposed standard will have a significant impact on a company's financial statements and supporting systems and controls. This will require significant effort. But it is not simply gathering the information or implementing software or processes. Companies must also consider the effort needed to weigh the benefits of the recently added transition relief options in order to develop a well thought out transition plan.

6.23.2 *FASB Accounting Standards Update No. 2015-05, Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*

In April 2015, the FASB issued new guidance on a customer's accounting for fees paid in a cloud computing arrangement (CCA). Previously, there was no specific US GAAP guidance on accounting for such fees from the customer's perspective. Under the new guidance, customers will apply the same criteria as vendors to determine whether a CCA contains a software license or is solely a service contract.

Under the new guidance, fees paid by a customer in a CCA will be within the scope of the internal-use software guidance if both of the following criteria are met:

- The customer has the contractual right to take possession of the software at any time during the CCA period without significant penalty.
- It is feasible for the customer to run the software on its own hardware (or to contract with another party to host the software).

Arrangements that do not meet both of the criteria are considered service contracts, and separate accounting for a license will not be permitted. Arrangements that meet the criteria are considered multiple-element arrangements to purchase both a software license and a service of hosting the software. Existing guidance on internal-use software is applied to the purchased license.

For public companies, the new guidance is effective for annual periods, including interim periods, beginning after December 15, 2015. For non-public companies, it is effective for annual periods beginning after December 15, 2015, and interim periods in annual periods beginning after December 15, 2016. Early adoption is permitted.

6.23.3 *IASB Amendments to IAS 16, Property, Plant, and Equipment and IAS 41, Agriculture: Bearer Plants*

In June 2014, the IASB published amendments that change the financial reporting for bearer plants. The amendment provides bearer plants to be accounted for in the same way as property, plant and equipment in IAS 16 Property, Plant and Equipment, because their operation is similar to that of manufacturing. Consequently, the amendments include bearer plants within the scope of IAS 16, instead of IAS 41. The produce growing on bearer plants will remain within the scope of IAS 41. The amendments are effective for annual periods beginning on or after January 1, 2016. Earlier application is permitted.

6.23.4 *IASB Annual Improvements to IFRSs 2012-2014 Cycle: IFRS 5, Non-current Assets Held for Sale and Discontinued Operations: Changes in methods of disposal*

In September 2014, the IASB issued an amendment to IFRS 5 that clarifies the guidance related to changes to a plan of sale or to a plan of distribution to owners. These clarifications are as follows:

- If an entity has classified an asset (or disposal group) as held for distribution to owners, but the specified criteria for such classification is no longer met, the entity should cease to apply held for distribution accounting in the same way as it ceases to apply the held for sale accounting when it no longer meets the held for sale criteria.
- A reclassification from held for sale to held for distribution (or vice versa) does not constitute a change to a plan of sale or distribution; rather, the change is considered a continuation of the original plan of disposal. Such a change does not change the date of classification (i.e., it does not, in itself, extend the one year period to complete a sale or distribution).

An entity shall apply these amendments prospectively to changes in a method of disposal that occur in annual periods beginning on or after January 1, 2016. Earlier application is permitted. If an entity applies these amendments in an earlier period, it should disclose that fact.

6.23.5 IASB amendments to IAS 16, Property, Plant, and Equipment and IAS 38, Intangible Assets: Clarification of Acceptable Methods of Depreciation and Amortization

In May 2014, the IASB issued an amendment to IAS 16 and IAS 38 that clarifies when a method of depreciation or amortization based on revenue may be appropriate.

The amendment to IAS 16 clarifies that depreciation of an item of property, plant and equipment based on revenue generated by using the asset is not appropriate.

The amendment to IAS 38 establishes a rebuttable presumption that amortization of an intangible asset based on revenue generated by using the asset is inappropriate. The presumption may only be rebutted in certain limited circumstances. These are:

- Where the intangible asset is expressed as a measure of revenue; or
- Where it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.

An entity shall apply these amendments prospectively for annual periods beginning on or after January 1, 2016. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

Chapter 7:
Assets—financial assets

7.1 *Assets—financial assets*

The FASB and IASB have both been working on projects to address the recognition and measurement of financial instruments. Whilst the Boards were jointly working together on some aspects of their projects they are no longer converged. With the publication of IFRS 9, *Financial Instruments* in July 2014, the IASB completed its project of replacing the classification and measurement, impairment and hedge accounting guidance. The FASB is almost finished redeliberating its financial instruments project on classification and measurement and impairment. Details on these and other developments are discussed in the Recent/proposed guidance section. The remainder of this section focuses on the current US GAAP and IFRS guidance.

Under current US GAAP, various specialized pronouncements provide guidance for the classification of financial assets. IFRS currently has only one standard for the classification of financial assets and requires that financial assets be classified in one of four categories: assets held for trading or designated at fair value, with changes in fair value reported in earnings; held-to-maturity investments; available-for-sale financial assets; and loans and receivables.

The specialized US guidance and the singular IFRS guidance in relation to classification can drive differences in measurement (because classification drives measurement under both IFRS and US GAAP).

Under US GAAP, the legal form of the financial asset drives classification. For example, debt instruments that are securities in legal form are typically carried at fair value under the available-for-sale category (unless they are held to maturity)—even if there is no active market to trade the securities. At the same time, a debt instrument that is not in the form of a security (for example, a corporate loan) is accounted for at amortized cost even though both instruments (i.e., the security and the loan) have similar economic characteristics. Under IFRS, the legal form does not drive classification of debt instruments; rather, the nature of the instrument (including whether there is an active market) is considered. As described in table below, additional differences include the calculation of amortized cost of financial assets that are carried at amortized cost, impairment models for available-for-sale debt securities and equities, the reversals of impairment losses, and some embedded derivatives that are not bifurcated.

The table also describes some fundamental differences in the way US GAAP and IFRS currently assess the potential derecognition of financial assets. These differences can have a significant impact on a variety of transactions such as asset securitizations. IFRS focuses on whether a qualifying transfer has taken place, whether risks and rewards have been transferred, and, in some cases, whether control over the asset(s) in question has been transferred. US GAAP focuses on whether an entity has surrendered control over an asset, including the surrendering of legal and effective control.

Technical references*US GAAP*

ASC 310, ASC 310-10-30, ASC 310-10-35, ASC 320, ASC 325, ASC 815, ASC 815-15-25-4 through 25-5, ASC 820, ASC 825, ASC 860

IFRS

IAS 39, IFRS 13, SIC 12

Note

The following discussion captures a number of the more significant GAAP differences. It is important to note that the discussion is not inclusive of all GAAP differences in this area.

Classification

7.2 Available-for-sale financial assets—fair value versus cost of unlisted equity instruments

More investments in unlisted equity securities are recorded at fair value under IFRS.

US GAAP

Unlisted equity investments generally are scoped out of ASC 320 and would be carried at cost, unless either impaired or the fair value option is elected.

Certain exceptions requiring that investments in unlisted equity securities be carried at fair value do exist for specific industries (e.g., broker/dealers, investment companies, insurance companies, and defined benefit plans).

IFRS

There are no industry-specific differences in the treatment of investments in equity instruments that do not have quoted market prices in an active market. Rather, all available-for-sale assets, including investments in unlisted equity instruments, are measured at fair value (with rare exceptions only for instances in which fair value cannot be reliably measured).

Fair value is not reliably measurable when the range of reasonable fair value estimates is significant and the probability of the various estimates within the range cannot be reasonably assessed.

7.3 *Available-for-sale debt financial assets—foreign exchange gains/losses on debt instruments*

The treatment of foreign exchange gains and losses on available-for-sale debt securities will create more income statement volatility under IFRS.

US GAAP	IFRS
<p>The <i>total</i> change in fair value of available-for-sale debt securities—net of associated tax effects—is recorded within other comprehensive income (OCI).</p> <p>Any component of the overall change in fair market value that may be associated with foreign exchange gains and losses on an available-for-sale debt security is treated in a manner consistent with the remaining overall change in the instrument’s fair value.</p>	<p>For available-for-sale debt instruments, the total change in fair value is bifurcated, with the portion associated with foreign exchange gains/losses on the amortized cost basis separately recognized in the income statement. The remaining portion of the total change in fair value is recognized in OCI, net of tax effect.</p>

7.4 *Effective interest rates—expected versus contractual cash flows*

Differences between the expected and contractual lives of financial assets carried at amortized cost have different implications under the two frameworks.

The difference in where the two accounting frameworks place their emphasis (contractual term for US GAAP and expected life for IFRS) can affect asset carrying values and the timing of income recognition.

US GAAP	IFRS
<p>For financial assets that are carried at amortized cost, the calculation of the effective interest rate generally is based on <i>contractual</i> cash flows over the asset’s <i>contractual</i> life.</p> <p>The expected life, under US GAAP, is typically used only for:</p> <ul style="list-style-type: none"> □ Loans if the entity holds a large number of similar loans and the prepayments can be reasonably estimated □ Certain structured notes 	<p>For financial assets that are carried at amortized cost, the calculation of the effective interest rate generally is based on the <i>estimated</i> cash flows (excluding future credit losses) over the <i>expected</i> life of the asset.</p> <p>Contractual cash flows over the full contractual term of the financial asset are used only in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial asset.</p>

US GAAP**IFRS**

-
- Certain beneficial interests in securitized financial assets
 - Certain loans or debt securities acquired in a transfer
-

7.4.1 Effective interest rates—changes in expectations

Differences in how changes in expectations (associated with financial assets carried at amortized cost) are treated can affect asset valuations and the timing of income statement recognition.

US GAAP**IFRS**

Different models apply to the ways revised estimates are treated depending on the type of financial asset involved (e.g., prepayable loans, structured notes, beneficial interests, loans, or debt acquired in a transfer).

If an entity revises its estimates of payments or receipts, the entity adjusts the carrying amount of the financial asset (or group of financial assets) to reflect both actual and revised estimated cash flows.

Depending on the nature of the asset, changes may be reflected prospectively or retrospectively. None of the US GAAP models is the equivalent of the IFRS cumulative-catch-up-based approach.

Revisions of the expected life or of the estimated future cash flows may exist, for example, in connection with debt instruments that contain a put or call option that doesn't need to be bifurcated or whose coupon payments vary because of an embedded feature that does not meet the definition of a derivative because its underlying is a nonfinancial variable specific to a party to the contract (e.g., cash flows that are linked to earnings before interest, taxes, depreciation, and amortization; sales volume; or the earnings of one party to the contract).

The entity recalculates the carrying amount by computing the present value of estimated future cash flows at the financial asset's original effective interest rate. The adjustment is recognized as income or expense in the income statement (i.e., by the cumulative-catch-up approach).

Generally, floating rate instruments (e.g., LIBOR plus spread) issued at par are not subject to the cumulative-catch-up approach; rather, the effective interest rate is revised as market rates change.

7.5 *Eligibility for fair value option*

The IFRS eligibility criteria for use of the fair value option are more restrictive.

US GAAP	IFRS
<p>With some limited exceptions for some financial assets addressed by other applicable guidance (e.g., an investment in a consolidated subsidiary, employer's rights under employee benefit plans), US GAAP permits entities to elect the fair value option for any recognized financial assets.</p> <p>The fair value option may only be elected upon initial recognition of the financial asset or upon some other specified election dates identified in ASC 825-10-25-4.</p>	<p>With the exception of those financial assets outside the scope of IAS 39 (e.g., an investment in a consolidated subsidiary, employer's rights under employee benefit plans, some investments in associates and joint ventures) IFRS permits entities to elect the fair value option when;</p> <ul style="list-style-type: none"> □ a contract contains one or more embedded derivatives and the entire contract is not measured as at fair value through profit or loss, or □ it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch'), or □ a group of financial instruments is managed and its performance is evaluated on a fair value basis in accordance with a risk management strategy. <p>The fair value option may only be elected upon initial recognition of the financial asset.</p>

7.6 *Fair value option for equity-method investments*

While both accounting standards include a fair value option for equity-method investments, the IFRS-based option has limits as to which entities can exercise it, whereas the US GAAP option is broad-based.

US GAAP**IFRS**

The fair value option exists for US GAAP entities under ASC 825, *Financial Instruments*, wherein the option is unrestricted. Therefore, any investor's equity-method investments are eligible for the fair value option.

IFRS permits venture capital organizations, mutual funds, and unit trusts (as well as similar entities, including investment-linked insurance funds) that have investments in associates (entities over which they have significant influence) to carry those investments at fair value, with changes in fair value reported in earnings (provided certain criteria are met) in lieu of applying equity-method accounting.

7.7 *Fair value of investments in investment company entities*

Contrary to US GAAP, IFRS does not include a practical expedient for the measurement of fair value of certain investments.

US GAAP**IFRS**

US GAAP provides a practical expedient for the measurement of fair value of certain investments that report a net asset value (NAV), to allow use of NAV as fair value.

Under IFRS, since NAV is not defined or calculated in a consistent manner in different parts of the world, the IASB decided against issuing a similar practical expedient.

7.8 *Loans and receivables*

Classification is not driven by legal form under IFRS, whereas legal form drives the classification of “debt securities” under US GAAP. The potential classification differences drive subsequent measurement differences under IFRS and US GAAP for the same debt instrument.

Loans and receivables may be carried at different amounts under the two frameworks.

US GAAP

The classification and accounting treatment of nonderivative financial assets such as loans and receivables generally depends on whether the asset in question meets the definition of a debt security under ASC 320. If the asset meets that definition, it is generally classified as trading, available for sale, or held to maturity. If classified as trading or available for sale, the debt security is carried at fair value. To meet the definition of a debt security under ASC 320, the asset is required to be of a type commonly available on securities exchanges or in markets, or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

Loans and receivables that are not within the scope of ASC 320 fall within the scope of other guidance. As an example, mortgage loans are either:

- Classified as loans held for investment, in which case they are measured at amortized cost
- Classified as loans held for sale, in which case they are measured at the lower of cost or fair value (market), or
- Carried at fair value if the fair value option is elected

IFRS

IFRS defines loans and receivables as nonderivative financial assets with fixed or determinable payments not quoted in an active market other than:

- Those that the entity intends to sell immediately or in the near term, which are classified as held for trading and those that the entity upon initial recognition designates as at fair value through profit or loss
- Those that the entity upon initial recognition designates as available for sale
- Those for which the holder may not recover substantially all of its initial investment (other than because of credit deterioration) and that shall be classified as available for sale

An interest acquired in a pool of assets that are not loans or receivables (i.e., an interest in a mutual fund or a similar fund) is not a loan or receivable.

Instruments that meet the definition of loans and receivables (regardless of whether they are legal form securities) are carried at amortized cost in the loan and receivable category unless designated into either the fair value through profit-or-loss category or the available-for-sale category. In either of the latter two cases, they are carried at fair value.

IFRS does not have a category of loans and receivables that is carried at the lower of cost or market.

7.9 *Reclassifications*

Transfers of financial assets into or out of different categories are permitted in limited circumstances under both frameworks. In general, reclassifications have the potential to be more common under IFRS. The ability to reclassify is impacted by initial classification, which can also vary (as discussed above).

US GAAP

Changes in classification between trading, available-for-sale, and held-to-maturity categories occur only when justified by the facts and circumstances within the concepts of ASC 320. Given the nature of a trading security, transfers into or from the trading category should be rare, though they do occur.

IFRS

Financial assets may be reclassified between categories, albeit with conditions.

More significantly, debt instruments may be reclassified from held for trading or available for sale into loans and receivables, if the debt instrument meets the definition of loans and receivables and the entity has the intent and ability to hold them for the foreseeable future.

Also, a financial asset can be transferred from trading to available for sale in rare circumstances.

Reclassification is prohibited for instruments where the fair value option is elected.

Impairments and subsequent loss

7.10 Impairment principles—available-for-sale debt securities

Regarding impairment triggers, IFRS focuses on events that affect the recovery of the cash flows from the asset regardless of the entity's intent. US GAAP looks to a two-step test based on intent or ability to hold and expected recovery of the cash flows.

Regarding measurement of impairment loss upon a trigger, IFRS uses the cumulative fair value losses deferred in other comprehensive income. Under US GAAP, the impairment loss depends on the triggering event.

US GAAP

An investment in certain debt securities classified as available for sale is assessed for impairment if the fair value is less than cost. An analysis is performed to determine whether the shortfall in fair value is temporary or other than temporary.

In a determination of whether impairment is other than temporary, the following factors are assessed for available-for-sale securities:

IFRS

A financial asset is impaired and impairment losses are incurred only if there is objective evidence of impairment as the result of one or more events that occurred after initial recognition of the asset (a loss event) and if that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be estimated reliably. In assessing the objective evidence of impairment, an entity considers the following factors:

US GAAP

Step 1—Can management assert (1) it does not have the intent to sell and (2) it is more likely than not that it will not have to sell before recovery of cost? If no, then impairment is triggered. If yes, then move to Step 2.

Step 2—Does management expect recovery of the entire cost basis of the security? If yes, then impairment is not triggered. If no, then impairment is triggered.

Once it is determined that impairment is other than temporary, the impairment loss recognized in the income statement depends on the impairment trigger:

- If impairment is triggered as a result of Step 1, the loss in equity due to changes in fair value is released into the income statement.
- If impairment is triggered in Step 2, impairment loss is measured by calculating the present value of cash flows expected to be collected from the impaired security. The determination of such expected credit loss is not explicitly defined; one method could be to discount the best estimate of cash flows by the original effective interest rate. The difference between the fair value and the post-impairment amortized cost is recorded within OCI.

IFRS

- Significant financial difficulty of the issuer
- High probability of bankruptcy
- Granting of a concession to the issuer
- Disappearance of an active market because of financial difficulties
- Breach of contract, such as default or delinquency in interest or principal
- Observable data indicating there is a measurable decrease in the estimated future cash flows since initial recognition

The disappearance of an active market because an entity's securities are no longer publicly traded or the downgrade of an entity's credit rating is not, by itself, evidence of impairment, although it may be evidence of impairment when considered with other information.

At the same time, a decline in the fair value of a debt instrument below its amortized cost is not necessarily evidence of impairment. For example, a decline in the fair value of an investment in a corporate bond that results solely from an increase in market interest rates is not an impairment indicator and would not require an impairment evaluation under IFRS.

An impairment analysis under IFRS focuses only on the triggering credit events that negatively affect the cash flows from the asset itself and does not consider the holder's intent.

Once impairment of a debt instrument is determined to be triggered, the cumulative loss recognized in OCI due to changes in fair value is released into the income statement.

7.11 Impairment principles—held-to-maturity debt instruments

Regarding impairment triggers, IFRS focuses on events that affect the recovery of the cash flows from the asset regardless of the entity's intent. US GAAP looks to a two-step test based on intent or ability to hold and expected recovery of the cash flows.

Regarding measurement of impairment loss upon a trigger, IFRS looks to the incurred loss amount. Under US GAAP, the impairment loss depends on the triggering event.

US GAAP

The two-step impairment test mentioned above is also applicable to certain investments classified as held to maturity. It would be expected that held-to-maturity investments would not trigger Step 1 (as tainting would result). Rather, evaluation of Step 2 may trigger impairment.

Once triggered, impairment is measured with reference to expected credit losses as described for available-for-sale debt securities. The difference between the fair value and the post-impairment amortized cost is recorded within OCI and accreted from OCI to the carrying value of the debt security over its remaining life prospectively.

IFRS

Impairment is triggered for held-to-maturity investments based on objective evidence of impairment described above for available-for-sale debt instruments.

Once impairment is triggered, the loss is measured by discounting the estimated future cash flows by the original effective interest rate. As a practical expedient, impairment may be measured based on the instrument's observable fair value.

7.12 *Impairment of available-for-sale equity instruments*

Impairment on available-for-sale equity instruments may be triggered at different points in time under IFRS compared with US GAAP.

US GAAP

US GAAP looks to whether the decline in fair value below cost is other than temporary. The factors to consider include:

- The length of the time and the extent to which the market value has been less than cost
- The financial condition and near-term prospects of the issuer, including any specific events that may influence the operations of the issuer, such as changes in technology that may impair the earnings potential of the investment or the discontinuance of a segment of the business that may affect the future earnings potential
- The intent and ability of the holder to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value

IFRS

Similar to debt investments, impairment of available-for-sale equity investments is triggered by objective evidence of impairment. In addition to examples of events discussed above, objective evidence of impairment of available-for-sale equity includes:

- Significant or prolonged decline in fair value below cost, or
- Significant adverse changes in technological, market, economic, or legal environment

Each factor on its own could trigger impairment (i.e., the decline in fair value below cost does not need to be both significant and prolonged).

US GAAP

The evaluation of the other-than-temporary impairment trigger requires significant judgment in assessing the recoverability of the decline in fair value below cost. Generally, the longer and greater the decline, the more difficult it is to overcome the presumption that the available-for-sale equity is other than temporarily impaired.

IFRS

Whether a decline in fair value below cost is considered significant must be assessed on an instrument-by-instrument basis and should be based on both qualitative and quantitative factors.

What is a “prolonged” decline in fair value will also require judgement and a policy will need to be established. In general, a period of 12 months or greater below original cost is likely to be a “prolonged” decline. However, the assessment of “prolonged” should not be compared to the entire period that the investment has been or is expected to be held.

7.13 *Losses on available-for-sale equity securities subsequent to initial impairment recognition*

In periods after the initial recognition of an impairment loss on available-for-sale equity securities, further income statement charges are more likely under IFRS.

US GAAP

Impairment charges establish a new cost basis. As such, further reductions in value below the new cost basis may be considered temporary (when compared with the new cost basis).

IFRS

Impairment charges do not establish a new cost basis. As such, further reductions in value below the original impairment amount are recorded within the current-period income statement.

7.14 *Impairments—measurement and reversal of losses*

Under IFRS, impairment losses on debt instruments may be reversed through the income statement. Under US GAAP, reversals are permitted for debt instruments classified as loans; however, one-time reversal of impairment losses on debt securities is prohibited. Expected recoveries are reflected over time by adjusting the interest rate to accrue interest income.

US GAAP**IFRS**

Impairments of loans held for investment measured under ASC 310-10-35 and ASC 450 are permitted to be reversed; however, the carrying amount of the loan can at no time exceed the recorded investment in the loan.

For financial assets carried at amortized cost, if in a subsequent period the amount of impairment loss decreases and the decrease can be objectively associated with an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. The reversal, however, does not exceed what the amortized cost would have been had the impairment not been recognized.

One-time reversals of impairment losses for debt securities classified as available-for-sale or held-to-maturity securities, however, are prohibited. Rather, any expected recoveries in future cash flows are reflected as a prospective yield adjustment.

For available-for-sale debt instruments, if in a subsequent period the fair value of the debt instrument increases and the increase can be objectively related to an event occurring after the loss was recognized, the loss may be reversed through the income statement.

Reversals of impairments on equity investments are prohibited.

Reversals of impairments on equity investments through profit or loss are prohibited.

Financial asset derecognition

7.15 *Derecognition*

The determination of whether financial assets should be derecognized (e.g., in securitizations or factorings) is based on very different models under the two frameworks.

Full derecognition under US GAAP is more common than under IFRS. However, the IFRS model includes continuing involvement presentation that has no equivalent under US GAAP.

US GAAP**IFRS**

The guidance focuses on an evaluation of the transfer of control. The evaluation is governed by three key considerations:

- Legal isolation of the transferred asset from the transferor
- The ability of the transferee (or, if the transferee is a securitization vehicle, the beneficial interest holder) to pledge or exchange the asset (or the beneficial interest holder)
- No right or obligation of the transferor to repurchase

The guidance focuses on evaluation of whether a qualifying transfer has taken place, whether risks and rewards have been transferred, and, in some cases, whether control over the asset(s) in question has been transferred.

The transferor first applies the consolidation guidance and consolidates any and all subsidiaries or special purpose entities it controls.

US GAAP

As such, derecognition can be achieved even if the transferor has significant ongoing involvement with the assets, such as the retention of significant exposure to credit risk.

ASC 860 does not apply to transfers in which the transferee is considered a consolidated affiliate of the transferor, as defined in the standard. If this is the case, regardless of whether the transfer criteria are met, derecognition is not possible as the assets are, in effect, transferred to the consolidated entity.

There is no concept of continuing involvement/partial derecognition under US GAAP.

When accounting for a transfer of an entire financial asset that qualifies for sale accounting, the asset transferred in the sale must be derecognized from the transferor's balance sheet. The total carrying amount of the asset is derecognized, and any assets and liabilities retained are recognized at fair value. The transferor should separately recognize any servicing assets or servicing liabilities retained in the transfer at their fair values. A gain or loss on the transfer is calculated as the difference between the net proceeds received and the carrying value of the assets sold.

If a participating interest was sold, the transferor must allocate the previous carrying value of the entire financial asset between the participating interest sold and retained.

IFRS

The model can be applied to part of a financial asset (or part of a group of similar financial assets) or to the financial asset in its entirety (or a group of similar financial assets in their entirety).

Under IAS 39, full derecognition is appropriate once both of the following conditions have been met:

- The financial asset has been transferred outside the consolidated group.
- The entity has transferred substantially all of the risks and rewards of ownership of the financial asset.

The first condition is achieved in one of two ways:

- When an entity transfers the contractual rights to receive the cash flows of the financial asset, or
- When an entity retains the contractual rights to the cash flows but assumes a contractual obligation to pass the cash flows on to one or more recipients (referred to as a pass-through arrangement)

Many securitizations do not meet the strict pass-through criteria to recognize a transfer of the asset outside of the consolidated group and as a result fail the first condition for derecognition.

If there is a qualifying transfer, an entity must determine the extent to which it retains the risks and rewards of ownership of the financial asset. IAS 39 requires the entity to evaluate the extent of the transfer of risks and rewards by comparing its exposure to the variability in the amounts and timing of the transferred financial assets' net cash flows, both before and after the transfer.

US GAAP**IFRS**

If the entity's exposure does not change substantially, derecognition would not be appropriate. Rather, a liability equal to the consideration received would be recorded (financing transaction). If, however, substantially all risks and rewards are transferred, the entity would derecognize the financial asset transferred and recognize separately any asset or liability created through any rights and obligations retained in the transfer (e.g., servicing assets).

Many securitization transactions include some ongoing involvement by the transferor that causes the transferor to retain substantial risks and rewards, thereby failing the second condition for derecognition, even if the pass-through test is met.

If the transferred asset is part of a larger financial asset (e.g., when an entity transfers interest cash flows that are part of a debt instrument) and the part transferred qualifies for derecognition in its entirety, the previous carrying amount of the larger financial asset shall be allocated between the part that continues to be recognized and the part that is derecognized, based on the relative fair values of those parts on the date of the transfer.

US GAAP**IFRS**

When an asset transfer has been accomplished but the entity has neither retained nor transferred substantially all risks and rewards, an assessment as to control becomes necessary. The transferor assesses whether the transferee has the practical ability to sell the financial asset transferred to a third party. The emphasis is on what the transferee can do in practice and whether it is able, unilaterally, to sell the transferred financial asset without imposing any restrictions on the transfer. If the transferee does not have the ability to sell the transferred financial asset, control is deemed to be retained by the transferor and the transferred financial asset may require a form of partial derecognition called continuing involvement. Under continuing involvement, the transferred financial asset continues to be recognized with an associated liability.

When the entity has continuing involvement in the transferred financial asset, the entity must continue to recognize the transferred financial asset to the extent of its exposure to changes in the value of the transferred financial asset. Continuing involvement is measured as either the maximum amount of consideration received that the entity could be required to repay (in the case of guarantees) or the amount of the transferred financial asset that the entity may repurchase (in the case of a repurchase option).

7.16 *Recent/proposed guidance*

7.16.1 *FASB and IASB Financial Instruments Projects*

7.16.1.1 *Overview*

Both the FASB's and IASB's projects on financial instruments were intended to address the recognition and measurement of financial instruments, including impairment and hedge accounting. Although once a joint project the Boards have since proceeded down different paths. The IASB had been conducting its work in separate phases: (1) classification and measurement of financial assets, (2) classification and measurement of financial liabilities, (3) impairment, and (4) hedge

accounting. The FASB initially elected to issue one comprehensive exposure draft on financial instruments.

In July 2014 the IASB finalized its project when it published the complete version of IFRS 9, *Financial instruments*, which replaces most of the guidance in IAS 39. This includes guidance on the classification and measurement of financial assets that is based on an entity's business model for managing financial assets and their contractual cash flow characteristics. It also contains a new expected credit losses impairment model which replaces the current incurred loss impairment model. The new hedging guidance that was issued in November 2013 has also been included. IFRS 9 is effective for annual periods beginning on or after 1 January 2018.

The FASB has substantially completed deliberations on its classification and measurement project and is redeliberating the impairment project. It is expected to issue final guidance for both projects by the end of 2015. The FASB is continuing to deliberate issues on the hedging project and is expected to issue an exposure draft in 2015.

7.16.1.2 FASB and IASB Impairment Projects

The FASB and IASB had originally proposed differing impairment models that they developed separately.

On May 26, 2010, the FASB released its financial instrument accounting exposure draft, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*. The FASB proposed a single model for recognizing and measuring impairment of financial assets recorded at fair value with changes in fair value recognized in OCI.

In November 2009, the IASB issued an exposure draft that proposed fundamental changes to the current impairment guidance for financial assets accounted for at amortized cost.

Many constituents who commented on those proposals emphasized the need for the Boards to develop a converged impairment approach. In January 2011, the Boards issued a joint supplementary document, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Impairment*, to gather input on new impairment approaches.

In June 2011, the Boards decided to change course on their proposed model for impairment of financial assets and discussed a new approach dividing financial assets into three categories (referred to as “buckets” by the Boards) for impairment purposes. The allocation to each category would be based on deterioration in credit quality and would ultimately determine the amount of the credit losses to be recognized.

In August 2012, the FASB concluded after considering constituent feedback that aspects of the “three bucket” impairment model were difficult to understand and presented operational challenges that could not be addressed through implementation guidance. As a result, the FASB decided not to move forward with an exposure draft

on the “three bucket” approach. The IASB decided to continue with the model. In July 2014, the IASB published the new and complete version of IFRS 9, which includes the new impairment requirements.

7.16.1.3 FASB Proposed Accounting Standards Update, Financial Instruments—Credit Losses (Subtopic 825-15)

In December 2012, the FASB issued a proposal that introduces a new model for accounting for credit losses on financial instruments. The proposal calls for an entity to recognize credit losses based on its current estimate of contractual cash flows not expected to be collected.

The FASB’s model will require recognition of full lifetime expected credit losses upon initial recognition of the financial asset, whereas the IASB would only record full lifetime expected credit losses upon a significant deterioration in credit risk. Absent a significant deterioration in credit risk, the IASB model would require a provision for credit losses that result from default events that are possible within 12 months after the reporting date.

The objective of recording an allowance for credit losses under the CECL approach is to reflect the estimate of an entity’s expectation of credit losses over the life of the debt. Expected credit losses are a current estimate of all contractual cash flows not expected to be collected. Estimates of credit losses must be based on relevant information about past events, including historical loss experience, current conditions, and reasonable and supportable forecasts that affect the expected collectability of the remaining contractual cash flows. There is no probability of loss threshold that must be met prior to recording credit losses.

The FASB is in the process of deliberating various aspects of its proposed accounting model, with the following key points of focus:

- Accounting for debt securities classified as available for sale (“AFS”). Recent deliberations have resulted in a proposal that AFS securities would not follow a CECL model but would instead revise current accounting guidance for recognizing and measuring impairment. Key proposed changes are the removal from current guidance of considerations such as duration of unrealized loss position and post balance sheet date recoveries when recognizing impairment. Additionally, another proposed change is the use of a valuation account such as an allowance to record impairment, as opposed to the model in today’s guidance that would require recognition of impairment as a write down in the AFS security’s cost basis.
- Whether the current proposal requiring a “day 1” CECL losses for purchased credit impaired (“PCI”) assets recorded as a gross up to the balance sheet should be expanded to any other originated or purchased assets. Currently, the proposed standard would require a day 1 CECL allowance recognized through the income statement for all originated assets and for purchased assets not deemed to be PCI.
- Developing implementation examples to address complexities of applying the accounting model in practice. Specifically, navigating the ability to use estimation approaches that explicitly utilize time value of money concepts versus estimation

approaches that do not, and providing implementation guidance on what defines a “loss rate” for purposes of inputs to estimation techniques.

Based on the deliberation points above, the FASB is estimating the issuance of final guidance by the end of 2015.

7.16.1.4 IFRS 9, *Financial Instruments—Expected Credit Losses*

The IASB issued in July 2014 the complete version of IFRS 9, *Financial instruments*, which includes the new impairment model. The new guidance introduces an expected credit loss impairment model that replaces the incurred loss model used today. The IASB’s model, now known as the “expected credit losses” model, has the following key elements.

General model

Under the IASB’s model, an entity will recognize an impairment loss at an amount equal to the 12-month expected credit loss (stage 1). If the credit risk on the financial instrument has increased significantly since initial recognition (even without objective evidence of impairment), it should recognize an impairment loss at an amount equal to the lifetime expected credit loss (stage 2). Interest income is calculated using the effective interest method on the gross carrying amount of the asset. When there is objective evidence of impairment (that is, the asset is impaired under the current rules of IAS 39, *Financial instruments: Recognition and Measurement*), lifetime expected credit losses are recognized and interest is calculated on the net carrying amount after impairment (stage 3).

The 12-month expected credit loss measurement represents all cash flows not expected to be received (“cash shortfalls”) over the life of the financial instrument that result from those default events that are possible within 12 months after the reporting date. Lifetime expected credit loss represents cash shortfalls that result from all possible default events over the life of the financial instrument.

Scope

The new guidance applies to: (a) debt instruments measured at amortized cost; (b) debt instruments measured at fair value through other comprehensive income; (c) all loan commitments not measured at fair value through profit or loss (FVPL); (d) financial guarantee contracts within the scope of IFRS 9 that are not accounted for at FVPL; and (e) lease receivables within the scope of IAS 17, *Leases*, and trade receivables or contract assets within the scope of IFRS 15, *Revenue from Contracts with Customers*, that give rise to an unconditional right to consideration.

Calculation of the impairment

Expected credit losses are determined using an unbiased and probability-weighted approach and should reflect the time value of money. The calculation is not a best-case or worst-case estimate. Rather, it should incorporate at least the probability that a credit loss occurs and the probability that no credit loss occurs.

Assessment of credit deterioration

When determining whether lifetime expected losses should be recognized, an entity should consider the best information available, including actual and expected changes in external market indicators, internal factors, and borrower-specific information. Where more forward-looking information is not available, delinquency data can be used as a basis for the assessment.

Under the IASB's model, there is a rebuttable presumption that lifetime expected losses should be provided for if contractual cash flows are 30 days past due. An entity has an option to recognize 12-month expected credit losses (i.e., not to apply the general model) for financial instruments that are equivalent to "investment grade."

Purchased or originated credit impaired assets

Impairment is determined based on full lifetime expected credit losses for assets where there is objective evidence of impairment on initial recognition. Lifetime expected credit losses are included in the estimated cash flows when calculating the asset's effective interest rate ("credit-adjusted effective interest rate"), rather than being recognized in profit or loss. Any later changes in lifetime expected credit losses will be recognize immediately in profit or loss.

Trade and lease receivables

For trade receivables or contract assets which contain a significant financing component in accordance with IFRS 15 and lease receivables, an entity has an accounting policy choice: either it can apply the simplified approach (that is, to measure the loss allowance at an amount equal to lifetime expected credit loss at initial recognition and throughout its life), or it can apply the general model. The use of a provision matrix is allowed, if appropriately adjusted to reflect current events and forecast future conditions.

If the trade receivables or contract assets do not contain a significant financing component, lifetime expected credit losses will be recognized.

Disclosures

Extensive disclosures are required, including reconciliations of opening to closing amounts and disclosure of assumptions and inputs.

7.16.1.5 FASB classification and measurement project

The FASB has substantially completed deliberations on its financial instruments—classification and measurement project. It is expected to result in only a few changes to current US GAAP. The most significant change for financial assets relates to accounting for equity securities, which do not qualify for consolidation or the equity method of accounting. These investments will be recognized at fair value through net income, except for certain non-publicly traded investments that may qualify for a practical expedient in determining their measurement.

Refer to SD 10.13 for the recent redeliberations on classification and measurement of financial liabilities.

7.16.1.6 IFRS 9, *Financial Instruments—Classification and measurement*

Classification under IFRS 9 for investments in debt instruments is driven by the entity’s business model for managing financial assets and their contractual cash flow characteristics. A debt instrument is measured at amortized cost if both of the following criteria are met:

- The asset is held to collect its contractual cash flows; and
- The asset’s contractual cash flows represent ‘solely payments of principal and interest’ (“SPPI”).

Financial assets included within this category are initially recognized at fair value and subsequently measured at amortized cost.

A debt instrument is measured at fair value through other comprehensive income (“FVOCI”) if both of the following criteria are met:

- The objective of the business model is achieved both by collecting contractual cash flows and selling financial assets; and
- The asset’s contractual cash flows represent SPPI.

Debt instruments included within the FVOCI category are initially recognized and subsequently measured at fair value. Movements in the carrying amount should be taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses which are recognized in profit and loss. Where the financial asset is derecognized, the cumulative gain or loss previously recognized in OCI is reclassified from equity to profit or loss.

Under the new model, FVPL is the residual category. Financial assets should be classified as FVPL if they do not meet the criteria of FVOCI or amortized cost.

Financial assets included within the FVPL category should be measured at fair value with all changes taken through profit or loss.

Regardless of the business model assessment, an entity can elect to classify a financial asset at FVPL if doing so reduces or eliminates a measurement or recognition inconsistency (‘accounting mismatch’).

The new standard requires that all equity investments be measured at fair value. IFRS 9 removes the cost exemption for unquoted equities and derivatives on unquoted equities but provides guidance on when cost may be an appropriate estimate of fair value. Fair value changes of equity investments are recognized in profit and loss unless management has elected the option to present in OCI unrealized and realized fair value gains and losses. However, this option does not apply to equity investments that are held for trading, puttable instruments, or contingent consideration. Such

designation is available on initial recognition on an instrument-by-instrument basis and is irrevocable. There is no subsequent recycling of fair value gains and losses to profit or loss; however, ordinary dividends from such investments will continue to be recognized in profit or loss.

IFRS 9 is effective for annual periods beginning on or after 1 January 2018, subject to endorsement in certain territories.

7.16.2 *FASB Proposed Accounting Standards Update: Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities and IASB IFRS 9 Financial Instruments, Hedge accounting and amendments to IFRS 9, IFRS 7 and IAS 39*

Refer to SD 11.21 for discussion of the guidance.

7.16.3 *IASB Exposure Draft—Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value (Proposed amendments to IFRS 10, IFRS 12, IAS 27, IAS 28 and IAS 36 and Illustrative Examples for IFRS 13)*

IFRS 13 and Topic 820 largely have the same requirements in relation to determination of fair value.

In September 2014 the IASB issued an exposure draft to clarify that an entity should measure the fair value of quoted investments and quoted CGUs as the product of the quoted price for the individual financial instruments that make up the investments held by the entity and the quantity of financial instruments. The exposure draft also includes proposed amendments to the Illustrative Examples for IFRS 13 to illustrate the application of the portfolio exception for a portfolio that comprises only quoted financial instruments whose market risks are substantially the same.

The FASB is not expected to incorporate similar guidance in ASC 820 at this time.

7.16.4 *FASB Accounting Standards Update No. 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*

Issued in June 2014, ASU 2014-11 amended the accounting guidance for repurchase-to-maturity agreements (commonly referred to as “repos-to-maturity”) and repurchase agreements executed in conjunction with so-called “repurchase financing” transactions. The new standard also requires transferors to provide additional disclosures about certain transfers of financial assets, including those reported as secured borrowings.

The new standard defines a repo-to-maturity transaction as a repurchase agreement in which the settlement date of the agreement to repurchase a transferred financial asset is at the maturity date of that financial asset and the agreement does not require the transferor to reacquire the financial asset. Repo-to-maturity transactions are now required to be reported as secured borrowings in all instances. (Under the previous

accounting standards in ASC 860, these transactions could qualify for sale accounting under certain circumstances.)

With respect to repurchase financial transactions, transferors will no longer apply the current “linked” accounting model to repurchase agreements executed contemporaneously with the initial transfer of the underlying financial asset with the same counterparty. Instead, ASU 2014-11 directs that the accounting for each transaction (that is, the initial transfer and the attendant repurchase agreement) be evaluated on a stand-alone basis.

The new accounting standards in ASU 2014-11 may lead to greater consistency in the accounting for repurchase transactions under US GAAP and IFRS, even though the underlying approach differs. IFRS embodies a “risk and rewards” approach—in contrast to ASC 860’s control-based transfer model—that generally results in repurchase agreements being reported as secured borrowings.

Chapter 8: ***Liabilities—taxes***

8.1 *Liabilities—taxes*

Both US GAAP and IFRS base their deferred tax accounting requirements on balance sheet temporary differences, measured at the tax rates expected to apply when the differences reverse. Discounting of deferred taxes is also prohibited under both frameworks. Although the two frameworks share many fundamental principles, they are at times applied in different manners and there are different exceptions to the principles under each framework. This often results in differences in income tax accounting between the two frameworks. Some of the more significant differences relate to the allocation of tax expense/benefit to financial statement components (“intra-period allocation”), the treatment of tax effects of intercompany transfers of assets, income tax accounting with respect to share-based payment arrangements, and presentation of deferred taxes on the face of the balance sheet.

The relevant differences are set out below, other than those related to share-based payment arrangements, which are described in the Expense recognition—share-based payments chapter.

Technical references

US GAAP

ASC 740

IFRS

IAS 1, IAS 12, IAS 34, IAS 37

Note

The following discussion captures a number of the more significant GAAP differences. It is important to note that the discussion is not inclusive of all GAAP differences in this area.

8.2 *Hybrid taxes*

Hybrid taxes are based on the higher of a tax applied to a net amount of income less expenses (such as taxable profit or taxable margin) and a tax applied to a gross amount which is not considered income (such as revenue or capital). Hybrid taxes are assessed differently under the two frameworks, which could lead to differences in presentation in the income statement and recognition and measurement of deferred taxes.

US GAAP

Taxes based on a gross amount which is not considered income (such as revenue or capital) are not accounted for as income taxes and should be reported as pre-tax items. A hybrid tax is considered an income tax and is presented as income tax expense only to the extent that it *exceeds* the tax based on the amount not considered income in a given year.

Deferred taxes should be recognized and measured according to that classification.

IFRS

Accounting for hybrid taxes is not specifically addressed within IFRS.

Applying the principles in IAS 12 to the accounting for hybrid taxes, entities can adopt either one of the following approaches and apply it consistently:

- Designate the tax based on the gross amount not considered income as the minimum amount and recognize it as a pre-tax item. Any excess over that minimum amount would then be reported as income tax expense; or
- Designate the tax based on the net amount of income less expenses as the minimum amount and recognize it as income tax expense. Any excess over that minimum would then be reported as a pre-tax item.
- Deferred taxes should be recognized and measured according to that classification.

8.3 *Tax base of an asset or a liability*

Under IFRS, a single asset or liability may have more than one tax base, whereas there would generally be only one tax base per asset or liability under US GAAP.

US GAAP

Tax base is based upon the relevant tax law. It is generally determined by the amount that is depreciable for tax purposes or deductible upon sale or liquidation of the asset or settlement of the liability.

IFRS

Tax base is based on the tax consequences which will occur based upon how an entity is expected to recover or settle the carrying amount of assets and liabilities.

The carrying amount of assets or liabilities can be recovered or settled through use or through sale.

Assets and liabilities may also be recovered or settled through use and through sale together. In that case, the carrying amount of the asset or liability is bifurcated, resulting in more than a single temporary difference related to that item.

A rebuttable presumption exists that investment property measured at fair value will be recovered through sale.

8.4 *Initial recognition of an asset or a liability*

In certain situations, there will be no deferred tax accounting under IFRS that would exist under US GAAP and vice versa.

US GAAP	IFRS
<p>A temporary difference may arise on initial recognition of an asset or liability. In asset purchases that are not business combinations, a deferred tax asset or liability is recorded with the offset generally recorded against the assigned value of the asset. The amount of the deferred tax asset or liability is determined by using a simultaneous equations method.</p> <p>An exemption exists from the initial recognition of temporary differences in connection with transactions that qualify as leveraged leases under lease-accounting guidance.</p>	<p>An exception exists that deferred taxes should not be recognized on the initial recognition of an asset or liability in a transaction which is not a business combination and affects neither accounting profit nor taxable profit/loss at the time of the transaction. No special treatment of leveraged leases exists under IFRS.</p>

8.5 *Recognition of deferred tax assets*

The frameworks take differing approaches to the recognition of deferred tax assets. It would be expected that net deferred tax assets recorded would be similar under both standards.

US GAAP	IFRS
<p>Deferred tax assets are recognized in full, but are then reduced by a valuation allowance if it is considered more likely than not that some portion of the deferred taxes will not be realized.</p>	<p>Deferred tax assets are recognized to the extent that it is probable (or “more likely than not”) that sufficient taxable profits will be available to utilize the deductible temporary difference or unused tax losses.</p>

8.6 *Deferred taxes on investments in subsidiaries, joint ventures, and equity investees*

Differences in the recognition criteria surrounding undistributed profits and other outside basis differences could result in changes in recognized deferred taxes under IFRS.

US GAAP

With respect to undistributed profits and other outside basis differences, different requirements exist depending on whether they involve investments in subsidiaries, joint ventures, or equity investees.

As it relates to investments in domestic subsidiaries, deferred tax liabilities are required on undistributed profits arising after 1992 unless the amounts can be recovered on a tax-free basis and the entity anticipates utilizing that method.

As it relates to investments in domestic corporate joint ventures, deferred tax liabilities are required on undistributed profits that arose after 1992.

No deferred tax liabilities are recognized on undistributed profits and other outside basis differences of foreign subsidiaries and corporate joint ventures that meet the indefinite reversal criterion.

Deferred taxes are generally recognized on temporary differences related to investments in equity investees.

US GAAP contains specific guidance on how to account for deferred taxes when there is a change in the status of an investment. A deferred tax liability related to undistributed profits of a foreign investee that would not otherwise be required after the foreign investee becomes a subsidiary is “frozen.” The deferred tax liability continues to be recognized to the extent that dividends from the subsidiary do not exceed the parent company’s share of the subsidiary’s earnings subsequent to the date it became a subsidiary, until the disposition of the subsidiary.

Deferred tax assets for investments in subsidiaries and corporate joint ventures may be recorded only to the extent they will reverse in the foreseeable future.

IFRS

With respect to undistributed profits and other outside basis differences related to investments in foreign and domestic subsidiaries, branches and associates, and interests in joint arrangements, deferred taxes are recognized except when a parent company, investor, joint venture or joint operator is able to control the timing of reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The general guidance regarding deferred taxes on undistributed profits and other outside basis differences is applied when there is a change in the status of an investment from significant influence or joint control to a being subsidiary.

Deferred tax assets for investments in foreign and domestic subsidiaries, branches and associates, and interests in joint arrangements are recorded only to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

8.7 *Recognition of deferred taxes where the local currency is not the functional currency*

US GAAP prohibits the recognition of deferred taxes on exchange rate changes and tax indexing related to nonmonetary assets and liabilities in foreign currency while it may be required under IFRS.

US GAAP

No deferred taxes are recognized for differences related to nonmonetary assets and liabilities that are remeasured from local currency into their functional currency by using historical exchange rates (if those differences result from changes in exchange rates or indexing for tax purposes).

IFRS

Deferred taxes should be recognized for the difference between the carrying amount determined by using the historical exchange rate and the relevant tax base, which may have been affected by exchange rate changes or tax indexing.

8.8 *Uncertain tax positions*

Differences with respect to recognition, unit-of-account, measurement and the treatment of subsequent events may result in varying outcomes under the two frameworks.

US GAAP

Uncertain tax positions are recognized and measured using a two-step process: (1) determine whether a benefit may be recognized and (2) measure the amount of the benefit. Tax benefits from uncertain tax positions may be recognized only if it is more likely than not that the tax position is sustainable based on its technical merits.

Uncertain tax positions are evaluated at the individual tax position level.

The tax benefit is measured by using a cumulative probability model: the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement.

IFRS

Accounting for uncertain tax positions is not specifically addressed within IFRS. IAS 37 excludes income taxes from its scope and is not used to measure uncertain tax positions. The principles in IAS 12 are applied to uncertain tax positions. The tax accounting should follow the manner in which an entity expects the tax position to be resolved with the taxation authorities at the balance sheet date.

Practice has developed such that uncertain tax positions may be evaluated at the level of the individual uncertainty or group of related uncertainties. Alternatively, they may be considered at the level of total tax liability to each taxing authority.

US GAAP**IFRS**

Acceptable methods by which to measure tax positions include (1) the expected-value/probability-weighted-average approach and (2) the single-best-estimate/most-likely-outcome method. Use of the cumulative probability model required by US GAAP is not consistent with IFRS.

Relevant developments affecting uncertain tax positions after the balance sheet date but before issuance of the financial statements (including the discovery of information that was not available as of the balance sheet date) would be considered a non-adjusting subsequent event for which no effect would be recorded in the current-period financial statements.

Relevant developments affecting uncertain tax positions occurring after the balance sheet date but before issuance of the financial statements (including the discovery of information that was not available as of the balance sheet date) would be considered either an adjusting or non-adjusting event depending on whether the new information provides evidence of conditions that existed at the end of the reporting period.

8.9 Special deductions, investment tax credits, and tax holidays

US GAAP has specific guidance related to special deductions and investment tax credits, generally grounded in US tax law. US GAAP also addresses tax holidays. IFRS does not specify accounting treatments for any specific national tax laws and entities instead are required to apply the principles of IAS 12 to local legislation.

US GAAP**IFRS**

Several specific deductions under US tax law have been identified under US GAAP as special deductions. Special deductions are recognized in the period in which they are claimed on the tax return. Entities subject to graduated tax rates should evaluate whether the ongoing availability of special deductions is likely to move the entity into a lower tax band which might cause deferred taxes to be recorded at a lower rate.

Special deductions are not defined under IFRS but are treated in the same way as tax credits. Tax credits are recognized in the period in which they are claimed on the tax return, however certain credits may have the substantive effect of reducing the entity's effective tax rate for a period of time. The impact on the tax rate can affect how entities should record their deferred taxes. In other cases the availability of credits might reduce an entity's profits in a way that moves it into a lower tax band, and again this may impact the rate at which deferred taxes are recorded.

US GAAP

It is preferable to account for investment tax credits using the “deferral method” in which the entity spreads the benefit of the credit over the life of the asset. However, entities might alternatively elect to recognize the benefit in full in the year in which it is claimed (the “flow-through method”).

Deferred taxes are not recorded for any tax holiday but rather the benefit is recognized in the periods over which the applicable tax rate is reduced or that the entity is exempted from taxes. Entities should, however, consider the rate at which deferred taxes are recorded on temporary differences. Temporary differences expected to reverse during the period of the holiday should be recorded at the rate applicable during the holiday rather than the normal statutory income tax rate.

IFRS

IAS 12 states that investment tax credits are outside the scope of the income taxes guidance. IFRS does not define investment tax credits, but we believe that as a general rule it is a credit received for investment in a recognized asset. Depending on the nature of the credit it might be accounted for in one of three ways:

- In the same way as other tax credits;
- As a government grant under IAS 20; or
- As an adjustment to the tax base of the asset to which the initial recognition exception is likely to apply.

While IFRS does not define a tax holiday, the treatment is in line with US GAAP in that the holiday itself does not create deferred taxes, but it might impact the rate at which deferred tax balances are measured.

8.10 *Intercompany transactions*

The frameworks require different approaches when current and deferred taxes on intercompany transfers of assets are considered.

US GAAP

For purposes of the consolidated financial statements, any tax impacts to the seller as a result of an intercompany sale or transfer are deferred until the asset is sold to a third-party or otherwise recovered (e.g., amortized or impaired). In addition, the buyer is prohibited from recognizing a deferred tax asset resulting from the difference between the tax basis and consolidated carrying amount of the asset.

IFRS

There is no exception to the model for the income tax effects of transferring assets between the entities in the consolidated groups. Any tax impacts to the consolidated financial statements as a result of the intercompany transaction are recognized as incurred.

If the transfer results in a change in the tax base of the asset transferred, deferred taxes resulting from the intragroup sale are recognized at the buyer’s tax rate.

8.11 *Change in tax laws and rates*

The impact on deferred and current taxes as a result of changes in tax laws and tax rates may be recognized earlier under IFRS.

US GAAP	IFRS
US GAAP requires the use of enacted rates when calculating current and deferred taxes.	Current and deferred tax is calculated using enacted or substantively enacted rates.

8.12 *Tax rate on undistributed earnings of a subsidiary*

In the case of dual rate tax jurisdiction, the tax rate to be applied on inside basis difference and outside basis difference in respect of undistributed earnings may differ between US GAAP and IFRS.

US GAAP	IFRS
<p>For jurisdictions that have a tax system under which undistributed profits are subject to a corporate tax rate higher than distributed profits, effects of temporary differences should be measured using the undistributed tax rate. Tax benefits of future tax credits that will be realized when the income is distributed cannot be recognized before the period in which those credits are included in the entity's tax return.</p> <p>A parent company with a subsidiary entitled to a tax credit for dividends paid should use the distributed rate when measuring the deferred tax effects related to the operations of the foreign subsidiary. However, the undistributed rate should be used in the consolidated financial statements if the parent, as a result of applying the indefinite reversal criteria, has not provided for deferred taxes on the unremitted earnings of the foreign subsidiary.</p> <p>For jurisdictions where the undistributed rate is lower than the distributed rate, the use of the distributed rate is preferable but the use of the undistributed rate is acceptable provided appropriate disclosures are added.</p>	<p>Where income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings are distributed as dividends, deferred taxes are measured at the tax rate applicable to undistributed profits.</p> <p>In consolidated financial statements, when a parent has a subsidiary in a dual-rate tax jurisdiction and expects to distribute profits of the subsidiary in the foreseeable future, it should measure the temporary differences relating to the investment in the subsidiary at the rate that would apply to distributed profits. This is on the basis that the undistributed earnings are expected to be recovered through distribution and the deferred tax should be measured according to the expected manner of recovery.</p>

8.13 Presentation

Presentation differences related to deferred taxes and uncertain tax positions could affect the calculation of certain ratios from the face of the balance sheet (including a company's current ratio).

US GAAP

The classification of deferred tax assets and deferred tax liabilities follows the classification of the related asset or liability for financial reporting (as either current or noncurrent). If a deferred tax asset or liability is not associated with an underlying asset or liability, it is classified based on the anticipated reversal periods. Within an individual tax jurisdiction, current deferred taxes are generally offset and classified as a single amount and noncurrent deferred taxes are offset and classified as a single amount. Any valuation allowances are allocated between current and noncurrent deferred tax assets for a tax jurisdiction on a pro rata basis.

A liability for uncertain tax positions is classified as a current liability only to the extent that cash payments are anticipated within 12 months of the reporting date. Otherwise, such amounts are reflected as noncurrent liabilities.

A liability for an unrecognized tax benefit should be presented as a reduction to a deferred tax asset for a net operating loss or tax credit carryforward if the carryforward is available at the reporting date to settle any additional income taxes that would result from the disallowance of the uncertain tax position. Netting would not apply, however, if the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the carryforward for such purpose.

The classification of interest and penalties related to uncertain tax positions (either in income tax expense or as a pretax item) represents an accounting policy decision that is to be consistently applied and disclosed.

IFRS

Deferred tax assets and deferred tax liabilities should be offset for presentation purpose if the deferred taxes relate to income taxes levied by the same authority and there is a legally enforceable right to offset. Deferred taxes after offsetting should be presented as noncurrent on the balance sheet.

Supplemental note disclosures may be included to distinguish deferred tax assets and liabilities between amounts expected to be recovered or settled less than or greater than one year from the balance sheet date.

A liability for uncertain tax positions relating to current or prior year returns (i.e., within the current tax provision) is generally classified as a current liability on the balance sheet because entities typically do not have the unconditional right to defer settlement of uncertain tax positions for at least twelve months after the end of the reporting period.

There is no specific guidance under IFRS on the presentation of liabilities for uncertain tax positions when a net operating loss carryforward or a tax credit carryforward exists. The general guidance in IAS 12 on the presentation of income taxes applies.

Interest and penalties related to uncertain tax positions may be classified as finance or other operating expense respectively in the income statement, when they can be clearly identified and separated from the related tax liability; or included in the tax line if they cannot be separated from the taxes, or as matter of accounting policy. The accounting policy decision should be consistently applied and disclosed.

8.14 *Intraperiod allocation*

Differences can arise in accounting for the tax effect of a loss from continuing operations. Subsequent changes to deferred taxes could result in less volatility in the statement of operations under IFRS.

US GAAP

The tax expense or benefit is allocated between the financial statement components (such as continuing operations, discontinued operations, other comprehensive income, and equity) following a “with and without” approach:

- First, the total tax expense or benefit for the period is computed,
- Then the tax expense or benefit attributable to continuing operations is computed separately without considering the other components, and
- The difference between the total tax expense or benefit for the period and the amount attributable to continuing operations is allocated amongst the other components.

An exception to that model requires that all components be considered to determine the amount of tax benefit that is allocated to a loss from continuing operations.

Subsequent changes in deferred tax balances due to enacted tax rate and tax law changes are taken through profit or loss regardless of whether the deferred tax was initially created through profit or loss or other comprehensive income, through equity, or in acquisition accounting. The same principle applies to changes in assertion with respect to unremitted earnings of foreign subsidiaries; deferred taxes are recognized in continuing operations even if some of the temporary difference arose as a result of foreign exchange recognized in OCI.

Changes in the amount of valuation allowance due to changes in assessment about realization in future periods are generally taken through the income statement, with limited exceptions for certain equity-related items.

IFRS

Tax follows the item. Current and deferred tax on items recognized in other comprehensive income or directly in equity is recognized in other comprehensive income or directly in equity, respectively. Where an entity pays tax on all its profits, including elements recognized outside profit or loss, the tax allocated to the different primary statements is calculated on a reasonable pro rata basis, or another basis that is more appropriate in the circumstances.

No exception to this principle is required under IFRS because IAS 12 always requires that the tax consequences follow the underlying item.

Subsequent changes in deferred tax are recognized in profit or loss, OCI, or equity depending on where the transaction(s) giving rise to the deferred tax were recorded. Entities must “backwards trace” based upon how the deferred tax balance arose to determine where the change in deferred tax is recorded.

8.15 Disclosures

The disclosures required by the frameworks differ in a number of respects, but perhaps the two most significant differences relate to uncertain tax positions and the rate used in the effective tax rate reconciliation. Other disclosure differences are largely a consequence of differences in the underlying accounting models.

US GAAP	IFRS
Public entities are required to present a tabular reconciliation of unrecognized tax benefits relating to uncertain tax positions from one year to the next.	Entities with contingent tax assets and liabilities are required to provide IAS 37 disclosures in respect of these contingencies, but there is no requirement for a tabular reconciliation.
The effective tax rate reconciliation is presented using the statutory tax rate of the parent company.	The effective tax rate reconciliation can be presented using either the applicable tax rates or the weighted average tax rate applicable to profits of the consolidated entities.

8.16 Interim reporting

A worldwide effective tax rate is used to record interim tax provisions under US GAAP. Under IFRS, a separate estimated average annual effective tax rate is used for each jurisdiction.

US GAAP	IFRS
In general, the interim tax provision is determined by applying the estimated annual worldwide effective tax rate for the consolidated entity to the worldwide consolidated year-to-date pretax income.	The interim tax provision is determined by applying an estimated average annual effective tax rate to interim period pretax income. To the extent practicable, a separate estimated average annual effective tax rate is determined for each material tax jurisdiction and applied individually to the interim period pretax income of each jurisdiction.

8.17 *Separate financial statements*

US GAAP provides guidance on the accounting for income taxes in the separate financial statements of an entity that is part of a consolidated tax group.

US GAAP	IFRS
<p>The consolidated current and deferred tax amounts of a group that files a consolidated tax return should be allocated among the group members when they issue separate financial statements using a method that is systematic, rational and consistent with the broad principles of ASC 740. An acceptable method is the “separate return” method. It is also acceptable to modify this method to allocate current and income taxes using the “benefits-for-loss” approach.</p>	<p>There is no specific guidance under IFRS on the methods that can be used to allocate current and deferred tax amounts of a group that files a consolidated tax return among the group members when they issue separate financial statements.</p>

8.18 *Share-based payment arrangements*

Significant differences in current and deferred taxes exist between US GAAP and IFRS with respect to share-based payment arrangements. The relevant differences are described in the Expense recognition—share-based payments chapter.

8.19 *Recent/proposed guidance*

8.19.1 *FASB’s ongoing projects*

As a follow-up on the results of the Financial Accounting Foundation’s post-implementation review of income tax accounting (concluded in November 2013), along with the FASB’s ongoing simplification initiative, the FASB staff has recommended eliminating the continuing operations loss exception to the intraperiod allocation “with and without” approach. Rather than addressing only that specific exception, however, the FASB requested the staff to conduct additional research regarding the possibility of eliminating the intraperiod allocation rules by adopting a single calculation and presentation of income taxes.

In addition, the FASB has now included income taxes as part of its Disclosure Framework project. Topics being addressed within the Disclosure Framework project include foreign earnings and uncertain tax positions.

8.19.2 *FASB Exposure Draft, Intra-entity asset transfers and balance sheet classification of deferred taxes*

The Board has published an exposure draft proposing to eliminate the current exception for recognition of taxes on intercompany transfers of assets, and requiring

the presentation of deferred tax assets and liabilities to be all noncurrent. The comment deadline for this “two-part” exposure draft closed on May 29, 2015. In both cases, if the FASB decides to make those changes, such differences in income tax accounting between US GAAP and IFRS would be eliminated.

8.19.3 *FASB Exposure Draft, Financial instruments classification and measurement—Recognition of deferred tax assets arising from unrealized losses on debt investments and IASB Exposure Draft, Recognition of deferred tax assets for unrealized losses*

In May 2014, the FASB issued a tentative decision indicating that the assessment of whether a valuation allowance is needed on deferred tax assets that arise from unrealized losses on debt investments measured at fair value through other comprehensive income should be evaluated in combination with the other deferred tax assets. The effective date for this new standard will be decided during final deliberations on the project.

The IASB issued an exposure draft to amend IAS 12 to confirm that decreases in the carrying amount of a fixed-rate debt instrument for which the principal is paid at maturity give rise to a deductible temporary difference if the instrument is measured at fair value and its tax base remains at cost, and that such temporary differences are assessed in combination with other temporary differences. Deferred tax assets are recognized for such temporary differences, unless recovering the debt instrument by holding it until an unrealized loss reverses does not reduce future tax payments and instead only avoids higher tax losses. The amendments also clarify that an entity can assume in assessing the recoverability of deferred tax assets that an asset is recovered for more than its carrying value and that future profits are considered before the impact of reversing deductible temporary differences. These proposed amendments achieve an outcome for deferred tax accounting that would be consistent with that proposed by the FASB. The comment period for the exposure draft closed on December 18, 2014, and on March 24, 2015, the Interpretations Committee recommended to the Board that they proceed with the proposed amendment.

8.19.4 *IASB Exposure Draft, Accounting for uncertainties in income taxes*

The IFRS Interpretations Committee will shortly publish a draft interpretation on the accounting for uncertainties in income taxes. The exposure draft is expected to propose that an uncertain tax position should be recognized on the balance sheet if it is probable that it will result in a further tax payment or a tax refund. Once recognized, uncertain tax positions would be measured at either the single most likely outcome or a probability weighted average of possible outcomes. The measurement model would be selected on a position-by-position basis depending on the approach that best predicts the amount that will be paid or recovered. This measurement model is different than the US GAAP cumulative probability model, and it is expected that the US GAAP approach will continue to be prohibited under IFRS.

Chapter 9: ***Liabilities—other***

9.1 *Liabilities—other*

The guidance in relation to nonfinancial liabilities (e.g., provisions, contingencies, and government grants) includes some fundamental differences with potentially significant implications.

For instance, a difference exists in the interpretation of the term “probable.” IFRS defines probable as “more likely than not,” but US GAAP defines probable as “likely to occur.” Because both frameworks reference probable within the liability recognition criteria, this difference could lead companies to record provisions earlier under IFRS than they otherwise would have under US GAAP. The use of the midpoint of a range when several outcomes are equally likely (rather than the low-point estimate, as used in US GAAP) might also lead to increased or earlier expense recognition under IFRS.

IFRS does not have the concept of an ongoing termination plan, whereas severance is recognized under US GAAP once probable and reasonably estimable. This could lead companies to record restructuring provisions in periods later than they would under US GAAP.

As it relates to reimbursement rights, IFRS has a higher threshold for the recognition of reimbursements of recognized losses by requiring that they be virtually certain of realization, whereas the threshold is lower under US GAAP.

Technical references

US GAAP

ASC 410-20, ASC 410-30, ASC 420, ASC 450-10, ASC 450-20, ASC 460-10, ASC 944-40, ASC 958-605

IFRS

IAS 19, IAS 20, IAS 37

Note

The following discussion captures a number of the more significant GAAP differences. It is important to note that the discussion is not inclusive of all GAAP differences in this area.

9.2 *Recognition of provisions*

Differences in the definition of “probable” may result in earlier recognition of liabilities under IFRS.

The IFRS “present obligation” criteria might result in delayed recognition of liabilities when compared with US GAAP.

US GAAP

A loss contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur.

An accrual for a loss contingency is required if two criteria are met: (1) if it is probable that a liability has been incurred and (2) the amount of loss can be reasonably estimated.

Implicit in the first condition above is that it is probable that one or more future events will occur confirming the fact of the loss.

The guidance uses the term “probable” to describe a situation in which the outcome is likely to occur. While a numeric standard for probable does not exist, practice generally considers an event that has a 75 percent or greater likelihood of occurrence to be probable.

IFRS

A contingent liability is defined as a possible obligation whose outcome will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events outside the entity’s control.

A contingent liability is not recognized. A contingent liability becomes a provision and is recorded when three criteria are met: (1) a present obligation from a past event exists, (2) it is probable that an outflow of resources will be required to settle the obligation, and (3) a reliable estimate can be made.

The term “probable” is used for describing a situation in which the outcome is more likely than not to occur. Generally, the phrase “more likely than not” denotes any chance greater than 50 percent.

9.3 *Measurement of provisions*

In certain circumstances, the measurement objective of provisions varies under the two frameworks.

IFRS results in a higher liability being recorded when there is a range of possible outcomes with equal probability.

US GAAP

A single standard does not exist to determine the measurement of obligations. Instead, entities must refer to guidance established for specific obligations (e.g., environmental or restructuring) to determine the appropriate measurement methodology.

IFRS

The amount recognized should be the best estimate of the expenditure required (the amount an entity would rationally pay to settle or transfer to a third party the obligation at the balance sheet date).

US GAAP

Pronouncements related to provisions do not necessarily have settlement price or even fair value as an objective in the measurement of liabilities, and the guidance often describes an accumulation of the entity's cost estimates.

When no amount within a range is a better estimate than any other amount, the low end of the range is accrued.

IFRS

Where there is a continuous range of possible outcomes and each point in that range is as likely as any other, the midpoint of the range is used.

9.4 *Discounting of provisions*

Provisions will be discounted more frequently under IFRS. At the same time, greater charges will be reflected as operating (versus financing) under US GAAP.

US GAAP

For losses that meet the accrual criteria of ASC 450, an entity will generally record them at the amount that will be paid to settle the contingency, without considering the time that may pass before the liability is paid. Discounting these liabilities is acceptable when the aggregate amount of the liability and the timing of cash payments for the liability are fixed or determinable. Entities with these liabilities that are eligible for discounting are not, however, required to discount those liabilities; the decision to discount is an accounting policy choice.

The classification in the statement of operations of the accretion of the liability to its settlement amount is an accounting policy decision that should be consistently applied and disclosed.

When discounting is applied, the discount rate applied to a liability should not change from period to period if the liability is not recorded at fair value.

There are certain instances outside of ASC 450 (e.g., in the accounting for asset retirement obligations) where discounting is required.

IFRS

IFRS requires that the amount of a provision be the present value of the expenditure expected to be required to settle the obligation. The anticipated cash flows are discounted using a pre-tax discount rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability (for which the cash flow estimates have not been adjusted) if the effect is material.

Provisions shall be reviewed at the end of each reporting period and adjusted to reflect the current best estimate. The carrying amount of a provision increases in each period to reflect the passage of time with said increase recognized as a borrowing cost.

9.5 *Restructuring provisions (excluding business combinations)*

IFRS does not have the concept of an ongoing termination plan, whereas a severance liability is recognized under US GAAP once it is probable and reasonably estimable. This could lead companies to record restructuring provisions in periods later than they would under US GAAP.

US GAAP

Guidance exists for different types of termination benefits (i.e., special termination benefits, contractual termination benefits, severance benefits, and one-time benefit arrangements).

If there is a pre-existing arrangement such that the employer and employees have a mutual understanding of the benefits the employee will receive if involuntarily terminated, the cost of the benefits are accrued when payment is probable and reasonably estimable. In this instance, no announcement to the workforce (nor initiation of the plan) is required prior to expense recognition.

IFRS

Involuntary termination benefits, which have no future service requirement, are recognized when the termination plan has been communicated to the affected employees and the plan meets specified criteria. This guidance applies to all termination benefits.

9.6 *Onerous contracts*

Onerous contract provisions may be recognized earlier and in different amounts under IFRS.

US GAAP

Provisions are not recognized for unfavorable contracts unless the entity has ceased using the rights under the contract (i.e., the cease-use date).

One of the most common examples of an unfavorable contract has to do with leased property that is no longer in use. With respect to such leased property, estimated sublease rentals are to be considered in a measurement of the provision to the extent such rentals could reasonably be obtained for the property, even if it is not management's intent to sublease or if the lease terms prohibit subleasing. Incremental expense in either instance is recognized as incurred.

IFRS

Provisions are recognized when a contract becomes onerous regardless of whether the entity has ceased using the rights under the contract.

When an entity commits to a plan to exit a lease property, sublease rentals are considered in the measurement of an onerous lease provision only if management has the right to sublease and such sublease income is probable.

IFRS requires recognition of an onerous loss for executory contracts if the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

US GAAP**IFRS**

Recording a liability is appropriate only when a lessee permanently ceases use of functionally independent assets (i.e., assets that could be fully utilized by another party).

US GAAP generally does not allow the recognition of losses on executory contracts prior to such costs being incurred.

9.7 *Accounting for government grants*

IFRS permits the recognition of government grants once there is reasonable assurance that requisite conditions will be met, rather than waiting for the conditions to be fulfilled, as is usually the case under US GAAP. As a result, government grants may be recognized earlier under IFRS.

US GAAP**IFRS**

If conditions are attached to the grant, recognition of the grant is delayed until such conditions have been fulfilled. Contributions of long-lived assets or for the purchase of long-lived assets are to be credited to income over the expected useful life of the asset for which the grant was received.

Government grants are recognized once there is reasonable assurance that both (1) the conditions for their receipt will be met and (2) the grant will be received. Income-based grants are deferred in the balance sheet and released to the income statement to match the related expenditure that they are intended to compensate. Asset-based grants are deferred and matched with the depreciation on the asset for which the grant arises.

Grants that involve recognized assets are presented in the balance sheet either as deferred income or by deducting the grant in arriving at the asset's carrying amount, in which case the grant is recognized as a reduction of depreciation.

9.8 Reimbursement and contingent assets

Guidance varies with respect to when these amounts should be recognized. As such, recognition timing differences could arise.

US GAAP

Recovery of recognized losses—An asset relating to the recovery of a recognized loss shall be recognized when realization of the claim for recovery is deemed probable.

Recoveries representing gain contingencies—Gain contingencies should not be recognized prior to their realization. In certain situations a gain contingency may be considered realized or realizable prior to the receipt of cash.

IFRS

Reimbursements—Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognized when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The amount recognized for the reimbursement shall be treated as a separate asset and shall not exceed the amount of the provision.

The virtually certain threshold may, in certain situations, be achieved in advance of the receipt of cash.

Contingent assets—Contingent assets are not recognized in financial statements because this may result in the recognition of income that may never be realized. If the inflow of economic benefits is probable, the entity should disclose a description of the contingent asset. However, when the realization of income is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate.

9.9 Levies

IFRS includes specific guidance related to the treatment of levies. US GAAP does not include specific guidance. This could result in differences between the timing and measurement of contingencies related to levies.

US GAAP

Specific guidance does not exist within US GAAP. Levies and their related fines and penalties follow the guidance in ASC 450 unless other guidance established for the specific obligation exists (e.g., environmental).

IFRS

Levies are defined as a transfer of resources imposed by a government on entities in accordance with laws and/or regulations, other than those within the scope of other standards (such as IAS 12); and fines or other penalties imposed for breaches of laws and/or regulations.

US GAAP**IFRS**

IFRIC 21, an interpretation of IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. The fact that an entity is economically compelled to continue operating in a future period, or prepares its financial statements under the going concern principle, does not create an obligation to pay a levy that will arise from operating in the future. The interpretation also clarifies that a liability to pay a levy is recognised when the obligating event occurs, at a point in time or progressively over time, and that an obligation to pay a levy triggered by a minimum threshold is recognised when the threshold is reached.

***Chapter 10:
Financial liabilities
and equity***

10.1 *Financial liabilities and equity*

Under current standards, both US GAAP and IFRS require the assessment of financial instruments to determine whether either equity or financial liability classification (or both) is required. Although the IFRS and US GAAP definitions of a financial liability bear some similarities, differences exist that could result in varying classification of identical instruments.

As an overriding principle, IFRS requires a financial instrument to be classified as a financial liability if the issuer can be required to settle the obligation in cash or another financial asset. US GAAP, on the other hand, defines a financial liability in a more specific manner. Unlike IFRS, financial instruments may potentially be equity-classified under US GAAP if the issuer's obligation to deliver cash or another financial asset at settlement is conditional. As such, US GAAP will permit more financial instruments to be equity-classified as compared to IFRS.

Many financial instruments contain provisions that require settlement in cash or another financial asset if certain contingent events occur. Contingently redeemable (settleable) instruments are more likely to result in financial liability classification, and financial instruments that are puttable are generally financial liabilities with very limited exceptions under IFRS. This is because the issuer cannot unconditionally avoid delivering cash or another financial asset at settlement. Identical contingently redeemable (settleable) and/or puttable instruments may be equity-classified under US GAAP due to the conditional nature of the issuer's obligation to deliver cash or another financial asset at settlement.

Oftentimes, reporting entities issue financial instruments that have both a liability and an equity component (e.g., convertible debt and redeemable preferred stock that is convertible into the issuer's common equity). Such instruments are referred to as compound financial instruments under IFRS and hybrid financial instruments under US GAAP. IFRS requires a compound financial instrument to be separated into a liability, and an equity component (or a derivative component, if applicable). Notwithstanding convertible debt with a cash conversion feature, which is accounted for like a compound financial instrument, hybrid financial instruments are evaluated differently under US GAAP. Unless certain conditions requiring bifurcation of the embedded feature(s) are met, hybrid financial instruments are generally accounted for as a financial liability or equity instrument in their entirety. The accounting for compound/hybrid financial instruments can result in significant balance sheet presentation differences while also impacting earnings.

Settlement of a financial instrument (freestanding or embedded) that results in delivery or receipt of an issuer's own shares may also be a source of significant differences between IFRS and US GAAP. For example, net share settlement would cause a warrant or an embedded conversion feature to require financial liability classification under IFRS. A similar feature would not automatically taint equity classification under US GAAP, and further analysis would be required to determine whether equity classification is appropriate. Likewise, a derivative contract providing for a choice between gross settlement and net cash settlement would fail equity classification under IFRS even if the settlement choice resides with the issuer. If net

cash settlement is within the issuer's control, the same derivative contract may be equity-classified under US GAAP.

Written options are another area where US GAAP and IFRS produce different accounting results. Freestanding written put options on an entity's own shares are classified as financial liabilities and recorded at fair value through earnings under US GAAP. Under IFRS, such instruments are recognized and measured as a financial liability at the discounted value of the settlement amount and accreted to their settlement amount. SEC-listed entities must also consider the SEC's longstanding view that written options should be accounted for at fair value through earnings.

In addition to the subsequent remeasurement differences described above, the application of the effective interest method when accreting a financial liability to its settlement amount differs under IFRS and US GAAP. The effective interest rate is calculated based on the estimated future cash flows of the instrument under IFRS, whereas the calculation is performed using contractual cash flows under US GAAP (with two limited exceptions, puttable and callable debt).

Technical references

US GAAP

ASC 470-20, ASC 470-20-25-12, ASC 480, ASC 480-10-65-1, ASC 815, ASC 815-15-25-4 through 25-5, ASC 815-40, ASC 815-40-25, ASC 820, ASC 825, ASC 850, ASC 860, ASR 268, CON 6

IFRS

IAS 32, IAS 39, IFRS 13, IFRIC 2

Note

The following discussion captures a number of the more significant GAAP differences. It is important to note that the discussion is not inclusive of all GAAP differences in this area.

Classification

10.2 Contingent settlement provisions

Contingent settlement provisions, such as provisions requiring redemption upon a change in control, result in financial liability classification under IFRS unless the contingency arises only upon liquidation or is not genuine.

Items classified as mezzanine equity under US GAAP generally are classified as financial liabilities under IFRS.

US GAAP

A contingently redeemable financial instrument (e.g., one redeemable only if there is a change in control) is outside the scope of ASC 480 because its redemption is not unconditional. Any conditional provisions must be assessed to ensure that the contingency is substantive.

For SEC-listed companies applying US GAAP, certain types of securities require classification in the mezzanine equity category of the balance sheet. Examples of items requiring mezzanine classification are instruments with contingent settlement provisions or puttable shares as discussed in the Puttable shares section.

Mezzanine classification is a US public company concept that is also encouraged (but not required) for private companies.

IFRS

IAS 32 notes that a financial instrument may require an entity to deliver cash or another financial asset in the event of the occurrence or nonoccurrence of uncertain future events beyond the control of both the issuer and the holder of the instrument. Contingencies may include linkages to such events as a change in control or to other matters such as a change in a stock market index, consumer price index, interest rates, or net income.

If the contingency is outside of the issuer's and holder's control, the issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset. Therefore, except in limited circumstances (such as if the contingency is not genuine or if it is triggered only in the event of a liquidation of the issuer), instruments with contingent settlement provisions represent financial liabilities.

As referenced previously, the guidance focuses on the issuer's unconditional ability to avoid settlement no matter whether the contingencies may or may not be triggered.

There is no concept of mezzanine classification under IFRS.

10.3 *Derivative on own shares—fixed-for-fixed versus indexed to issuer's own shares*

When determining the issuer's classification of a derivative on its own shares, IFRS looks at whether the equity derivative meets a fixed-for-fixed requirement while US GAAP uses a two-step model. Although Step 2 of the US GAAP model uses a similar fixed-for-fixed concept, the application of the concept differs significantly between US GAAP and IFRS.

These differences can impact classification as equity or a derivative asset or liability (with derivative classification more common under IFRS).

US GAAP**IFRS**

Equity derivatives need to be indexed to the issuer's own shares to be classified as equity. The assessment follows a two-step approach under ASC 815-40-15.

Step 1—Considers where there are any contingent exercise provisions and, if so, they cannot be based on an observable market or index other than those referenced to the issuer's own shares or operations.

Step 2—Considers the settlement amount. Only settlement amounts equal to the difference between the fair value of a fixed number of the entity's equity shares and a fixed monetary amount, or a fixed amount of a debt instrument issued by the entity, will qualify for equity classification.

If the instrument's strike price (or the number of shares used to calculate the settlement amount) is not fixed as outlined above, the instrument may still meet the equity classification criteria; this could occur where the variables that might affect settlement include inputs to the fair value of a fixed-for-fixed forward or option on equity shares and the instrument does not contain a leverage factor.

In case of rights issues, if the strike price is denominated in a currency other than the issuer's functional currency, it shall not be considered as indexed to the entity's own stock as the issuer is exposed to changes in foreign currency exchange rates. Therefore, rights issues of this nature would be classified as liabilities at fair value through profit or loss.

Only contracts that provide for gross physical settlement and meet the fixed-for-fixed criteria (i.e., a fixed number of shares for a fixed amount of cash) are classified as equity. Variability in the amount of cash or the number of shares to be delivered results in financial liability classification.

For example, a warrant issued by Company X has a strike price adjustment based on the movements in Company X's stock price. This feature would fail the fixed-for-fixed criteria under IFRS, but the same adjustment would meet the criteria under US GAAP. As such, for Company X's accounting for the warrant, IFRS would result in financial liability classification, whereas US GAAP would result in equity classification.

However, there is an exception to the fixed-for-fixed criteria in IAS 32 for rights issues. Under this exception, rights issues are classified as equity if they are issued for a fixed amount of cash regardless of the currency in which the exercise price is denominated, provided they are offered on a pro rata basis to all owners of the same class of equity.

10.4 Derivatives on own shares—settlement models

Entities will need to consider how derivative contracts on an entity's own shares will be settled. Many of these contracts that are classified as equity under US GAAP (e.g., warrants that will be net share settled or those where the issuer has settlement options) will be classified as derivatives under IFRS. Derivative classification will create additional volatility in the income statement.

US GAAP

Derivative contracts that are in the scope of ASC 815-40 and both (1) require physical settlement or net share settlement, and (2) give the issuer a choice of net cash settlement or settlement in its own shares are considered equity instruments, provided they meet the criteria set forth within the literature.

Analysis of a contract's terms is necessary to determine whether the contract meets the qualifying criteria, some of which can be difficult to meet in practice.

Similar to IFRS, derivative contracts that require net cash settlement are assets or liabilities.

Contracts that give the counterparty a choice of net cash settlement or settlement in shares (physical or net settlement) result in derivative classification. However, if the issuer has a choice of net cash settlement or share settlement, the contract can still be considered an equity instrument.

IFRS

Contracts that are net settled (net cash or net shares) are classified as liabilities or assets. This is also the case even if the settlement method is at the issuer's discretion.

Gross physical settlement is required to achieve equity classification.

Unlike US GAAP, under IFRS, a derivative contract that gives one party (either the holder or the issuer) a choice over how it is settled (net in cash, net in shares, or by gross delivery) is a derivative asset/liability unless all of the settlement alternatives would result in the contract being an equity instrument.

10.5 *Written put option on the issuer's own shares*

Written puts that are to be settled by gross receipt of the entity's own shares are treated as derivatives under US GAAP, while IFRS requires the entity to set up a financial liability for the discounted value of the amount of cash the entity may be required to pay.

US GAAP

A financial instrument—other than an outstanding share—that at inception (1) embodies an obligation to repurchase the issuer's equity shares or is indexed to such an obligation, and (2) requires or may require the issuer to settle the obligation by transferring assets shall be classified as a financial liability (or an asset, in some circumstances). Examples include written put options on the issuer's equity shares that are to be physically settled or net cash settled.

IFRS

If the contract meets the definition of an equity instrument (because it requires the entity to purchase a fixed amount of its own shares for a fixed amount of cash), any premium received or paid must be recorded in equity. Therefore, the premium received on such a written put is classified as equity (whereas under US GAAP, the fair value of the written put is recorded as a financial liability).

US GAAP**IFRS**

ASC 480 requires written put options to be measured at fair value, with changes in fair value recognized in current earnings.

In addition, when an entity has an obligation to purchase its own shares for cash (e.g., under a written put) the issuer records a financial liability for the discounted value of the amount of cash that the entity may be required to pay. The financial liability is recorded against equity.

10.6 *Compound instruments that are not convertible instruments (that do not contain equity conversion features)*

Bifurcation and split accounting under IFRS may result in significantly different treatment, including increased interest expense.

US GAAP**IFRS**

The guidance does not have the concept of compound financial instruments outside of instruments with certain equity conversion features. As such, under US GAAP the instrument would be classified wholly within liabilities or equity.

If an instrument has both a liability component and an equity component—known as a compound instrument (e.g., redeemable preferred stock with dividends paid solely at the discretion of the issuer)—IFRS requires separate accounting for each component of the compound instrument.

The liability component is recognized at fair value calculated by discounting the cash flows associated with the liability component at a market rate for a similar debt host instrument excluding the equity feature, and the equity component is measured as the residual amount.

The accretion calculated in the application of the effective interest rate method on the liability component is classified as interest expense.

10.7 *Convertible instruments (compound instruments that contain equity conversion features)*

Differences in how and when convertible instruments get bifurcated and/or how the bifurcated portions get measured can drive substantially different results.

US GAAP

Equity conversion features should be separated from the liability host and recorded separately as embedded derivatives only if they meet certain criteria (e.g., fail to meet the scope exception of ASC 815).

If the conversion feature is not recorded separately, then the entire convertible instrument may be considered one unit of account—interest expense would reflect cash interest if issued at par. However, there are a few exceptions:

- For certain convertible debt instruments that may be settled in cash upon conversion, the liability and equity components of the instrument should be separately accounted for by allocating the proceeds from the issuance of the instrument between the liability component and the embedded conversion option (i.e., the equity component). This allocation is done by first determining the carrying amount of the liability component based on the fair value of a similar liability excluding the embedded conversion option, and then allocating to the embedded conversion option the excess of the initial proceeds ascribed to the convertible debt instrument over the amount allocated to the liability component.
- A convertible debt may contain a beneficial conversion feature (BCF) when the strike price on the conversion option is “in the money.” The BCF is generally recognized and measured by allocating a portion of the proceeds received, equal to the intrinsic value of the conversion feature, to equity.

IFRS

For convertible instruments with a conversion feature that exchanges a fixed amount of cash for a fixed number of shares, IFRS requires bifurcation and split accounting between the liability and equity components of the instrument.

The liability component is recognized at fair value calculated by discounting the cash flows associated with the liability component—at a market rate for nonconvertible debt—and the equity conversion feature is measured as the residual amount and recognized in equity with no subsequent remeasurement.

Equity conversion features within liability host instruments that fail the fixed-for-fixed requirement are considered to be embedded derivatives. Such embedded derivatives are bifurcated from the host debt contract and measured at fair value, with changes in fair value recognized in the income statement.

IFRS does not have a concept of BCF, as the compound instruments are already accounted for based on their components.

10.8 Puttable shares/redeemable upon liquidation

10.8.1 Puttable shares

Puttable shares are more likely to be classified as financial liabilities under IFRS.

The potential need to classify certain interests in open-ended mutual funds, unit trusts, partnerships, and the like as liabilities under IFRS could lead to situations where some entities have no equity capital in their financial statements.

US GAAP	IFRS
<p>Puttable shares</p> <p>The redemption of puttable shares is conditional upon the holder exercising the put option. This contingency removes puttable shares from the scope of instruments that ASC 480 requires to be classified as a financial liability.</p> <p>As discussed for contingently redeemable instruments, SEC registrants would classify these instruments as “mezzanine.” Such classification is encouraged, but not required, for private companies.</p>	<p>Puttable shares</p> <p>Puttable instruments generally are classified as financial liabilities because the issuer does not have the unconditional right to avoid delivering cash or other financial assets. Under IFRS, the legal form of an instrument (i.e., debt or equity) does not necessarily influence the classification of a particular instrument.</p> <p>Under this principle, IFRS may require certain interests in open-ended mutual funds, unit trusts, partnerships, and the like to be classified as liabilities (because holders can require cash settlement). This could lead to situations where some entities have no equity capital in their financial statements.</p> <p>However, an entity is required to classify puttable instruments as equity when they have particular features and meet certain specific conditions in IAS 32. This exemption does not apply to puttable instruments issued by a subsidiary. Even if the puttable instruments are classified as equity in the financial statements of the issuing subsidiary, they are always shown as financial liabilities in the consolidated financial statements of the parent.</p>

10.8.2 Redeemable upon liquidation

Differences with respect to the presentation of these financial instruments issued by a subsidiary in the parent’s consolidated financial statements can drive substantially different results.

US GAAP	IFRS
<p>Redeemable upon liquidation</p> <p>ASC 480 scopes out instruments that are redeemable only upon liquidation. Therefore, such instruments may achieve equity classification for finite-lived entities.</p>	<p>Redeemable upon liquidation</p> <p>For instruments issued out of finite-lived entities that are redeemable upon liquidation, equity classification is appropriate only if certain conditions are met.</p>

US GAAP

In classifying these financial instruments issued by a subsidiary in a parent's consolidated financial statements, US GAAP permits an entity to defer the application of ASC 480; the result is that the redeemable noncontrolling interests issued by a subsidiary are not financial liabilities in the parent's consolidated financial statements.

IFRS

However, when classifying redeemable financial instruments issued by a subsidiary (either puttable or redeemable upon liquidation) for a parent's consolidated accounts, equity classification at the subsidiary level is not extended to the parent's classification of the redeemable noncontrolling interests in the consolidated financial statements, as the same instrument would not meet the specific IAS 32 criteria from the parent's perspective.

Measurement**10.9 Initial measurement of a liability with a related party**

Fundamental differences in the approach to related-party liabilities under the two accounting models may impact the values at which these liabilities initially are recorded. The IFRS model may, in practice, be more challenging to implement.

US GAAP

When an instrument is issued to a related party at off-market terms, one should consider which model the instrument falls within the scope of as well as the facts and circumstances of the transaction (i.e., the existence of unstated rights and privileges) in determining how the transaction should be recorded. There is, however, no requirement to initially record the transaction at fair value.

The presumption in ASC 850 that related party transactions are not at arm's length and the associated disclosure requirements also should be considered.

IFRS

When an instrument is issued to a related party, the financial liability initially should be recorded at fair value, which may not be the value of the consideration received.

The difference between fair value and the consideration received (i.e., any additional amount lent or borrowed) is accounted for as a current-period expense, income, or as a capital transaction based on its substance.

10.10 Effective-interest-rate calculation

Differences between the expected lives and the contractual lives of financial liabilities have different implications under the two frameworks unless the instruments in question are carried at fair value. The difference in where the two accounting frameworks place their emphasis (contractual term for US GAAP and expected life for IFRS) can impact carrying values and the timing of expense recognition.

Similarly, differences in how revisions to estimates get treated also impact carrying values and expense recognition timing, with the potential for greater volatility under IFRS.

US GAAP

The effective interest rate used for calculating amortization under the effective interest method generally discounts contractual cash flows through the contractual life of the instrument. However, expected life may be used in some circumstances. For example, puttable debt is generally amortized over the period from the date of issuance to the first put date and callable debt can be amortized either over the contractual or expected life as a policy decision.

IFRS

The effective interest rate used for calculating amortization under the effective interest method discounts estimated cash flows through the expected—not the contractual—life of the instrument.

Generally, if the entity revises its estimate after initial recognition, the carrying amount of the financial liability should be revised to reflect actual and revised estimated cash flows at the original effective interest rate, with a cumulative-catch-up adjustment being recorded in profit and loss. Revisions of the estimated life or of the estimated future cash flows may exist, for example, in connection with debt instruments that contain a put or call option that does not need to be bifurcated or whose coupon payments vary. Payments may vary because of an embedded feature that does not meet the definition of a derivative because its underlying is a nonfinancial variable specific to a party to the contract (e.g., cash flows that are linked to earnings before interest, taxes, depreciation, and amortization; sales volume; or the earnings of one party to the contract).

Generally, floating rate instruments (e.g., LIBOR plus spread) issued at par are not subject to the cumulative-catch-up approach; rather, the effective interest rate is revised as market rates change.

10.11 *Modification or exchange of debt instruments and convertible debt instruments*

Differences in when a modification or exchange of a debt instrument would be accounted for as a debt extinguishment can drive different conclusions as to whether extinguishment accounting is appropriate.

US GAAP

When a debt modification or exchange of debt instruments occurs, the first step is to consider whether the modification or exchange qualifies for troubled debt restructuring. If this is the case, the restructuring follows the specific troubled debt restructuring guidance.

If the modification or exchange of debt instruments does not qualify for troubled debt restructuring, one has to consider whether the modification or exchange of debt instruments has to be accounted for as a debt extinguishment.

An exchange or modification of debt instruments with substantially different terms is accounted for as a debt extinguishment. In order to determine whether the debt is substantively different, a quantitative assessment must be performed.

If the present value of the cash flows under the new terms of the new debt instrument differs by at least 10 percent from the present value of the remaining cash flows under the original debt, the exchange is considered an extinguishment. The discount rate for determining the present value is the effective rate on the old debt.

If the debt modifications involve changes in noncash embedded features, the following two-step test is required:

Step 1—If the change in cash flows as described above is greater than 10 percent of the carrying value of the original debt instrument, the exchange or modification should be accounted for as an extinguishment. This test would not include any changes in fair value of the embedded conversion option.

IFRS

Under IFRS, there is no concept of troubled debt restructuring.

A substantial modification of the terms of an existing financial liability or part of the financial liability should be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. In this regard, the terms are substantially different if the discounted present value of the cash flows under the new terms is at least 10 percent different from the discounted present value of the remaining cash flows of the original financial liability. If this test is met, the exchange is considered an extinguishment.

It is clear that if the discounted cash flows change by at least 10 percent, the original debt should be accounted for as an extinguishment. It is not clear, however, in IAS 39 whether the quantitative analysis is an example or is the definition of substantially different. Accordingly, there is an accounting policy choice where entities can perform either (1) an additional qualitative analysis of any modification of terms when the change in discounted cash flows is less than 10 percent or (2) only the 10 percent test (quantitative test) as discussed above.

US GAAP**IFRS**

Step 2—If the test in Step 1 is not met, the following should be assessed:

- Whether the modification or exchange affects the terms of an embedded conversion option, where the difference between the fair value of the option before and after the modification or exchange is at least 10 percent of the carrying value of the original debt instrument prior to the modification or exchange.
- Whether a substantive conversion option is added or a conversion option that was substantive at the date of modification is eliminated.

If either of these criteria is met, the exchange or modification would be accounted for as an extinguishment.

For debt instruments with embedded derivative features, the modification of the host contract and the embedded derivative should be assessed together when applying the 10 percent test as the host debt and the embedded derivative are interdependent. However, a conversion option that is accounted for as an equity component would not be considered in the 10 percent test. In such cases, an entity would also consider whether there is a partial extinguishment of the liability through the issuance of equity before applying the 10 percent test.

10.12 Transaction costs (also known as debt issue costs)

When applicable, the balance sheet presentation of transaction costs (separate asset versus a component of the instrument's carrying value) differs under the two standards. IFRS prohibits the balance sheet gross up required by US GAAP.

US GAAP**IFRS**

When the financial liability is not carried at fair value through income, third party costs are deferred as an asset. Creditor fees are deducted from the carrying value of the financial liability and are not recorded as separate assets.

Transaction costs are expensed immediately when the financial liability is carried at fair value, with changes recognized in profit and loss.

When the financial liability is not carried at fair value through income, transaction costs including third party costs and creditor fees are deducted from the carrying value of the financial liability and are not recorded as separate assets. Rather, they are accounted for as a debt discount and amortized using the effective interest method.

Transaction costs are expensed immediately when the financial liability is carried at fair value, with changes recognized in profit and loss.

10.13 *Recent/proposed guidance*

10.13.1 *IFRS 9, Financial Instruments*

In July 2014, the IASB published the complete version of IFRS 9, *Financial Instruments*, which replaces most of the guidance in IAS 39. This includes amended guidance for the classification and measurement of financial assets by introducing a fair value through other comprehensive income category for certain debt instruments. It also contains a new impairment model which will result in earlier recognition of losses.

No changes were introduced for the classification and measurement of financial liabilities, except for the recognition of changes in own credit risk in other comprehensive income for liabilities designated at fair value through profit or loss. These changes are likely to have a significant impact on entities that have significant financial assets and, in particular, financial institutions.

IFRS 9 will be effective for annual periods beginning on or after January 1, 2018, subject to endorsement in certain territories.

10.13.2 *FASB Proposed Accounting Standards Update, Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*

In February 2013, the FASB issued a revised proposal for the classification and measurement of financial instruments. The proposal calls for a mixed measurement approach for financial assets and financial liabilities — either fair value or amortized cost. It is intended to be responsive to the considerable feedback the FASB received on its 2010 exposure draft, which proposed fair value measurement for all financial instruments. The comment period ended May 15, 2013.

The key proposals with regard to financial liabilities are as follows:

10.13.2.1 *Classification and measurement approach*

Financial liabilities will generally be measured at amortized cost. However, if either of the following conditions exists, fair value through net income would be required:

- The financial liabilities are liabilities for which the company's business strategy upon initial recognition is to subsequently transact at fair value;
- The financial liabilities are short sales

Comparison to IFRS: IFRS 9 carried forward the classification and measurement approach for financial liabilities in IAS 39 where the amortized cost measurement is used for liabilities with the exception of trading liabilities, which are measured at fair value through profit or loss.

10.13.2.2 Hybrid financial and nonfinancial liabilities

Hybrid financial liabilities retain the accounting as currently required under ASC 815-15. Therefore, separate accounting for embedded derivative features remains, and embedded derivatives will continue to be measured at fair value through net income. Once the bifurcation and separate analysis have been performed, the financial host or debt-equity hybrid host that is recognized as a financial liability will be subject to the proposed classification and measurement model.

Comparison to IFRS: Similarly, IFRS 9 retains a bifurcation approach for hybrid financial liabilities. However, there are currently differences between IFRS and US GAAP in the definition of a derivative and the assessment of whether an embedded derivative is closely related to its host, which the boards are not currently addressing (refer to the Derivatives and hedging chapter for existing differences). As a result, differences will continue to arise as to when bifurcation is required under the two sets of accounting standards.

10.13.2.3 Convertible debt

An issuer's accounting for convertible debt will remain unchanged under the FASB's proposed approach. Conventional convertible debt, i.e., convertible debt that qualifies for the derivatives scope exception in ASC 815 and cannot be settled wholly or partially in cash, will be measured by the issuer at amortized cost in its entirety. Convertible debt that can be settled upon conversion wholly or partially in cash by the issuer will continue to be bifurcated into a conversion option, which is recognized in equity, and a host contract, which is recognized as a liability and measured at amortized cost. Similarly, the accounting in situations where the embedded conversion option will need to be separated from the host contract and accounted for as a derivative or where there is a beneficial conversion feature will remain unchanged.

Comparison to IFRS: The IAS 39 approach to classification and measurement was carried forward to IFRS 9. The IAS 32 guidance for determining whether an instrument should be recognized entirely or in part in equity or liability remains unchanged. Therefore, the existing differences for convertible debt instruments will continue to exist after completion of this project.

10.13.2.4 Non-recourse liabilities

Financial liabilities that can only be settled with specified financial assets and do not have other recourse, are required under the proposal to be measured consistently (same method and same amount) with those specified assets. For example, beneficial interests in a securitization that can only be settled using the cash flows from the debt investments held in the securitization entity will be measured consistently with those debt investments held in the entity. If the debt investments are carried at amortized cost and credit impairment is recognized in the reporting period, the beneficial interests will also be carried at amortized cost and written down for the same impairment charge as recognized on the assets.

Comparison to IFRS: IFRS 9 does not provide a separate measurement approach for non-recourse liabilities. Financial assets and liabilities will follow their respective classification and measurement models. However, under IFRS 9, a fair value option is provided for financial assets and financial liabilities if measuring those assets or liabilities at fair value through net income would eliminate or significantly reduce a measurement mismatch.

10.13.2.5 Fair value option

If the fair value option is elected for a financial liability, any changes in fair value that result from a change in the company's own credit risk will be recognized separately in other comprehensive income. The accumulated gains and losses due to changes in a company's own credit will be recycled from accumulated other comprehensive income to net income when the financial liability is settled before maturity.

The change in fair value due to a change in the company's own credit risk will be measured as the portion of the change in fair value that is not due to a change in the benchmark rate of market risk (e.g., the risk above a base market interest rate). However, a company can use an alternative method if it believes it to be a more faithful measurement of that credit risk.

Comparison to IFRS: Unlike the FASB's proposed approach, IFRS 9 allows an irrevocable election at initial recognition to measure a financial asset or a financial liability at fair value through profit or loss if that measurement eliminates or significantly reduces an accounting mismatch. Additionally, IFRS 9 has a fair value option for groups of financial assets and/or liabilities that are managed together on a net fair value basis. Finally, IFRS 9 allows a fair value option for hybrid financial liabilities if certain conditions are met. In virtually all cases, where the fair value option is elected for financial liabilities, IFRS 9 requires the effects due to a change in the company's own credit to be reflected in other comprehensive income, which is similar to the FASB's proposed approach. However, IFRS 9 does not allow recycling if the liability is settled before maturity.

10.13.3 IFRS Interpretations Committee Draft Interpretation, IAS 32 Financial Instruments: Presentation—Put Options Written on Non-controlling Interests

In May 2012, the IFRS Interpretations Committee published a draft interpretation on the accounting for put options written on non-controlling interests in the parent's consolidated financial statements (NCI puts). NCI puts are contracts that oblige a parent to purchase shares of its subsidiary that are held by a non-controlling-interest shareholder for cash or another financial asset. The draft interpretation clarifies that based on paragraph 23 of IAS 32 the subsequent measurement of NCI puts should be in accordance with IAS 39/IFRS 9, which require changes in the measurement of the financial liability to be recognized in the income statement. However, after discussing the Interpretations Committee's views and the feedback received in the comment letters, the IASB decided in June 2014 that this project should be incorporated into the broader project looking at the distinction between liabilities and equity.

10.13.4 FASB Accounting Standards Update No. 2015-03, Simplifying the Presentation of Debt Issuance Costs

On April 7, 2015, the FASB issued Accounting Standards Update 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability, consistent with the presentation of a debt discount.

Prior to the issuance of the standard, debt issuance costs were required to be presented in the balance sheet as a deferred charge (i.e., an asset). This presentation differed from the presentation for a debt discount, which is a direct adjustment to the carrying value of the debt (i.e., a contra liability). The new standard requires that all costs incurred to issue debt be presented in the balance sheet as a direct deduction from the carrying value of the debt, aligning the U.S. GAAP presentation with IFRS. For public business entities, the standard is effective for fiscal years beginning after December 15, 2015. For all other entities, the standard is effective for fiscal years beginning after December 15, 2015.

Chapter 11:
Derivatives and hedging

11.1 *Derivatives and hedging*

Derivatives and hedging represent one of the more complex and nuanced topical areas within both US GAAP and IFRS. While IFRS generally is viewed as less rules-laden than US GAAP, the difference is less dramatic in relation to derivatives and hedging, wherein both frameworks embody a significant volume of detailed implementation guidance.

In the area of derivatives and embedded derivatives, the definition of derivatives is broader under IFRS than under US GAAP; therefore, more instruments may be required to be accounted for at fair value through the income statement under IFRS. On the other hand, the application of the scope exception around “own use”/“normal purchase normal sale” may result in fewer derivative contracts at fair value under IFRS, as these are scoped out of IFRS while elective under US GAAP. Also, there are differences that should be carefully considered in the identification of embedded derivatives within financial and nonfinancial host contracts. In terms of measurement of derivatives, day one gains or losses cannot be recognized under IFRS unless supported by appropriate observable current market transactions or if all of the inputs into the valuation model used to derive the day one difference are observable. Under US GAAP, day one gains and losses are permitted where fair value is derived from unobservable inputs.

Although the hedging models under IFRS and US GAAP are founded on similar principles, there are a number of application differences. Some of the differences result in IFRS being more restrictive than US GAAP, whereas other differences provide more flexibility under IFRS.

Areas where IFRS is more restrictive than US GAAP include the nature, frequency, and methods of measuring and assessing hedge effectiveness. As an example, US GAAP provides for a shortcut method that allows an entity to assume no ineffectiveness and, hence, bypass an effectiveness test as well as the need to measure quantitatively the amount of hedge ineffectiveness. The US GAAP shortcut method is available only for certain fair value or cash flow hedges of interest rate risk using interest rate swaps (when certain stringent criteria are met). IFRS has no shortcut method equivalent. To the contrary, IFRS requires that, in all instances, hedge effectiveness be measured and any ineffectiveness be recorded in profit or loss. IFRS does acknowledge that in certain situations little or no ineffectiveness could arise, but IFRS does not provide an avenue whereby an entity may assume no ineffectiveness.

Because the shortcut method is not accepted under IFRS, companies utilizing the shortcut method under US GAAP will need to prepare the appropriate level of IFRS-compliant documentation if they want to maintain hedge accounting. The documentation will need to be in place no later than at the transition date to IFRS if hedge accounting is to be maintained on an uninterrupted basis. For example, for a company whose first IFRS-based financial statements will be issued for the three years ended December 31, 2014, hedging documentation needs to be in place as of the opening balance sheet date. Hence, documentation needs to be in place as of January 1, 2012, if the entity wants to continue to apply hedge accounting on an uninterrupted basis.

Another area where IFRS is more restrictive involves the use of purchased options as a hedging instrument. Under IFRS, when hedging one-sided risk in a forecasted transaction under a cash flow hedge (e.g., for foreign currency or price risk), only the intrinsic value of a purchased option is deemed to reflect the one-sided risk of the hedged item. As a result, for hedge relationships where the critical terms of the purchased option match the hedged risk, generally, the change in intrinsic value will be deferred in equity while the change in time value will be recorded in the income statement. However, US GAAP permits an entity to assess effectiveness based on the entire change in fair value of the purchased option. There is also less flexibility under IFRS in the hedging of servicing rights because they are considered nonfinancial interests.

IFRS is also more restrictive than US GAAP in relation to the use of internal derivatives. Restrictions under the IFRS guidance may necessitate that entities desiring hedge accounting enter into separate, third-party hedging instruments for the gross amount of foreign currency exposures in a single currency, rather than on a net basis (as is done by many treasury centers under US GAAP).

At the same time, IFRS provides opportunities not available under US GAAP in a number of areas. Such opportunities arise in a series of areas where hedge accounting can be accomplished under IFRS, whereas it would have been precluded under US GAAP. For example, under IFRS an entity can achieve hedge accounting in relation to the foreign currency risk associated with a firm commitment to acquire a business in a business combination (whereas US GAAP would not permit hedge accounting). At the same time, IFRS allows an entity to utilize a single hedging instrument to hedge more than one risk in two or more hedged items (this designation is precluded under US GAAP). That difference may allow entities under IFRS to adopt new and sometimes more complex risk management strategies while still achieving hedge accounting. IFRS is more flexible than US GAAP with respect to the ability to achieve fair value hedge accounting in relation to interest rate risk within a portfolio of dissimilar financial assets and in relation to hedging a portion of a specified risk and/or a portion of a time period to maturity (i.e., partial-term hedging) of a given instrument to be hedged. A series of further differences exists as well.

As companies work to understand and embrace the new opportunities and challenges associated with IFRS in this area, it is important that they ensure that data requirements and underlying systems support are fully considered.

In November 2013, the IASB published the new general hedge accounting requirement added to IFRS 9. In July 2014, the IASB issued the complete version of IFRS 9, *Financial Instruments*, which replaces the guidance on the classification and measurement, and impairment. Initial deliberations on macro hedging guidance are ongoing. Refer to SD 11.21.2 for further discussion. The FASB is expected to issue its final guidance on classification and measurement and impairment by the end of 2015. The Board's redeliberations on hedge accounting are at an early stage and an exposure draft is expected to be issued by the end of 2015.

Technical references

US GAAP

ASC 815, ASC 815-15-25-4 through 25-5, ASC 815-20-25-3, ASC 815-20-25-94 through 25-97, ASC 830-30-40-2 through 40-4

IFRS

IAS 39, IFRS 7, IFRIC 9, IFRIC 16

Note

The following discussion captures a number of the more significant GAAP differences. It is important to note that the discussion is not inclusive of all GAAP differences in this area.

Derivative definition and scope

11.2 Net settlement provisions

More instruments will qualify as derivatives under IFRS.

Some instruments, such as option and forward agreements to buy unlisted equity investments, are accounted for as derivatives under IFRS but not under US GAAP.

US GAAP

IFRS

To meet the definition of a derivative, a financial instrument or other contract must require or permit net settlement.

US GAAP generally excludes from the scope of ASC 815 certain instruments linked to unlisted equity securities when such instruments fail the net settlement requirement and are, therefore, not accounted for as derivatives.

An option contract between an acquirer and a seller to buy or sell stock of an acquiree at a future date that results in a business combination may not meet the definition of a derivative as it may fail the net settlement requirement (e.g., the acquiree’s shares are not listed so the shares may not be readily convertible to cash).

IFRS does not include a requirement for net settlement within the definition of a derivative. It only requires settlement at a future date.

There is an exception under IAS 39 for derivatives whose fair value cannot be measured reliably (i.e., instruments linked to equity instruments that are not reliably measurable), which could result in not having to account for such instruments at fair value. In practice, however, this exemption is very narrow in scope because in most situations it is expected that fair value can be measured reliably even for unlisted securities.

11.3 *Own use versus normal purchase normal sale (NPNS)*

The “own use” exception is mandatory under IFRS but the “normal purchase normal sale” exception is elective under US GAAP.

US GAAP	IFRS
There are many factors to consider in determining whether a contract related to nonfinancial items can qualify for the NPNS exception.	Similar to US GAAP, there are many factors to consider in determining whether a contract related to nonfinancial items qualifies for the “own use” exception.
If a contract meets the requirement of the NPNS exception, then the reporting entity must document that it qualifies in order to apply the NPNS exception—otherwise, it will be considered a derivative.	While US GAAP requires documentation to apply the NPNS exception (i.e., it is elective), IFRS requires a contract to be accounted for as own use (i.e., not accounted for as a derivative) if the own use criteria are satisfied.

Embedded derivatives

11.4 *Reassessment of embedded derivatives*

Differences with respect to the reassessment of embedded derivatives may result in significantly different outcomes under the two frameworks. Generally, reassessment is more frequent under US GAAP.

US GAAP	IFRS
If a hybrid instrument contains an embedded derivative that is not clearly and closely related at inception, and it is not bifurcated (because it does not meet the definition of a derivative), it must be continually reassessed to determine whether bifurcation is required at a later date. Once it meets the definition of a derivative, the embedded derivative is bifurcated and measured at fair value with changes in fair value recognized in earnings.	IFRS precludes reassessment of embedded derivatives after inception of the contract unless there is a change in the terms of the contract that significantly modifies the expected future cash flows that would otherwise be required under the contract.

US GAAP

IFRS

Similarly, the embedded derivative in a hybrid instrument that is not clearly and closely related at inception and is bifurcated must also be continually reassessed to determine whether it subsequently fails to meet the definition of a derivative. Such an embedded derivative should cease to be bifurcated at the point at which it fails to meet the requirements for bifurcation.

Having said that, if an entity reclassifies a financial asset out of the held-for-trading category, embedded derivatives must be assessed and, if necessary, bifurcated.

An embedded derivative that is clearly and closely related is not reassessed subsequent to inception for the “clearly and closely related” criterion. For nonfinancial host contracts, the assessment of whether an embedded foreign currency derivative is clearly and closely related to the host contract should be performed only at inception of the contract.

11.5 Calls and puts in debt instruments

IFRS and US GAAP have fundamentally different approaches to assessing whether call and puts embedded in debt host instruments require bifurcation.

US GAAP

IFRS

Multiple tests are required in evaluating whether an embedded call or put is clearly and closely related to the debt host. The failure of one or both of the below outlined tests is common and typically results in the need for bifurcation.

Calls, puts, or prepayment options embedded in a hybrid instrument are closely related to the debt host instrument if either (1) the exercise price approximates the amortized cost on each exercise date or (2) the exercise price of a prepayment option reimburses the lender for an amount up to the approximate present value of the lost interest for the remaining term of the host contract. Once determined to be closely related as outlined above, these items do not require bifurcation.

Test 1—If a debt instrument is issued at a substantial premium or discount and a contingent call or put can accelerate repayment of principal, the call or put is not clearly and closely related.

US GAAP**IFRS**

Test 2—If there is no contingent call or put that can accelerate repayment of principal, or if the debt instrument is not issued at a substantial premium or discount, then it must be assessed whether the debt instrument can be settled in such a way that the holder would not recover substantially all of its recorded investments or the embedded derivative would at least double the holder's initial return and the resulting rate would be double the then current market rate of return. However, this rule is subject to certain exceptions.

11.6 *Nonfinancial host contracts—currencies commonly used*

Although IFRS and US GAAP have similar guidance in determining when to separate foreign currency embedded derivatives in a nonfinancial host, there is more flexibility under IFRS in determining that the currency is closely related.

US GAAP**IFRS**

US GAAP requires bifurcation of a foreign currency embedded derivative from a nonfinancial host unless the payment is (1) denominated in the local currency or functional currency of a substantial party to the contract, (2) the price that is routinely denominated in that foreign currency in international commerce (e.g., US dollar for crude oil transactions), or (3) a foreign currency used because a party operates in a hyperinflationary environment.

Criteria (1) and (2) cited for US GAAP also apply under IFRS. However, bifurcation of a foreign currency embedded derivative from a nonfinancial host is not required if payments are denominated in a currency that is commonly used to purchase or sell such items in the economic environment in which the transaction takes place.

For example, Company X, in Russia (functional currency and local currency is Russian ruble), sells timber to another Russian company (with a ruble functional currency) in euros. Because the euro is a currency commonly used in Russia, bifurcation of a foreign currency embedded derivative from the nonfinancial host contract would not be required under IFRS.

Measurement of derivatives

11.7 *Day one gains and losses*

Day one gains and losses occur when the entity uses a model to measure the fair value of the instrument and the model price at initial recognition is different from the transaction price.

The ability to recognize day one gains and losses is different under both frameworks, with gain/loss recognition more common under US GAAP.

US GAAP

In some circumstances, the transaction price is not equal to fair value, usually when the market in which the transaction occurs differs from the market where the reporting entity could transact. For example, banks can access wholesale and retail markets; the wholesale price may result in a day one gain compared to the transaction price in the retail market.

In these cases, entities must recognize day one gains and losses even if some inputs to the measurement model are not observable.

IFRS

Day one gains and losses are recognized only when the fair value is evidenced by comparison with other observable current market transactions in the same instrument or is based on a valuation technique whose variables include only data from observable markets.

Hedge qualifying criteria

11.8 *When to assess effectiveness*

Non-SEC-listed entities may see greater flexibility in the frequency of required effectiveness testing under IFRS.

Although the rules under IFRS allow less-frequent effectiveness testing in certain situations, SEC-listed entities will still be required to assess effectiveness on a quarterly basis in conjunction with their interim reporting requirements.

US GAAP

US GAAP requires that hedge effectiveness be assessed whenever financial statements or earnings are reported and at least every three months (regardless of how often financial statements are prepared).

IFRS

IFRS requires that hedges be assessed for effectiveness on an ongoing basis and that effectiveness be measured, at a minimum, at the time an entity prepares its annual or interim financial reports.

US GAAP**IFRS**

Therefore, if an entity is required to produce only annual financial statements, IFRS requires that effectiveness be tested only once a year. An entity may, of course, choose to test effectiveness more frequently.

Hedge accounting practices allowed under US GAAP that are not acceptable under IFRS

11.9 Effectiveness testing and measurement of hedge ineffectiveness

IFRS requires an increased level of hedge effectiveness testing and/or detailed measurement compared to US GAAP.

There are a number of similarities between the effectiveness-testing methods acceptable under US GAAP and those acceptable under IFRS. At the same time, important differences exist in areas such as the use of the shortcut method and the critical matched-terms method.

US GAAP**IFRS**

US GAAP does not specify a single method for assessing hedge effectiveness prospectively or retrospectively. The method an entity adopts depends on the entity's risk management strategy and is included in the documentation prepared at the inception of the hedge. The most common methods used are the critical-terms match, the dollar-offset method, and regression analysis.

IFRS does not specify a single method for assessing hedge effectiveness prospectively or retrospectively. The method an entity adopts depends on the entity's risk management strategy and is included in the documentation prepared at the inception of the hedge. The most common methods used are the critical-terms match, the dollar-offset method, and regression analysis.

US GAAP**IFRS****Shortcut method**

US GAAP provides for a shortcut method that allows an entity to assume no ineffectiveness (and, hence, bypass an effectiveness test) for certain fair value or cash flow hedges of interest rate risk using interest rate swaps (when certain stringent criteria are met).

Critical terms match

Under US GAAP, for hedges that do not qualify for the shortcut method, if the critical terms of the hedging instrument and the entire hedged item are the same, the entity can conclude that changes in fair value or cash flows attributable to the risk being hedged are expected to completely offset. An entity is not allowed to assume (1) no ineffectiveness when it exists or (2) that testing can be avoided. Rather, matched terms provide a simplified approach to effectiveness testing in certain situations.

The SEC has clarified that the critical terms have to be perfectly matched to assume no ineffectiveness. Additionally, the critical-terms-match method is not available for interest rate hedges.

Shortcut method

IFRS does not allow a shortcut method by which an entity may assume no ineffectiveness.

IFRS permits portions of risk to be designated as the hedged risk for financial instruments in a hedging relationship such as selected contractual cash flows or a portion of the fair value of the hedged item, which can improve the effectiveness of a hedging relationship. Nevertheless, entities are still required to test effectiveness and measure the amount of any ineffectiveness.

Critical terms match

IFRS does not specifically discuss the methodology of applying a critical-terms-match approach in the level of detail included within US GAAP. However, if an entity can prove for hedges in which the critical terms of the hedging instrument and the hedged items are the same that the relationship will always be 100 percent effective based on an appropriately designed test, then a similar qualitative analysis may be sufficient for prospective testing.

Even if the critical terms are the same, retrospective effectiveness must be assessed, and ineffectiveness must be measured in all cases because IFRS precludes the assumption of perfect effectiveness.

11.10 Credit risk and hypothetical derivatives

In a cash flow hedge, an entity's assessment of hedge effectiveness may be impacted by an entity's own credit risk or by the credit risk of the hedging derivative's counterparty. When using the hypothetical derivative method, a difference between IFRS and US GAAP may arise depending on (1) whether the derivative is in an asset or a liability position and (2) the method used for valuing liabilities.

US GAAP

Under US GAAP, a hypothetical derivative will reflect an adjustment for the counterparty's (or an entity's own) credit risk. This adjustment will be based upon the credit risk in the actual derivative. As such, no ineffectiveness will arise due to credit risk, as the same risk is reflected in both the actual and hypothetical derivative.

If, however, the likelihood that the counterparty will perform ceases to be probable, an entity would be unable to conclude that the hedging relationship in a cash flow hedge is expected to be highly effective in achieving offsetting cash flows. In those instances, the hedging relationship is discontinued.

IFRS

Under IFRS, a hypothetical derivative perfectly matches the hedged risk of the hedged item. Because the hedged item would not contain the derivative counterparty's (or an entity's own) credit risk, the hypothetical derivative would not reflect that credit risk. The actual derivative, however, would reflect credit risk. The resulting mismatch between changes in the fair value of the hypothetical derivative and the hedging instrument would result in ineffectiveness.

11.11 Servicing rights

Differences exist in the recognition and measurement of servicing rights, which may result in differences with respect to the hedging of servicing rights. This is especially relevant for financial institutions that originate mortgages and retain the right to service them.

US GAAP

US GAAP specifically permits servicing rights to be hedged for the benchmark interest rate or for overall changes in fair value in a fair value hedge.

An entity may, however, avoid the need to apply hedge accounting by electing to measure servicing rights at fair value through profit or loss as both the hedging instrument and the hedged item would be measured at fair value through profit or loss.

IFRS

Under IFRS, servicing rights are considered nonfinancial items. Accordingly, they can only be hedged for foreign currency risk or hedged in their entirety for all risks (i.e., not only for interest rate risk).

Furthermore, IFRS precludes measurement of servicing rights at fair value through profit or loss because the fair value option is applicable only to financial items and therefore cannot be applied to servicing rights.

11.12 Cash flow hedges with purchased options

For cash flow hedges, US GAAP provides more flexibility than IFRS with respect to designating a purchased option as a hedging instrument.

As a result of the difference, there may be more income statement volatility for IFRS entities using purchased options in their hedging strategies.

US GAAP

IFRS

US GAAP permits an entity to assess effectiveness based on total changes in the purchased option's cash flows (that is, the assessment will include the hedging instrument's entire change in fair value). As a result, the entire change in the option's fair value (including time value) may be deferred in equity based on the level of effectiveness.

Alternatively, the hedge relationship can exclude time value from the hedging instrument such that effectiveness is assessed based on intrinsic value.

Under IFRS, when hedging one-sided risk via a purchased option in a cash flow hedge of a forecasted transaction, only the intrinsic value of the option is deemed to be reflective of the one-sided risk of the hedged item. Therefore, in order to achieve hedge accounting with purchased options, an entity will be required to separate the intrinsic value and time value of the purchased option and designate as the hedging instrument only the changes in the intrinsic value of the option.

As a result, for hedge relationships where the critical terms of the purchased option match the hedged risk, generally, the change in intrinsic value will be deferred in equity while the change in time value will be recorded in the income statement.

11.13 Foreign currency risk and internal derivatives

Restrictions under the IFRS guidance require that entities with treasury centers that desire hedge accounting either change their designation or enter into separate third-party hedging instruments for the gross amount of foreign currency exposures.

US GAAP

IFRS

US GAAP permits hedge accounting for foreign currency risk with internal derivatives, provided specified criteria are met and, thus, accommodates the hedging of foreign currency risk on a net basis by a treasury center. The treasury center enters into derivatives contracts with unrelated third parties that would offset, on a net basis for each foreign currency, the foreign exchange risk arising from multiple internal derivative contracts.

Under IFRS, internal derivatives do not qualify for hedge accounting in the consolidated financial statements (because they are eliminated in consolidation). However, a treasury center's net position that is laid off to an external party may be designated as a hedge of a gross position in the consolidated financial statements. Careful consideration of the positions to be designated as hedged items may be necessary to minimize the effect of this difference. Entities may use internal derivatives as an audit trail or a tracking mechanism to relate external derivatives to the hedged item.

US GAAP**IFRS**

The internal derivatives would qualify as hedging instruments in the separate financial statements of the subsidiaries entering into internal derivatives with a group treasury center.

Hedge accounting practices not allowed under US GAAP that are acceptable under IFRS

11.14 *Hedges of a portion of the time period to maturity*

IFRS is more permissive than US GAAP with respect to a partial-term fair value hedge.

US GAAP**IFRS**

US GAAP does not permit the hedged risk to be defined as a portion of the time period to maturity of a hedged item.

IFRS permits designation of a derivative as hedging only a portion of the time period to maturity of a financial hedged item if effectiveness can be measured and the other hedge accounting criteria are met. For example, an entity with a 10 percent fixed bond with remaining maturity of 10 years can acquire a five-year pay-fixed, receive-floating swap and designate the swap as hedging the fair value exposure of the interest rate payments on the bond until the fifth year and the change in value of the principal payment due at maturity to the extent affected by changes in the yield curve relating to the five years of the swap. That is, a five-year bond is the imputed hedged item in the actual 10-year bond; the interest rate risk hedged is the five-year interest rate implicit in the 10-year bond.

11.15 *Designated risks for financial assets or liabilities*

IFRS provides opportunities with respect to achieving hedge accounting for a portion of a specified risk.

Those opportunities may reduce the amount of ineffectiveness that needs to be recorded in the income statement under IFRS (when compared with US GAAP).

US GAAP	IFRS
<p>The guidance does not allow a portion of a specific risk to qualify as a hedged risk in a hedge of financial assets or financial liabilities. US GAAP specifies that the designated risk be in the form of changes in one of the following:</p> <ul style="list-style-type: none"> □ Overall fair value or cash flows □ Benchmark interest rates □ Foreign currency exchange rates □ Creditworthiness and credit risk <p>The interest rate risk that can be hedged is explicitly limited to specified benchmark interest rates.</p>	<p>The guidance allows a portion of a specific risk to qualify as a hedged risk (so long as effectiveness can be reliably measured). Designating a portion of a specific risk may reduce the amount of ineffectiveness that needs to be recorded in the income statement under IFRS compared to US GAAP.</p> <p>Under IFRS, portions of risks can be viewed as portions of the cash flows (e.g., excluding the credit spread from a fixed-rate bond in a fair value hedge of interest rate risk) or different types of financial risks, provided the types of risk are separately identifiable and effectiveness can be measured reliably.</p>

11.16 *Fair value hedge of interest rate risk in a portfolio of dissimilar items*

IFRS is more flexible than US GAAP with respect to the ability to achieve fair value hedge accounting in relation to interest rate risk within a portfolio of dissimilar items.

That difference is especially relevant for financial institutions that use such hedging as a part of managing overall exposure to interest rate risk and may result in risk management strategies that do not qualify for hedge accounting under US GAAP being reflected as hedges under IFRS.

US GAAP	IFRS
<p>US GAAP does not allow a fair value hedge of interest rate risk in a portfolio of dissimilar items.</p>	<p>IFRS allows a fair value hedge of interest rate risk in a portfolio of dissimilar items whereby the hedged portion may be designated as an amount of a currency, rather than as individual assets (or liabilities). Furthermore, an entity is able to incorporate changes in prepayment risk by using a simplified method set out in the guidance, rather than specifically calculating the fair value of the prepayment option on a (prepayable) item-by-item basis.</p> <p>In such a strategy, the change in fair value of the hedged item is presented in a separate line in the balance sheet and does not have to be allocated to individual assets or liabilities.</p>

11.17 *Firm commitment to acquire a business*

IFRS permits entities to hedge, with respect to foreign exchange risk, a firm commitment to acquire a business in a business combination, which is precluded under US GAAP.

US GAAP

US GAAP specifically prohibits a firm commitment to enter into a business combination, or acquire or dispose of a subsidiary, minority interest, or equity method investee, from qualifying as a hedged item for hedge accounting purposes (even if it is with respect to foreign currency risk).

IFRS

An entity is permitted to hedge foreign exchange risk to a firm commitment to acquire a business in a business combination only for foreign exchange risk.

11.18 *Foreign currency risk and location of hedging instruments*

In hedging forecasted transactions and net investments for foreign currency exposure, IFRS provides an opportunity for a parent to hedge the exposures of an indirect subsidiary regardless of the functional currency of intervening entities within the organizational structure.

US GAAP

Under the guidance, either the operating unit that has the foreign currency exposure is a party to the hedging instrument or another member of the consolidated group that has the same functional currency as that operating unit is a party to the hedging instrument. However, for another member of the consolidated group to enter into the hedging instrument, there may be no intervening subsidiary with a different functional currency.

IFRS

For foreign currency hedges of forecasted transactions, IFRS does not require the entity with the hedging instrument to have the same functional currency as the entity with the hedged item. At the same time, IFRS does not require that the operating unit exposed to the risk being hedged within the consolidated accounts be a party to the hedging instrument.

As such, IFRS allows a parent company with a functional currency different from that of a subsidiary to hedge the subsidiary's transactional foreign currency exposure.

The same flexibility regarding location of the hedging instrument applies to net investment hedges.

11.19 Hedging more than one risk

IFRS provides greater flexibility with respect to utilizing a single hedging instrument to hedge more than one risk in two or more hedged items.

That difference may allow entities to adopt new and sometimes more complex strategies to achieve hedge accounting while managing certain risks.

US GAAP	IFRS
<p>US GAAP does not allow a single hedging instrument to hedge more than one risk in two or more hedged items. US GAAP does not permit creation of a hypothetical component in a hedging relationship to demonstrate hedge effectiveness in the hedging of more than one risk with a single hedging instrument.</p>	<p>IFRS permits designation of a single hedging instrument to hedge more than one risk in two or more hedged items.</p> <p>A single hedging instrument may be designated as a hedge of more than one type of risk if the risks hedged can be identified clearly, the effectiveness of the hedge can be demonstrated, and it is possible to ensure that there is specific designation of the hedging instrument and different risk positions. In the application of this guidance, a single swap may be separated by inserting an additional (hypothetical) leg, provided that each portion of the contract is designated as a hedging instrument in a qualifying and effective hedge relationship.</p>

11.20 Cash flow hedges and basis adjustments on acquisition of nonfinancial items

In the context of a cash flow hedge, IFRS permits more flexibility regarding the presentation of amounts that have accumulated in equity (resulting from a cash flow hedge of nonfinancial assets and liabilities).

Therefore, the balance sheet impacts may be different depending on the policy election made by entities for IFRS purposes. The income statement impact, however, is the same regardless of this policy election.

US GAAP**IFRS**

In the context of a cash flow hedge, US GAAP does not permit basis adjustments. That is, under US GAAP, an entity is not permitted to adjust the initial carrying amount of the hedged item by the cumulative amount of the hedging instruments' fair value changes that were recorded in equity.

US GAAP does refer to "basis adjustments" in a different context wherein the term is used to refer to the method by which, in a fair value hedge, the hedged item is adjusted for changes in its fair value attributable to the hedged risk.

Under IFRS, "basis adjustment" commonly refers to an adjustment of the initial carrying value of a nonfinancial asset or nonfinancial liability that resulted from a forecasted transaction subject to a cash flow hedge. That is, the initial carrying amount of the nonfinancial item recognized on the balance sheet (i.e., the basis of the hedged item) is adjusted by the cumulative amount of the hedging instrument's fair value changes that were recorded in equity.

IFRS gives entities an accounting policy choice to either basis adjust the hedged item (if it is a nonfinancial item) or release amounts to profit or loss as the hedged item affects earnings.

11.21 Recent/proposed guidance

11.21.1 FASB Proposed Accounting Standards Update, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

The FASB is reconsidering the accounting for financial instruments, including hedge accounting. Among other things, the Board expects the project to result in simplification of the accounting requirements for hedging activities, resolve hedge accounting practice issues that have arisen under the current guidance, and make the hedge accounting model and associated disclosures more useful and understandable to financial statement users.

In this regard, on May 26, 2010, the FASB issued its exposure draft on financial instruments. The FASB proposed to carry forward many of its ideas contained in a 2008 exposure draft on hedge accounting. However, the FASB subsequently suspended work on the hedging project, while it focused on the other parts of the financial instruments project.

In November 2014, the FASB added the hedging project back to its technical agenda. In reactivating the project, the Board decided to make only targeted changes to the existing model in the following areas:

- Hedge effectiveness requirements
- Component hedging
- The shortcut and critical terms match methods
- Voluntary de-designations of hedge relationships

- Recording ineffectiveness
- Benchmark interest rates
- Simplifying hedge documentation requirements
- Presentation and disclosure of hedging instruments, hedged items, and ineffectiveness

An exposure draft on hedge accounting is expected to be issued by the end of 2015.

In February 2015 the FASB proposed Accounting Standards Update (ASU) on disclosures about hybrid financial instruments containing embedded derivatives. The proposed ASU would require certain additional disclosures by entities with hybrid financial instruments containing embedded derivatives that require bifurcation. The intent of the proposed disclosures is to allow users to better understand the linkage between bifurcated embedded derivatives and the related host contracts.

11.21.2 IASB's amendment of hedge accounting requirements

In November 2013, the IASB published the new general hedge accounting requirement added to IFRS 9 as a result of the third phase of its project to revise its financial instruments accounting model.

The IFRS model is more principle-based than the current IASB and US GAAP models and the US GAAP proposal, and aims to simplify hedge accounting. It would also align hedge accounting more closely with the risk management activities undertaken by companies and provide decision-useful information regarding an entity's risk management strategies.

The following key changes to the IAS 39 general hedge accounting model are contained in the IASB amendment:

- Replacement of the "highly" effective threshold as the qualifying criteria for hedging. Instead, an entity's designation of the hedging relationship should be based on the economic relationship between the hedged item and the hedging instrument, which gives rise to offset. Hedge ineffectiveness is still required to be measured and accounted for in earnings. The new standard defines hedge ratio to help entities align hedge accounting with its risk management strategy. It also introduces the concept of "rebalancing" to enable entities to maintain a hedge ratio without resulting in de-designation and re-designation. The objective of the IASB is to allow greater flexibility in qualifying for hedge accounting but also to ensure that entities do not systematically under-hedge to avoid recording any ineffectiveness.
- Ability to designate risk components of non-financial items as hedged items. The IASB's amendment would permit entities to hedge risk components for non-financial items, provided such components are separately identifiable and reliably measurable.
- Ability to designate as hedged items aggregated exposures that are a combination of an exposure and a derivative. When designating such a hedged item, an entity

assesses whether the aggregated exposure combines an exposure with a derivative so that it creates a different aggregated exposure that is managed as one exposure for a particular risk (or risks).

- More flexibility in hedging groups of dissimilar items (including net exposures). The IASB's amendment would allow hedges of (1) groups of similar items without a requirement that the fair value change for each individual item be proportional to the overall group (e.g., hedging a portfolio of S&P 500 shares with an S&P 500 future) as well as (2) groups of offsetting exposures (e.g., exposures resulting from forecast sale and purchase transactions). Additional qualifying criteria would be required for such hedges of offsetting exposures.
- Accounting for the time value component as "cost" of buying the protection when hedging with options in both fair value and cash flow hedges. The IASB's amendment introduces significant changes to the guidance related to the accounting for the time value of options. It analogizes the time value to an insurance premium. Hence, the time value would be recorded as an asset on day one and then released to net income based on the type of item the option hedges. The same accounting can be applied for forward points in a forward contract. Additionally, the concept of "cost" of hedging would be broadened to also incorporate the currency basis spread. This will help to reduce income statement volatility mainly in cash flow hedges of foreign currency risk.
- Prohibition of voluntary de-designation of the hedging relationship unless the risk management objective for such relationship changes. The IASB's amendment allows termination of the hedging relationship only if it is no longer viable for risk management purposes, or the hedging instrument is sold, expired, exercised, or terminated.
- Introduction of incremental disclosure requirements to provide users with useful information on the entity's risk management practices.
- Clarifying in the IFRS 9 Basis for Conclusions the relevance of the IAS 39 Implementation Guidance not carried forward to IFRS 9.
- Providing an accounting policy choice on the hedge accounting model to be applied. Entities may elect to continue applying the hedging model as per IAS 39 or to adopt IFRS 9. The accounting model must be applied as a whole (no cherry picking allowed).

The macro hedge accounting principles will be addressed as a separate project. In April 2014, the IASB issued a discussion paper (DP) on accounting for dynamic risk management: a portfolio revaluation approach to macro hedging ("macro hedging"). The DP addresses the accounting for dynamic risk management strategies on open portfolios (that is, portfolios that change over time). This project is still ongoing. In the meantime, if an entity transitions to IFRS 9 for hedge accounting, for a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities (and only for such a hedge), an entity may apply the hedge accounting requirements in IAS 39 instead of the new IFRS 9 requirements.

11.21.3 *FASB Accounting Standards Update No. 2014-03, Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swap—Simplified Hedge Accounting Approach*

In January 2014, the FASB issued ASU 2014-03 to provide private companies, other than financial institutions, not-for-profit entities, and employee benefit plans with an accounting alternative intended to make it easier for certain interest rate swaps to qualify for hedge accounting. Under the simplified hedge accounting approach, an eligible private company would be able to apply hedge accounting to its receive-variable, pay-fixed interest rate swaps as long as certain conditions are met. Existing guidance would be simplified in that a company electing this alternative would be able to (1) assume the cash flow hedge has no ineffectiveness, (2) delay completing its necessary hedge documentation, and (3) recognize the interest rate swap at its settlement value, which excludes non-performance risk, instead of at its fair value. The standard is effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015.

The IASB issued *IFRS for SMEs* in 2009 for non-public entities, where hedge accounting may be applied to a limited number of risks and hedging instruments. Although no quantitative effectiveness test is required, there must be an expectation that the hedge relationship will be highly effective. The hedge relationship must be designated and documented at inception. All derivative instruments are recognized at fair value.

11.21.4 *Balance sheet netting of derivatives and other financial instruments*

Further details on the balance sheet netting of derivatives and other financial instruments are described in the Assets—financial assets chapter.

Chapter 12: ***Consolidation***

12.1 Consolidation

IFRS is a principles-based framework, and the approach to consolidation reflects that structure. IFRS provides indicators of control, some of which individually determine the need to consolidate. However, where control is not apparent, consolidation is based on an overall assessment of all of the relevant facts, including the allocation of risks and benefits between the parties. The indicators provided under IFRS help the reporting entity in making that assessment. Consolidation in financial statements is required under IFRS when an entity is exposed to variable returns from another entity and has the ability to affect those returns through its power over the other entity.

US GAAP has a two-tier consolidation model: one focused on voting rights (the voting interest model) and the second focused on a qualitative analysis of power over significant activities and exposure to potentially significant losses or benefits (the variable interest model). Under US GAAP, all entities are first evaluated to determine whether they are variable interest entities (VIEs). If an entity is determined not to be a VIE, it is assessed on the basis of voting and other decision-making rights under the voting interest model.

Even in cases for which both US GAAP and IFRS look to voting rights to drive consolidation, differences can arise. Examples include cases in which de facto control (when a minority shareholder has the practical ability to exercise power unilaterally) exists and how the two frameworks address potential voting rights. As a result, careful analysis is required to identify any differences.

Differences in consolidation under US GAAP and IFRS may also arise when a subsidiary's set of accounting policies differs from that of the parent. While under US GAAP it is acceptable to apply different accounting policies within a consolidation group to address issues relevant to certain specialized industries, exceptions to the requirement to consistently apply standards in a consolidated group do not exist under IFRS. In addition, potential adjustments may occur in situations where a parent company has a fiscal year-end different from that of a consolidated subsidiary (and the subsidiary is consolidated on a lag). Under US GAAP, significant transactions in the gap period may require disclosure only, whereas IFRS may require recognition of transactions in the gap period in the consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, *Amendments to the Consolidation Analysis*, which amends the current consolidation guidance under US GAAP. These amendments become effective on January 1, 2016; however, when it becomes effective, consolidation conclusions will continue to be different under US GAAP and IFRS in certain circumstances. Refer to SD 12.19.1 for further discussion.

Technical references

US GAAP

ASC 205, ASC 323, ASC 323-10-15-8 through 15-11, ASC 325-20, ASC 810, ASC 810-10-25-1 through 25-14, ASC 810-10-60-4, SAB Topic 5H, SAB Topic 5H (2)-(6)

IFRS

IAS 1, IAS 27 (amended 2011), IAS 28 (amended 2011), IAS 36, IAS 39, IFRS 5, IFRS 10, IFRS 11, IFRS 12

Note

The following discussion captures a number of the more significant GAAP differences. It is important to note that the discussion is not inclusive of all GAAP differences in this area.

General requirements

12.2 Requirements to prepare consolidated financial statements

IFRS does not provide industry-specific exceptions (e.g., investment companies and broker/dealers) to the requirement for consolidation of controlled entities.

However, IFRS is, in limited circumstances, more flexible with respect to the ability to issue nonconsolidated financial statements (IAS 27, *Separate Financial Statements*). In addition, on adoption of the amendment to IFRS 10, entities that meet the definition of an investment entity would be prohibited from consolidating controlled investments except for certain circumstances.

US GAAP

The guidance applies to legal structures. Industry-specific guidance precludes consolidation of controlled entities by certain types of organizations, such as investment companies or broker/dealers.

In 2013, the FASB amended its definition of an investment company and specified that entities registered under the Investment Company Act of 1940 would qualify. Investment companies measure their investments at fair value, including any investments in which they have a controlling financial interest. While the FASB and the IASB definitions of an investment company/entity are converged in most areas, there are several key differences (see below). In addition, unlike the IASB standard, US GAAP retains the specialized investment company accounting in consolidation by a non-investment company parent.

IFRS

Parent entities prepare consolidated financial statements that include all subsidiaries. An exemption applies to a parent entity when all of the following conditions apply:

- It is a wholly owned subsidiary and the owners of the minority interests have been informed about and do not object to the parent not presenting consolidated financial statements
- The parent's debt or equity securities are not publicly traded and the parent is not in the process of issuing any class of instruments in public securities markets
- The ultimate or any intermediate parent of the parent publishes consolidated financial statements available for public use that comply with IFRS

US GAAP

Consolidated financial statements are presumed to be more meaningful and are required for SEC registrants.

There are no exemptions for consolidating subsidiaries in general-purpose financial statements.

IFRS

A subsidiary is not excluded from consolidation simply because the investor is a venture capital organization, mutual fund, unit trust, or similar entity.

However, an exception is provided for an investment entity from consolidating its subsidiaries unless those subsidiaries are providing investment-related services. Instead, the investment entity measures those investments at fair value through profit or loss. Unlike US GAAP, the exception from consolidation only applies to the financial reporting of an investment entity and that exception does not carry over for the financial reporting by a non-investment entity parent.

When separate (parent only) financial statements are prepared, investments in subsidiaries, joint ventures and associates are accounted for at cost or in accordance with IFRS 9. In 2014, an amendment to IAS 27 was issued allowing investments in subsidiaries, joint ventures and associates to be accounted for under the equity method in separate financial statements. This amendment is effective for annual periods beginning on or after January 1, 2016 with early application permitted, and must be applied on a retrospective basis.

12.3 Investment company/entity definition

The US GAAP and IFRS definitions of an investment entity are substantially converged; however, differences do exist.

US GAAP

An investment company is an entity with the following fundamental characteristics:

- It is an entity that does both of the following:
 - Obtains funds from one or more investors and provides the investor(s) with investment management services

IFRS

The IFRS definition of an investment entity is substantially converged with the US GAAP definition with the following exceptions:

- The IFRS definition requires an entity to measure and evaluate the performance of substantially all of its investments on a fair value basis

US GAAP**IFRS**

- | | |
|--|--|
| <ul style="list-style-type: none"> ○ Commits to its investor(s) that's its business purpose and only substantive activities are investing the funds solely for returns from capital appreciation, investment income, or both □ The entity or its affiliates do not obtain or have the objective of obtaining returns or benefits from an investee or its affiliates that are not normally attributable to ownership interests or that are other than capital appreciation or investment income | <ul style="list-style-type: none"> □ The IFRS definition does not provide for entities that are subject to certain regulatory requirements (such as the Investment Company Act of 1940) to qualify as investment entities without meeting the stated criteria |
|--|--|

An investment company would also be expected to have all of the following typical characteristics:

- It has more than one investment
- It has more than one investor
- It has investors that are not related parties of the parent and the investment manager
- It has ownership interests in the form of equity or partnership interests
- It manages substantially all of its investments on a fair value basis

An entity may still be considered an investment company if it does not exhibit one or more of the typical characteristics, depending on facts and circumstances.

All entities subject to the Investment Company Act of 1940 are investment companies.

12.4 Consolidation model

Differences in consolidation under current US GAAP and IFRS can arise as a result of:

- Differences in how economic benefits are evaluated when the consolidation assessment considers more than just voting rights (i.e., differences in methodology)
- Specific differences or exceptions, such as:
 - The consideration of variable interests
 - De facto control

- How potential voting rights are evaluated
- Guidance related to de facto agents and related parties
- Reconsideration events

US GAAP**IFRS**

All consolidation decisions are evaluated first under the VIE model. US GAAP requires an entity with a variable interest in a VIE to qualitatively assess the determination of the primary beneficiary of the VIE.

In applying the qualitative model, an entity is deemed to have a controlling financial interest if it meets both of the following criteria:

- Power to direct activities of the VIE that most significantly impact the VIE's economic performance (power criterion)
- Obligation to absorb losses from or right to receive benefits of the VIE that could potentially be significant to the VIE (losses/benefits criterion)

In assessing whether an enterprise has a controlling financial interest in an entity, it should consider the entity's purpose and design, including the risks that the entity was designed to create and pass through to its variable interest holders.

Only one enterprise, if any, is expected to be identified as the primary beneficiary of a VIE. Although more than one enterprise could meet the losses/benefits criterion, only one enterprise, if any, will have the power to direct the activities of a VIE that most significantly impact the entity's economic performance.

Increased skepticism should be given to situations in which an enterprise's economic interest in a VIE is disproportionately greater than its stated power to direct the activities of the VIE that most significantly impact the entity's economic performance. As the level of disparity increases, the level of skepticism about an enterprise's lack of power is expected to increase.

IFRS focuses on the concept of control in determining whether a parent-subsidary relationship exists.

An investor controls an investee when it has all of the following:

- Power, through rights that give it the current ability, to direct the activities that significantly affect (the relevant activities that affect) the investee's returns
- Exposure, or rights, to variable returns from its involvement with the investee (returns must vary and can be positive, negative, or both)
- The ability to use its power over the investee to affect the amount of the investor's returns

In assessing control of an entity, an investor should consider the entity's purpose and design to identify the relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities, and who is exposed or has rights to the returns from those activities. Only substantive rights can provide power.

The greater an investor's exposure to variability of returns, the greater its incentive to obtain rights to give it power, i.e., it is an indicator of power and is not by itself determinative of having power.

US GAAP

All other entities are evaluated under the voting interest model. Unlike IFRS, only actual voting rights are considered. Under the voting interest model, control can be direct or indirect. In certain unusual circumstances, control may exist with less than 50 percent ownership, when contractually supported. The concept is referred to as effective control.

De facto control concept

No de facto control concept exists. Effective control as described above is limited to contractual arrangements.

Potential voting rights

No specific guidance exists requiring the consideration of potential voting rights.

IFRS

When an entity is controlled by voting rights, control is presumed to exist when a parent owns, directly or indirectly, more than 50 percent of an entity's voting power. Control also exists when a parent owns half or less of the voting power but has legal or contractual rights to control either the majority of the entity's voting power or the board of directors. Control may exist even in cases where an entity owns little or none of a structured equity. The application of the control concept requires, in each case, judgment in the context of all relevant factors.

De facto control concept

An investor can control an entity where it holds less than 50 percent of the voting rights of the entity and lacks legal or contractual rights by which to control the majority of the entity's voting power or board of directors (de facto control). An example of de facto control is when a major shareholder holds an investment in an entity with an otherwise dispersed public shareholding. The assertion of de facto control is evaluated on the basis of all relevant facts and circumstances, including the legal and regulatory environment, the nature of the capital market, and the ability of the majority owners of voting shares to vote together.

Potential voting rights

IFRS requires potential voting rights to be considered in the assessment of power if they are substantive. Sometimes rights can be substantive even though not currently exercisable. To be substantive, rights need to be exercisable when decisions about the relevant activities need to be made.

US GAAP**IFRS****Shared power**

Current US GAAP for VIEs notes that power is shared, and consequently no party consolidates, when two or more unrelated parties together have power to direct the entity's activities that most significantly impact the entity's economic performance and decisions about those activities require the consent of each party sharing the power.

Agent versus principal analysis

Current US GAAP for VIEs includes specific guidance to determine whether the remuneration of a decision maker is considered a variable interest in the entity. For limited partnerships or similar entities that are not VIEs, US GAAP presumes that the general partner controls the entity, although that presumption of control can be overcome if the limited partners possess substantive rights to remove the general partner or liquidate the entity.

Shared power

IFRS includes the concept of shared power by noting that two or more investors collectively control an entity and do not individually control when they must act together to direct the relevant activities. Note that if there is joint control (which is different from collective control) then the standard on joint arrangements (IFRS 11) applies.

Agent versus principal analysis

IFRS includes guidance on agent/principal relationships. An agent may be engaged to act on behalf of a single party or a group of investors (principals). Certain power is delegated by the principals to the agent. An agent does not consolidate the entity. Instead, the principal shall treat the decision-making rights delegated to the agent as held by the principal directly. Where there is more than one principal, each shall assess whether it has power over the investee.

Four key factors need to be considered when determining whether the investor is acting as an agent, as follows:

Indicators relating to power:

- the scope of its decision-making authority, and
- the rights held by other parties.
- Indicators relating to exposure to variable returns:
 - the remuneration it receives, and
 - exposure to variability of returns from other interests that it holds in the entity.

US GAAP**IFRS****Related parties and de facto agents**

US GAAP includes specific guidance on interests held by related parties. A related party group includes the reporting entity's related parties and de facto agents (e.g., close business advisors, partners, employees) whose actions are likely to be influenced or controlled by the reporting entity.

Individual parties within a related party group (including de facto agency relationships) are required to first separately consider whether they meet both the power and losses/benefits criteria. If one party within the related party group meets both criteria, it is the primary beneficiary of the VIE. If no party within the related party group on its own meets both criteria, the determination of the primary beneficiary within the related party group is based on an analysis of the facts and circumstances, with the objective of determining which party is most closely associated with the VIE.

Reconsideration events

Determination of whether an entity is a VIE gets reconsidered either when a specific reconsideration event occurs or, in the case of a voting interest entity, when voting interests or rights change.

However, the determination of a VIE's primary beneficiary is an ongoing assessment.

Related parties and de facto agents

IFRS requires that an investor consider the nature of rights and exposures held by related parties and others to determine if they are acting as de facto agents. Rights and exposures held by de facto agents would need to be considered together with the investor's own rights and exposures in the consolidation analysis. However, there is no related party tiebreaker guidance as contained in US GAAP to address situations where no party in a related party group controls an entity on a stand-alone basis but the related party group as a whole controls the entity.

Reconsideration events

IFRS 10 requires the consolidation analysis to be reassessed when facts and circumstances indicate that there are changes to one or more of the elements of the control definition.

US GAAP**IFRS****Silos**

Although US GAAP applies to legal structures, guidance is provided to address circumstances in which an entity with a variable interest shall treat a portion of the entity as a separate VIE if specific assets or activities (a silo) are essentially the only source of payment for specified liabilities or specified other interests. A party that holds a variable interest in the silo then assesses whether it is the silo's primary beneficiary. The key distinction is that the US GAAP silo guidance applies only when the larger entity is a VIE.

Silos

IFRS incorporates guidance for silos that is similar to US GAAP; however, the silo guidance under IFRS applies regardless of whether the larger entity is a VIE.

12.5 Accounting policies and reporting periods

In relation to certain specialized industries, US GAAP allows more flexibility for use of different accounting policies within a single set of consolidated financial statements.

In the event of nonuniform reporting periods, the treatment of significant transactions in any gap period varies under the two frameworks, with the potential for earlier recognition under IFRS.

US GAAP**IFRS**

Consolidated financial statements are prepared by using uniform accounting policies for all of the entities in a group. Limited exceptions exist when a subsidiary has specialized industry accounting principles. Retention of the specialized accounting policy in consolidation is permitted in such cases.

Consolidated financial statements are prepared by using uniform accounting policies for like transactions and events in similar circumstances for all of the entities in a group.

The consolidated financial statements of the parent and the subsidiary are usually drawn up at the same reporting date. However, the consolidation of subsidiary accounts can be drawn up at a different reporting date, provided the difference between the reporting dates is no more than three months. Recognition is given, by disclosure or adjustment, to the effects of intervening events that would materially affect consolidated financial statements.

The consolidated financial statements of the parent and the subsidiary are usually drawn up at the same reporting date. However, the subsidiary accounts as of a different reporting date can be consolidated, provided the difference between the reporting dates is no more than three months. Adjustments are made to the financial statements for significant transactions that occur in the gap period.

Equity investments/investments in associates and joint ventures

12.6 Potential voting rights

The consideration of potential voting rights might lead to differences in whether an investor has significant influence.

US GAAP

Potential voting rights are generally not considered in the assessment of whether an investor has significant influence.

IFRS

Potential voting rights are considered in determining whether the investor exerts significant influence over the investee. Potential voting rights are important in establishing whether the entity is an associate. Potential voting rights are not, however, considered in the measurement of the equity earnings recorded by the investor.

12.7 Definition and types of joint ventures

Differences in the definition or types of joint ventures may result in different arrangements being considered joint ventures, which could affect reported figures, earnings, ratios, and covenants.

US GAAP

The term *joint venture* refers only to jointly controlled entities, where the arrangement is carried on through a separate entity.

A *corporate joint venture* is defined as a corporation owned and operated by a small group of businesses as a separate and specific business or project for the mutual benefit of the members of the group.

Most joint venture arrangements give each venturer (investor) participating rights over the joint venture (with no single venturer having unilateral control), and each party sharing control must consent to the venture's operating, investing, and financing decisions.

IFRS

A *joint arrangement* is a contractual agreement whereby two or more parties undertake an economic activity that is subject to joint control. *Joint control* is the contractually agreed sharing of control of an economic activity. Unanimous consent is required of the parties sharing control, but not necessarily of all parties in the venture.

IFRS classifies joint arrangements into two types:

- Joint operations, which give parties to the arrangement direct rights to the assets and obligations for the liabilities
 - Joint ventures, which give the parties rights to the net assets or outcome of the arrangement
-

12.8 Accounting for joint arrangements

Under IFRS, classification of joint arrangement as a joint venture or a joint operation determines the accounting by the investor. Under US GAAP, the proportional consolidation method is allowed for entities in certain industries.

US GAAP

Prior to determining the accounting model, an entity first assesses whether the joint venture is a VIE. If the joint venture is a VIE, the accounting model discussed earlier is applied. Joint ventures often have a variety of service, purchase, and/or sales agreements, as well as funding and other arrangements that may affect the entity's status as a VIE. Equity interests are often split 50-50 or near 50-50, making nonequity interests (i.e., any variable interests) highly relevant in consolidation decisions. Careful consideration of all relevant contracts and governing documents is critical in the determination of whether a joint venture is within the scope of the variable interest model and, if so, whether consolidation is required.

If the joint venture is not a VIE, venturers apply the equity method to recognize the investment in a jointly controlled entity. Proportionate consolidation is generally not permitted except for unincorporated entities operating in certain industries. A full understanding of the rights and responsibilities conveyed in management, shareholder, and other governing documents is necessary.

IFRS

The classification of a joint arrangement as a joint venture or a joint operation determines the investor's accounting. An investor in a joint venture must account for its interest using the equity method in accordance with IAS 28.

An investor in a joint operation accounts for its share of assets, liabilities, income and expenses based on its direct rights and obligations.

12.9 *Accounting for contributions to a jointly controlled entity*

Gain recognition upon contribution to a jointly controlled entity is more likely under IFRS.

US GAAP

As a general rule, a venturer records its contributions to a joint venture at cost (i.e., the amount of cash contributed and the carrying value of other nonmonetary assets contributed).

When a venturer contributes appreciated noncash assets and others have invested cash or other hard assets, it might be appropriate to recognize a gain for a portion of that appreciation. Practice and existing literature vary in this area. As a result, the specific facts and circumstances affect gain recognition and require careful analysis.

IFRS

A venturer that contributes nonmonetary assets—such as shares; property, plant, and equipment; or intangible assets—to a jointly controlled entity in exchange for an equity interest in the jointly controlled entity generally recognizes in its consolidated income statement the portion of the gain or loss attributable to the equity interests of the other venturers, except when:

- The significant risks and rewards of ownership of the contributed assets have not been transferred to the jointly controlled entity,
- The gain or loss on the assets contributed cannot be measured reliably, or
- The contribution transaction lacks commercial substance.

Note that where the nonmonetary asset is a business, a policy choice is currently available for full or partial gain or loss recognition.

IAS 28 (Amended 2011) provides an exception to the recognition of gains or losses only when the transaction lacks commercial substance.

12.10 *Equity method of accounting—exemption from applying the equity method*

An exemption from applying the equity method of accounting (i.e., use of the fair value through profit or loss option) is available to a broader group of entities under US GAAP.

US GAAP**IFRS**

Equity method investments are considered financial assets and therefore are eligible for the fair value accounting option. An entity can measure an investment in associates or joint ventures at fair value through profit or loss, regardless of whether it is a venture capital or similar organization.

An entity can only elect fair value through profit or loss accounting for equity method investments held by venture capital organizations, mutual funds, unit trusts, and similar entities, including investment-linked insurance funds. In other instances, an entity must apply the equity method to its investments in associates and joint ventures unless it is exempt from preparing consolidated financial statements.

12.11 *Equity method of accounting—classification as held for sale*

Application of the equity method of accounting may cease before significant influence is lost under IFRS (but not under US GAAP).

US GAAP**IFRS**

Under US GAAP, equity method investments are not classified as held for sale. An investor applies equity method accounting until significant influence is lost.

If an equity method investment meets the held for sale criteria in accordance with IFRS 5, an investor records the investment at the lower of its (1) fair value less costs to sell or (2) carrying amount as of the date the investment is classified as held for sale.

12.12 *Equity method of accounting—acquisition date excess of investor's share of fair value over cost*

IFRS may allow for day one gain recognition (whereas US GAAP would not).

US GAAP**IFRS**

Any acquisition date excess of the investor's share of the net fair value of the associate's identifiable assets and liabilities over the cost of the investment is included in the basis differences and is amortized—if appropriate—over the underlying asset's useful life. If amortization is not appropriate, the difference is included in the gain/loss upon ultimate disposition of the investment.

Any acquisition date excess of the investor's share of net fair value of the associates' identifiable assets and liabilities over the cost of the investment is recognized as income in the period in which the investment is acquired.

12.13 *Equity method of accounting—conforming accounting policies*

A greater degree of conformity is required under IFRS.

US GAAP	IFRS
The equity investee's accounting policies do not have to conform to the investor's accounting policies if the investee follows an acceptable alternative US GAAP treatment.	An investor's financial statements are prepared using uniform accounting policies for similar transactions and events. This also applies to equity method investees.

12.14 *Equity method of accounting—impairment*

Impairment losses may be recognized earlier, and potentially may be reversed, under IFRS.

US GAAP	IFRS
An investor should determine whether a loss in the fair value of an investment below its carrying value is a temporary decline. If it is other than temporary, the investor calculates an impairment as the excess of the investment's carrying amount over the fair value.	An investor should assess whether impairment indicators exist, in accordance with IAS 39. If there are indicators that the investment may be impaired, the investment is tested for impairment in accordance with IAS 36. The concept of a temporary decline does not exist under IFRS.
Reversals of impairments on equity method investments are prohibited.	Impairments of equity method investments can be reversed in accordance with IAS 36.

12.15 *Equity method of accounting—losses in excess of an investor's interest*

Losses may be recognized earlier under US GAAP.

US GAAP	IFRS
Even without a legal or constructive obligation to fund losses, a loss in excess of the investment amount (i.e., a negative or liability investment balance) should be recognized when the imminent return to profitable operations by an investee appears to be assured.	Unless an entity has incurred a legal or constructive obligation, losses in excess of the investment are not recognized. The concept of an imminent return to profitable operations does not exist under IFRS.

12.16 *Equity method of accounting—loss of significant influence or joint control*

The potential for greater earnings volatility exists under IFRS.

US GAAP

Upon the loss of significant influence or joint control, any retained interest is measured at the carrying amount of the investment at the date of the change in status.

IFRS

If an entity loses significant influence or joint control over an equity method investment and the retained interest is a financial asset, the entity should measure the retained interest at fair value. The resultant gain or loss is recognized in the income statement.

In contrast, if an investment in an associate becomes an investment in a joint venture, or vice versa, such that the equity method of accounting continues to apply, no gain or loss is recognized in the income statement.

12.17 *Accounting for investments in qualified affordable housing projects*

US GAAP permits reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met.

US GAAP

An investor that owns a passive investment in limited liability entities that manage or invest in qualified affordable housing projects can use the proportional amortization method if certain conditions are met.

Under the proportional amortization method, the initial cost of the investment is amortized in proportion to the tax benefits received over the period that the investor expects to receive the tax credits and other benefits.

IFRS

IFRS does not contain any guidance specific to accounting for investments in qualified affordable housing projects.

US GAAP**IFRS**

Both the amortization expense determined under the proportional amortization method and the tax benefits received will be recognized as a component of income taxes.

Use of the proportional amortization method for investments that meet the requisite conditions is an accounting policy election. Once elected, the proportional amortization method should be applied to all qualifying investments.

Disclosure**12.18 Disclosures**

US GAAP and IFRS both require extensive disclosure about an entity's involvement in VIEs/structured entities, including those that are not consolidated.

US GAAP**IFRS**

Guidance applies to both nonpublic and public enterprises.

The principal objectives of VIE disclosures are to provide financial statement users with an understanding of the following:

- Significant judgments and assumptions made by an enterprise in determining whether it must consolidate a VIE and/or disclose information about its involvement in a VIE
- The nature of restrictions on a consolidated VIE's assets and on the settlement of its liabilities reported by an enterprise in its statement of financial position, including the carrying amounts of such assets and liabilities

IFRS has disclosure requirements for interests in subsidiaries, joint arrangements, associates, and unconsolidated structured entities which include the following:

- Significant judgments and assumptions in determining if an investor has control or joint control over another entity, and the type of joint arrangement
- The composition of the group and interests that non-controlling interests have in the group's activities and cash flows
- The nature and extent of any significant restrictions on the ability of the investor to access or use assets, and settle liabilities
- The nature and extent of an investor's interest in unconsolidated structured entities

US GAAP

- The nature of, and changes in, the risks associated with an enterprise's involvement with the VIE
- How an enterprise's involvement with the VIE affects the enterprise's financial position, financial performance, and cash flows

The level of disclosure to achieve these objectives may depend on the facts and circumstances surrounding the VIE and the enterprise's interest in that entity.

Additional detailed disclosure guidance is provided for meeting the objectives described above.

Specific disclosures are required for (1) a primary beneficiary of a VIE and (2) an entity that holds a variable interest in a VIE (but is not the primary beneficiary).

IFRS

- The nature of, and changes in, the risks associated with an investor's interest in consolidated and unconsolidated structured entities
- The nature, extent and financial effects of an investors' interests in joint arrangements and associates, and the nature of the risks associated with those interests
- The consequences of changes in ownership interest of a subsidiary that do not result in loss of control
- The consequences of a loss of control of a subsidiary during the period

An entity is required to consider the level of detail necessary to satisfy the disclosure objectives of enabling users to evaluate the nature and associated risks of its interests, and the effects of those interests on its financial statements.

Additional detailed disclosure guidance is provided for meeting the objectives described above.

If control of a subsidiary is lost, the parent shall disclose the gain or loss, if any, and:

- Portion of that gain or loss attributable to recognizing any investment retained in former subsidiary at its fair value at date when control is lost
- Line item(s) in the statement of comprehensive income in which the gain or loss is recognized (if not presented separately in the statement of comprehensive income)

Additional disclosures are required in instances when separate financial statements are prepared for a parent that elects not to prepare consolidated financial statements, or when a parent, venturer with an interest in a jointly controlled entity, or investor in an associate prepares separate financial statements.

12.19 Recent/proposed guidance

12.19.1 FASB Accounting Standards Update No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis

In February 2015, the FASB issued guidance that makes targeted amendments to the current consolidation guidance and ends the deferral granted to investment companies from applying the variable interest entity (VIE) guidance. This new guidance applies to entities in all industries and provides a new scope exception to registered money market funds and similar unregistered money market funds. Some of the more notable amendments are summarized below.

12.19.1.1 Determining whether an entity is a variable interest entity (VIE)

The standard does not add or remove any of the five characteristics that determine if an entity is a VIE. However, it does change the manner in which a reporting entity assesses one of the characteristics. In particular, when decision-making over the entity's most significant activities has been outsourced, the standard changes how a reporting entity assesses if the equity holders at risk lack decision making rights. The new guidance requires that the reporting entity first consider the rights of all of the equity holders at risk. If the equity holders have certain rights that are deemed to give them the power to direct the entity's most significant activities, then the entity does not have this VIE characteristic.

The new guidance also introduces a separate analysis specific to limited partnerships and similar entities for assessing if the equity holders at risk lack decision making rights. Limited partnerships and similar entities will be VIEs unless the limited partners hold substantive kick-out rights or participating rights. In order for such rights to be substantive, they must be exercisable by a simple majority vote (or less) of all of the partners (exclusive of the general partner and its related parties).

The guidance for limited partnerships under the voting model has been eliminated in conjunction with the introduction of this separate analysis, including the rebuttable presumption that a general partner unilaterally controls a limited partnership and should therefore consolidate it. A limited partner with a controlling financial interest obtained through substantive kick out rights would consolidate a limited partnership.

12.19.1.2 Fees paid to a decision maker or a service provider

A precondition to assessing whether an entity needs to be consolidated is that the reporting entity must have a variable interest in the entity. For an outsourced decision maker or service provider, current GAAP provides six criteria that must be met for a fee arrangement to not be a variable interest. The new guidance eliminates three of the six criteria, and as a result, focuses on whether the fees are "market-based" and "commensurate" with the services provided.

Under the VIE model, the primary beneficiary is defined as the party that has both the power to direct the most significant activities (the "power" test) and the potential for significant economic exposure (the "economics" test). A decision maker fee that is

both market-based and commensurate would be excluded when applying the economics test to determine the primary beneficiary.

12.19.1.3 *Related parties*

Under the new guidance, a reporting entity that meets the power test will also include “indirect interests” – interests held through related parties – on a proportionate basis to determine whether it meets the economics test and is the primary beneficiary on a standalone basis.

In addition to incorporating related party interests earlier in the analysis for a party with power, the new guidance reduces situations where the “related party tiebreaker” test is performed. The new guidance limits the application of the tiebreaker test to when (1) power is shared among related parties, or (2) the power test is met by a single party and related parties that are under common control meet the economics test. The new guidance also requires that if a single party meets the power test, but substantially all of the VIE’s activities are being conducted on behalf of one party in the related party group, then that party would consolidate.

12.19.1.4 *What’s next?*

The standard is effective for public business entities for annual periods beginning after December 15, 2015. Nonpublic business entities are required to apply the standard for annual periods beginning after December 15, 2016. Early adoption is allowed, including in any interim period.

12.19.2 *FASB Accounting Standards Update No. 2014-13, Consolidation (Topic 810): Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity*

In August 2014, the FASB issued guidance that provides an alternative for measuring the financial assets and financial liabilities of a collateralized financing entity (CFE) that is consolidated by a reporting entity.

Under current GAAP, if a reporting entity elects the fair value option, financial assets and financial liabilities of the CFE must be measured separately at their fair values. As a result, the aggregate fair value of the financial assets may differ from the aggregate fair value of the financial liabilities. This guidance allows the use of the more observable of the fair value of the financial assets or the fair value of the financial liabilities of the CFE to measure both. This guidance eliminates the measurement difference that may exist when the financial assets and the financial liabilities are measured independently at fair value.

For those reporting entities that apply the fair value option and do not adopt this measurement alternative, this guidance also clarifies how to account for the differences between the fair values of the financial assets and liabilities of consolidated CFEs.

This guidance will be effective in 2016 for calendar year-end public business entities and 2017 for all other calendar year-end entities. Early adoption is permitted as of the beginning of an annual period.

12.19.3 FASB Accounting Standards Update No. 2014-10, Development Stage Entities (Topic 915): Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810, Consolidation

In June 2014, the FASB issued guidance that eliminates the concept of a development stage entity (DSE) in its entirety from current accounting guidance. Amendments to the consolidation guidance may result in more DSEs being considered variable interest entities (VIEs).

This guidance eliminates the following:

- Current incremental reporting requirements for a DSE, including inception-to-date information.
- The relief provided to DSEs when evaluating the sufficiency of equity at risk criterion in the VIE consolidation model.

By eliminating the relief in the current consolidation guidance, reporting entities that invest in DSEs would need to consider whether a DSE has sufficient equity at risk to fund its current and ongoing activities. This will likely result in more entities being deemed to be VIEs and may change previous consolidation conclusions.

The amendment to the consolidation guidance is effective for public business entities for annual reporting periods beginning after December 15, 2015, and interim periods therein. For all other entities, the amendment is effective for annual reporting periods beginning after December 15, 2016, and interim reporting periods beginning after December 15, 2017. The changes are to be applied to existing investments as of the date of adoption. Retrospective application is required and early adoption is permitted.

12.19.4 IASB amendments to IAS 27, Separate Financial Statements: Equity Method in Separate Financial Statements

In August 2014, the IASB issued an amendment allowing entities to account for their investments in subsidiaries, joint ventures and associates under the equity method of accounting in separate (parent only) financial statements. Today, these investments are required to be accounted for at cost or under IFRS 9, *Financial Instruments* in an entity's separate financial statements. The standard should be applied retrospectively for annual periods beginning on or after January 1, 2016. Early application is allowed.

12.19.5 IASB amendments to IFRS 10, Consolidated Financial Statements; IFRS 12, Disclosure of Interests in Other Entities; and IAS 28, Investments in Associates and Joint Ventures: Investment Entities: Applying the Consolidation Exception

In December 2014, the IASB issued an amendment to IFRS 10 and IAS 28 to clarify the application of the consolidation exception for investment entities and their subsidiaries.

The amendments to IFRS 10 clarify that:

- The exception from preparing consolidated financial statements is available to intermediate parent entities which are subsidiaries of investment entities. The exception is available when the investment entity parent measures its subsidiaries at fair value.
- An investment entity should consolidate a subsidiary which is not an investment entity and whose main purpose and activity is to provide services in support of the investment entity's activities. However, the amendments confirm that if the subsidiary is itself an investment entity, the investment entity parent should measure its investment in the subsidiary at fair value through profit or loss. This approach is required regardless of whether the subsidiary provides investment related services to the parent or to third parties.

The amendments to IAS 28 allow an entity which is not an investment entity, but has an interest in an associate or joint venture which is an investment entity, a policy choice when applying the equity method of accounting. The entity may choose to retain the fair value measurement applied by the investment entity associate or joint venture, or to unwind the fair value measurement and instead perform a consolidation at the level of the investment entity associate or joint venture.

The amendments to IFRS 10 and IAS 28 are effective from January 1, 2016. Earlier application is permitted.

12.19.6 IASB amendments to IFRS 10, Consolidated Financial Statements and IAS 28, Investments in Associates and Joint Ventures: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

In September 2014, the IASB issued an amendment to IFRS 10 and IAS 28 to clarify the accounting treatment for sales or contribution of assets between an investor and its associates or joint ventures.

The amendments resolve a current inconsistency between IFRS 10 and IAS 28. The accounting treatment depends on whether the nonmonetary assets sold or contributed to an associate or joint venture constitute a 'business.'

Full gain or loss will be recognized by the investor when the nonmonetary assets constitute a 'business.' If the assets do not meet the definition of a business, the gain or loss is recognized by the investor to the extent of the other investors' interests.

The amendments to IFRS 10 and IAS 28 are prospective and are effective from January 1, 2016. Earlier application is permitted. If an entity applies these amendments earlier, it should disclose that fact.

12.19.7 IASB proposed amendments to IFRS 10, Consolidated Financial Statements; IFRS 12, Disclosure of Interests in Other Entities; IAS 27, Separate Financial Statements; IAS 28, Investments in Associates and Joint Ventures; IAS 36, Impairment of Assets; and Illustrative Examples for IFRS 13, Fair Value Measurements: Measuring Quoted Investments in Subsidiaries, Joint Ventures, and Associates at Fair Value

In September 2014, the IASB issued an exposure draft to address questions received on the unit of account for investments in subsidiaries, joint ventures, and associates and on their fair value measurement when those investments are quoted in an active market (quoted investments). The IASB also addressed questions on the measurement of the recoverable amount of cash-generating units (CGUs) on the basis of fair value less costs of disposal when they correspond to entities that are quoted in an active market (quoted CGUs).

The proposed amendments clarify that an entity should measure the fair value of quoted investments and quoted CGUs as the product of the quoted price for the individual financial instruments that make up the investments held by the entity and the quantity of financial instruments.

Comments on the exposure draft were due on January 1, 2015 and the IASB is currently in redeliberations.

12.19.8 IASB amendments to IFRS 11, Joint Arrangements: Accounting for Acquisitions of Interests in Joint Operations

In May 2014, the IASB issued an amendment to IFRS 11 to address the accounting for the acquisition of an interest in a joint operation that constitutes a business. The amendment requires that acquirers of such interests apply the relevant principles on business combination accounting contained in IFRS 3, *Business Combinations*, and other standards, and disclose the related information required under those standards. A joint operator that increases its interest in a joint operation that constitutes a business should not remeasure previously held interests in the joint operation when joint control is retained. The standard should be applied prospectively for annual periods beginning on or after January 1, 2016. Early application is allowed.

Chapter 13:
Business combinations

13.1 *Business combinations*

IFRS and US GAAP are largely converged in this area. The business combinations standards under US GAAP and IFRS are close in principles and language. However, some differences remain between US GAAP and IFRS pertaining to (1) the definition of control, (2) recognition of certain assets and liabilities based on the reliably measurable criterion, (3) accounting for contingencies, and (4) accounting for noncontrolling interests. Significant differences also continue to exist in subsequent accounting. Different requirements for impairment testing and accounting for deferred taxes (e.g., the recognition of a valuation allowance) are among the most significant.

Technical references

US GAAP

ASC 205-20, ASC 350-10, ASC 350-20, ASC 350-30, ASC 360-10, ASC 805, ASC 810

IFRS

IAS 12, IAS 38, IAS 39, IFRS 2, IFRS 3, IFRS 10, IFRS 13

PwC Guide

Business combinations and noncontrolling interests, 2014 global edition

Note

The following discussion captures a number of the more significant GAAP differences. It is important to note that the discussion is not inclusive of all GAAP differences in this area.

Determining whether the acquisition method should be applied

13.2 *Definition of control*

Determining whether the acquisition method applies to a transaction begins with understanding whether the transaction involves the acquisition of one or more businesses and whether it is a business combination within the scope of the business combinations guidance.

The business combinations guidance states that for a business combination to occur, an acquirer must obtain control over a business. US GAAP and IFRS define control differently. Consequently, the same transaction may be accounted for as a business combination under US GAAP, but not under IFRS, or vice versa. The table below highlights various considerations in determining control under US GAAP and IFRS.

US GAAP

Consolidation decisions are evaluated first under the variable interest entity model.

- Qualitatively assess if the variable interest meets both criteria:
 - Power to direct activities that most significantly impact economic performance
 - Potential to receive significant benefits or absorb significant losses

All other entities are evaluated under the voting interest model.

See SD 12 for further information on the concept of control and the consolidation model under US GAAP.

IFRS

An investor has control over an investee when all of the following elements are present:

- Power over the investee
- Exposure, or rights, to variable returns from its involvement with the investee
- Ability to use power to affect the returns

See SD 12 for further information on the concept of control and the consolidation model under IFRS.

Acquired assets and liabilities

13.3 Acquired contingencies

There are significant differences related to the recognition of contingent liabilities and contingent assets.

US GAAP

Acquired assets and liabilities subject to contingencies are recognized at fair value if fair value can be determined during the measurement period. If fair value cannot be determined, companies should typically account for the acquired contingencies using existing guidance. If recognized at fair value on acquisition, an acquirer should develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature.

IFRS

The acquiree's contingent liabilities are recognized at the acquisition date provided their fair values can be measured reliably. The contingent liability is measured subsequently at the higher of the amount initially recognized less, if appropriate, cumulative amortization recognized under the revenue guidance (IAS 18) or the best estimate of the amount required to settle (under the provisions guidance—IAS 37). Contingent assets are not recognized.

13.4 Assignment/allocation and impairment of goodwill

The definition of the levels at which goodwill is assigned/allocated and tested for impairment varies between the two frameworks and might not be the same.

Additional differences in the impairment testing methodologies could create further variability in the timing and extent of recognized impairment losses.

US GAAP

Goodwill is assigned to an entity's reporting units, as defined within the guidance.

Goodwill is tested for impairment at least on an annual basis and between annual tests if an event occurs or circumstances change that may indicate an impairment.

When performing the goodwill impairment test, an entity may first assess qualitative factors to determine whether the two-step goodwill impairment test is necessary. If the entity determines, based on the qualitative assessment, that it is more likely than not that the fair value of a reporting unit is below its carrying amount, the two-step impairment test is performed. An entity can bypass the qualitative assessment for any reporting unit in any period and proceed directly to Step 1 of the two-step goodwill impairment test:

- In Step 1, the fair value and the carrying amount of the reporting unit, including goodwill, are compared. If the fair value of the reporting unit is less than the carrying amount, Step 2 is completed to determine the amount of the goodwill impairment loss, if any.
- Goodwill impairment is measured as the excess of the carrying amount of goodwill over its implied fair value. The implied fair value of goodwill—calculated in the same manner that goodwill is determined in a business combination—is the difference between the fair value of the reporting unit and the fair value of the various assets and liabilities included in the reporting unit.

Any loss recognized is not permitted to exceed the carrying amount of goodwill. The impairment charge is included in operating income.

IFRS

Goodwill is allocated to a cash-generating unit (CGU) or group of CGUs, as defined within the guidance.

Goodwill is tested for impairment at least on an annual basis and between annual tests if an event occurs or circumstances change that may indicate an impairment.

Goodwill impairment testing is performed using a one-step approach:

The recoverable amount of the CGU or group of CGUs (i.e., the higher of its fair value less costs of disposal and its value in use) is compared with its carrying amount.

Any impairment loss is recognized in operating results as the excess of the carrying amount over the recoverable amount.

The impairment loss is allocated first to goodwill and then on a pro rata basis to the other assets of the CGU or group of CGUs to the extent that the impairment loss exceeds the carrying value of goodwill.

US GAAP**IFRS**

For reporting units with zero or negative carrying amounts, Step 1 of the two-step impairment test is always qualitative. An entity must first determine whether it is more likely than not that a goodwill impairment exists. An entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that goodwill impairment exists.

In January 2014, the FASB issued new guidance for private companies. Private companies will have the option to amortize goodwill on a straight-line basis over a period of up to ten years, and apply a trigger-based, single-step impairment test at either the entity level or the reporting unit level at the company's election. The single-step impairment test compares the fair value of the entity (or reporting unit) to its carrying amount.

13.5 Contingent consideration—seller accounting

Entities that sell a business that includes contingent consideration might encounter significant differences in the manner in which such contingent considerations are recorded.

US GAAP**IFRS**

Under US GAAP, the seller should determine whether the arrangement meets the definition of a derivative. If the arrangement meets the definition of a derivative, the arrangement should be recorded at fair value. If the arrangement does not meet the definition of a derivative, the seller should make an accounting policy election to record the arrangement at either fair value at inception or at the settlement amount when the consideration is realized or is realizable, whichever is earlier.

Under IFRS, a contract to receive contingent consideration that gives the seller the right to receive cash or other financial assets when the contingency is resolved meets the definition of a financial asset. When a contract for contingent consideration meets the definition of a financial asset, it is measured using one of the measurement categories specified in the financial instruments guidance.

Other

13.6 *Noncontrolling interests*

Noncontrolling interests are measured at full fair value under US GAAP whereas IFRS provides two valuation options, which could result in differences in the carrying values of noncontrolling interests.

US GAAP	IFRS
Noncontrolling interests are measured at fair value.	Entities have an option, on a transaction-by-transaction basis, to measure noncontrolling interests at their proportion of the fair value of the identifiable net assets or at full fair value. This option applies only to instruments that represent present ownership interests and entitle their holders to a proportionate share of the net assets in the event of liquidation. All other components of noncontrolling interest are measured at fair value unless another measurement basis is required by IFRS. The use of the full fair value option results in full goodwill being recorded on both the controlling and noncontrolling interest.

13.7 *Combinations involving entities under common control*

Under US GAAP, there are specific rules for common-control transactions.

US GAAP	IFRS
Combinations of entities under common control are generally recorded at predecessor cost, reflecting the transferor's carrying amount of the assets and liabilities transferred.	IFRS does not specifically address such transactions. In practice, entities develop and consistently apply an accounting policy; management can elect to apply the acquisition method of accounting or the predecessor value method to a business combination involving entities under common control. The accounting policy can be changed only when criteria for a change in an accounting policy are met in the applicable guidance in IAS 8 (i.e., it provides more reliable and more relevant information).

13.8 Identifying the acquirer

Different entities might be determined to be the acquirer when applying purchase accounting.

Impacted entities should refer to the Consolidation chapter for a more detailed discussion of differences related to the consolidation models between the frameworks that might create significant differences in this area.

US GAAP	IFRS
The acquirer is determined by reference to ASC 810–10, under which generally the party that holds greater than 50 percent of the voting shares has control, unless the acquirer is the primary beneficiary of a variable interest entity in accordance with ASC 810.	The acquirer is determined by reference to the consolidation guidance, under which generally the party that holds greater than 50 percent of the voting rights has control. In addition, control might exist when less than 50 percent of the voting rights are held, if the acquirer has the power to most significantly affect the variable returns of the entity in accordance with IFRS 10.

13.9 Push-down accounting

The lack of push-down accounting under IFRS can lead to significant differences in instances where push down accounting was utilized under US GAAP.

US GAAP	IFRS
<p>Companies have the option to apply pushdown accounting in their separate financial statements upon a change-in-control event. The election is available to the acquired company, as well as to any direct or indirect subsidiaries of the acquired company.</p> <p>If an acquired company elects to apply pushdown accounting, the acquired company should reflect the new basis of accounting established by the parent for the individual assets and liabilities of the acquired company arising from the acquisition in its standalone financial statements.</p>	<p>There is no discussion of pushdown accounting under IFRS. There may be situations in which transactions, such as capital reorganizations, common control transactions, etc., may result in an accounting outcome that is similar to pushdown accounting where the new basis of accounting established by the parent, including goodwill and purchase price adjustments, is reflected in the company's standalone financial statements.</p>

US GAAP**IFRS**

Goodwill should be calculated and recognized consistent with business combination accounting. Bargain purchase gains, however, should not be recognized in the income statement of the acquired company that applies pushdown accounting. Instead, they should be recognized in additional paid-in capital within equity.

Debt (including acquisition related debt) and any other liabilities of the acquirer should be recognized by the acquired company only if they represent an obligation of the acquired company pursuant to other applicable guidance in US GAAP.

13.10 *Employee benefit arrangements and income tax*

Accounting for share-based payments and income taxes in accordance with separate standards not at fair value might result in different results being recorded as part of purchase accounting.

13.11 *Recent/proposed guidance*

13.11.1 *IASB amendment to IFRS 11, Joint Arrangements: Accounting for Acquisitions of Interests in Joint Operations*

In May 2014, the IASB issued an amendment to IFRS 11 to address the accounting for the acquisition of an interest in a joint operation that constitutes a business. The amendment requires that acquirers of such interests apply the relevant principles on business combination accounting contained in IFRS 3, *Business Combinations*, and other standards, and disclose the related information required under those standards. A joint operator that increases its interest in a joint operation that constitutes a business should not remeasure previously held interests in the joint operation when joint control is retained. The standard should be applied prospectively for annual periods beginning on or after January 1, 2016. Early application is allowed.

***Chapter 14:
Other accounting and
reporting topics***

14.1 Other accounting and reporting topics

In addition to areas previously discussed, differences exist in a multitude of other standards, including translation of foreign currency transactions, calculation of earnings per share, disclosures regarding operating segments, and discontinued operations treatment. Differences also exist in the presentation and disclosure of annual and interim financial statements; however, each of the boards has several projects in progress which may impact some of these differences.

Technical references

US GAAP

ASC 205, ASC 205-20, ASC 230, ASC 260, ASC 280, ASC 360-10, ASC 830, ASC 830-30-40-2 through 40-4, ASC 850, ASC 853

IFRS

IAS 1, IAS 8, IAS 21, IAS 23, IAS 24, IAS 29, IAS 33, IFRS 5, IFRS 8, IFRIC 12

Note

The following discussion captures a number of the more significant GAAP differences. It is important to note that the discussion is not inclusive of all GAAP differences in this area.

Financial statements

14.2 Balance sheet—offsetting assets and liabilities

Differences in the guidance covering the offsetting of assets and liabilities under master netting arrangements, repurchase and reverse-repurchase arrangements, and the number of parties involved in the offset arrangement could change the balance sheet presentation of items currently shown net (or gross) under US GAAP. Consequently, more items are likely to appear gross under IFRS.

US GAAP

The guidance states that “it is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except where a right of setoff exists.” A right of setoff is a debtor’s legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor. A debtor having a valid right of setoff may offset the related asset and liability and report the net amount. A right of setoff exists when all of the following conditions are met:

- Each of two parties owes the other determinable amounts
- The reporting party has the right to set off the amount owed with the amount owed by the other party
- The reporting party intends to set off
- The right of setoff is enforceable by law

Repurchase agreements and reverse-repurchase agreements that meet certain conditions are permitted, but not required, to be offset in the balance sheet.

The guidance provides an exception to the previously described intent condition for derivative instruments executed with the same counterparty under a master netting arrangement. An entity may offset (1) fair value amounts recognized for derivative instruments and (2) fair value amounts (or amounts that approximate fair value) recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from derivative instruments recognized at fair value. Entities must adopt an accounting policy to offset fair value amounts under this guidance and apply that policy consistently.

IFRS

Under the guidance, a right of setoff is a debtor’s legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. Two conditions must exist for an entity to offset a financial asset and a financial liability (and thus present the net amount on the balance sheet). The entity must both:

- Currently have a legally enforceable right to set off
- Intend either to settle on a net basis or to realize the asset and settle the liability simultaneously

In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor, provided that there is an agreement among the three parties that clearly establishes the debtor’s right of setoff.

Master netting arrangements do not provide a basis for offsetting unless both of the criteria described earlier have been satisfied. If both criteria are met, offsetting is required.

14.3 *Balance sheet—~~X~~disclosures for offsetting assets and liabilities*

While differences exist between IFRS and US GAAP in the offsetting requirements, the boards were able to reach a converged solution on the nature of the disclosure requirements.

US GAAP

The balance sheet offsetting disclosures are limited to derivatives, repurchase agreements, and securities lending transactions to the extent that they are (1) offset in the financial statements or (2) subject to an enforceable master netting arrangement or similar agreement.

IFRS

The disclosure requirements are applicable for (1) all recognized financial instruments that are set off in the financial statements and (2) all recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in the financial statements.

14.4 *Balance sheet: classification—post-balance sheet refinancing agreements*

Under IFRS, the classification of debt does not consider post-balance sheet refinancing agreements. As such, more debt is classified as current under IFRS.

US GAAP

Entities may classify debt instruments due within the next 12 months as noncurrent at the balance sheet date, provided that agreements to refinance or to reschedule payments on a long-term basis (including waivers for certain debt covenants) get completed before the financial statements are issued.

SEC registrants subject to S-X Article 5 for commercial and industrial companies are required to present a classified balance sheet, but no other Articles within S-X contain this requirement. ASC 210-10-05-4 notes that most reporting entities present a classified balance sheet.

IFRS

If completed after the balance sheet date, neither an agreement to refinance or reschedule payments on a long-term basis nor the negotiation of a debt covenant waiver would result in noncurrent classification of debt, even if executed before the financial statements are issued.

The presentation of a classified balance sheet is required, except when a liquidity presentation is more reliable and more relevant.

14.5 *Balance sheet: classification—refinancing counterparty*

Differences in the guidance for accounting for certain refinancing arrangements may result in more debt classified as current under IFRS.

US GAAP**IFRS**

A short-term obligation may be excluded from current liabilities if the entity intends to refinance the obligation on a long-term basis and the intent to refinance on a long-term basis is supported by an ability to consummate the refinancing as demonstrated by meeting certain requirements. The refinancing does not necessarily need to be with the same counterparty.

If an entity expects and has the discretion to refinance or roll over an obligation for at least 12 months after the reporting period under an existing loan financing, it classifies the obligation as noncurrent, even if it would otherwise be due within a shorter period. In order for refinancing arrangements to be classified as noncurrent, the arrangement should be with the same counterparty.

14.6 *Income statement and statement of comprehensive income*

The most significant difference between the frameworks is that under IFRS an entity can present expenses based on their nature or their function.

US GAAP**IFRS**

The income statement may be presented in either (1) a single-step format, whereby all expenses are classified by function and then deducted from total income to arrive at income before tax, or (2) a multiple-step format separating operating and nonoperating activities before presenting income before tax.

SEC regulations require all registrants to categorize expenses in the income statement by their function. However, depreciation expense may be presented as a separate income statement line item. In such instances, the caption “cost of sales” should be accompanied by the phrase “exclusive of depreciation” shown below and presentation of a gross margin subtotal is precluded.

Although US GAAP does not use the term “exceptional items,” significant unusual or infrequently occurring items are reported as components of income separate from continuing operations—either on the face of the income statement or in the notes to the financial statements.

Expenses may be presented either by function or by nature, whichever provides information that is reliable and more relevant depending on historical and industry factors and the nature of the entity. Additional disclosure of expenses by nature, including depreciation and amortization expense and employee benefit expense, is required in the notes to the financial statements if functional presentation is used on the face of the income statement.

While certain minimum line items are required, no prescribed statement of comprehensive income format exists.

Entities that disclose an operating result should include all items of an operating nature, including those that occur irregularly or infrequently or are unusual in amount, within that caption.

Entities should not mix functional and nature classifications of expenses by excluding certain expenses from the functional classifications to which they relate.

US GAAP

IFRS

“Extraordinary items” are defined as being both infrequent and unusual and are rare in practice.

Entities may present items of net income and other comprehensive income either in one single statement of comprehensive income or in two separate, but consecutive, statements.

Components of accumulated other comprehensive income cannot be presented on the face of the statement of changes in equity but have to be presented in the footnotes.

All items included in other comprehensive income are subject to recycling.

In February 2013, the FASB issued ASU 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, which require entities to present either parenthetically on the face of the financial statements or in the notes, significant amounts reclassified from each component of accumulated other comprehensive income and the income statement line items affected by the reclassification.

The term “exceptional items” is not used or defined. However, the separate disclosure is required (either on the face of the comprehensive/separate income statement or in the notes) of items of income and expense that are of such size, nature, or incidence that their separate disclosure is necessary to explain the performance of the entity for the period.

“Extraordinary items” are prohibited.

Entities are permitted to present items of net income and other comprehensive income either in one single statement of profit or loss and other comprehensive income or in two separate, but consecutive, statements.

IAS 1, *Presentation of Financial Statements*, requires items included in other comprehensive income that may be reclassified into profit or loss in future periods to be presented separately from those that will not be reclassified. Entities that elect to show items in other comprehensive income before tax are required to allocate the tax between the tax on items that might be reclassified subsequently to profit or loss and tax on items that will not be reclassified subsequently. The amount of income tax relating to each item of other comprehensive income should be disclosed either in the statement of profit or loss and other comprehensive income or in the footnotes.

Under IFRS, entities have the option to show the impact of items of other comprehensive income on each component of equity either on the face of the statement of changes in equity or in the footnotes.

14.7 *Statements of equity*

IFRS requires a statement of changes in equity to be presented as a primary statement for all entities.

US GAAP

Permits the statement of changes in shareholders' equity to be presented either as a primary statement or within the notes to the financial statements.

IFRS

A statement of changes in equity is presented as a primary statement for all entities.

14.8 *Statement of cash flows*

Differences exist between the two frameworks for the presentation of the statement of cash flows that could result in differences in the actual amount shown as cash and cash equivalents in the statement of cash flows as well as changes to each of the operating, investing, and financing sections of the statement of cash flows.

US GAAP

Bank overdrafts are not included in cash and cash equivalents; changes in the balances of bank overdrafts are classified as financing cash flows.

There is no requirement for expenditures to be recognized as an asset in order to be classified as investing activities.

The guidance is specific on the cash flow classification of certain items, requiring dividends paid to be classified in the financing section of the cash flow statement and requiring interest paid (and expensed), interest received, and dividends received to be classified as cash flows from operations. Interest capitalized relating to borrowings that are directly attributable to property, plant, and equipment is classified as cash flows from investing activities. If the indirect method is used, amounts of interest paid (net of amounts capitalized) during the period must be disclosed.

IFRS

Cash and cash equivalents may also include bank overdrafts repayable on demand that form an integral part of an entity's cash management. Short-term bank borrowings are not included in cash or cash equivalents and are considered to be financing cash flows.

Only expenditures that result in a recognized asset are eligible for classification as investing activities.

Interest and dividends received should be classified in either operating or investing activities. Interest and dividends paid should be classified in either operating or financing cash flows. IFRS does not specify where interest capitalized under IAS 23 is classified. The total amount of interest paid during a period, whether expensed or capitalized, is disclosed in the statement of cash flows.

US GAAP

Taxes paid are generally classified as operating cash flows; specific rules exist regarding the classification of the tax benefit associated with share-based compensation arrangements. If the indirect method is used, amounts of taxes paid during the period must be disclosed.

IFRS

Taxes paid should be classified within operating cash flows unless specific identification with a financing or investing activity exists. Once an accounting policy election is made, it should be followed consistently.

14.9 *Disclosure of critical accounting policies and significant estimates*

An increased prominence exists in the disclosure of an entity's critical accounting policies and disclosures of significant accounting estimates under IFRS in comparison to the requirements of US GAAP.

US GAAP

For SEC registrants, disclosure of the application of critical accounting policies and significant estimates is normally made in the *Management's Discussion and Analysis* section of Form 10-K.

Financial statements prepared under US GAAP include a summary of significant accounting policies used within the notes to the financial statements.

IFRS

Within the notes to the financial statements, entities are required to disclose both:

- The judgments that management has made in the process of applying its accounting policies that have the most significant effect on the amounts recognized in those financial statements
- Information about the key assumptions concerning the future—and other key sources of estimation uncertainty at the balance sheet date—that have significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year

14.10 *Capital management disclosures*

Entities applying IFRS are required to disclose information that will enable users of its financial statements to evaluate the entity's objectives, policies, and processes for managing capital.

US GAAP

There are no specific requirements of capital management disclosures under US GAAP.

For SEC registrants, disclosure of capital resources is normally made in the *Management's Discussion and Analysis* section of Form 10-K.

IFRS

Entities are required to disclose the following:

- Qualitative information about their objectives, policies, and processes for managing capital
- Summary quantitative data about what they manage as capital
- Changes in the above from the previous period
- Whether during the period they complied with any externally imposed capital requirements to which they are subject and, if not, the consequences of such non-compliance

The above disclosure should be based on information provided internally to key management personnel.

14.11 Comparative financial information

IFRS specifies the periods for which comparative financial information is required, which differs from both US GAAP and SEC requirements.

US GAAP

Comparative financial statements are not required; however, SEC requirements specify that most registrants provide two years of comparatives for all statements except for the balance sheet, which requires only one comparative year.

IFRS

One year of comparatives is required for all numerical information in the financial statements, with limited exceptions in disclosures. In limited note disclosures and the statement of equity (where a reconciliation of opening and closing positions are required), more than one year of comparative information is required.

A third statement of financial position at the beginning of preceding period is required for first-time adopters of IFRS and in situations where a retrospective application of an accounting policy, retrospective restatement or reclassification having a material effect on the information in the statement of financial position at the beginning of the preceding period have occurred. Restatements or reclassifications in this context are in relation to errors, or changes in presentation of previously issued financial statements.

Earnings per share

14.12 *Diluted earnings-per-share calculation— year-to-date period calculation*

Differences in the calculation methodology could result in different denominators being utilized in the diluted earnings-per-share (EPS) year-to-date period calculation.

US GAAP	IFRS
In computing diluted EPS, the treasury stock method is applied to instruments such as options and warrants. This requires that the number of incremental shares applicable to the contract be included in the EPS denominator by computing a year-to-date weighted-average number of incremental shares by using the incremental shares from each quarterly diluted EPS computation.	The guidance states that dilutive potential common shares shall be determined independently for each period presented, not a weighted average of the dilutive potential common shares included in each interim computation.

14.13 *Diluted earnings-per-share calculation— contracts that may be settled in stock or cash (at the issuer's election)*

Differences in the treatment of convertible debt securities may result in lower diluted EPS under IFRS.

US GAAP	IFRS
Certain convertible debt securities give the issuer a choice of either cash or share settlement. These contracts would typically follow the if-converted method, as US GAAP contains the presumption that contracts that may be settled in common shares or in cash at the election of the entity will be settled in common shares. However, that presumption may be overcome if past experience or a stated policy provides a reasonable basis to believe it is probable that the contract will be paid in cash.	Contracts that can be settled in either common shares or cash at the election of the issuer are always presumed to be settled in common shares and are included in diluted EPS if the effect is dilutive; that presumption may not be rebutted.

14.14 Diluted earnings-per-share calculation

The treatment of contingency features in the dilutive EPS calculation may result in higher diluted EPS under IFRS.

US GAAP	IFRS
Contingently convertible debt securities with a market price trigger (e.g., debt instruments that contain a conversion feature that is triggered upon an entity's stock price reaching a predetermined price) should always be included in diluted EPS computations if dilutive—regardless of whether the market price trigger has been met. That is, the contingency feature should be ignored.	The potential common shares arising from contingently convertible debt securities would be included in the dilutive EPS computation only if the contingency condition was met as of the reporting date.

14.15 Diluted EPS calculation—application of treasury stock method to share-based payments—windfall tax benefits

Differences in the deferred tax accounting for share-based payments under US GAAP and IFRS could impact the theoretical proceeds that are assumed to have been used to repurchase the entity's common shares. As a consequence, a different number of potential shares would be included in the denominator for purposes of the diluted EPS.

Refer to the Expenses recognition—share-based payments section for a broader discussion of income tax effects associated with share-based payments.

US GAAP	IFRS
ASC 260 requires the amount of windfall tax benefits to be received by an entity upon exercise of stock options to be included in the theoretical proceeds from the exercise for purposes of computing diluted EPS under the treasury stock method. This is calculated as the amount of tax benefits (both current and deferred), if any, that will be credited to additional paid-in-capital.	Tax benefits for vested options are already recorded in the financial statements because IAS 12, <i>Income Taxes</i> , requires the deductible temporary differences to be based on the entity's share price at the end of the period. As a result, no adjustment to the proceeds is needed under the treasury stock method for EPS purposes.
The treatment is the same as for vested options (i.e., windfall tax benefits included in the theoretical proceeds).	

US GAAP**IFRS**

However, it is not clear whether the amount of tax benefit attributable to unvested stock options (which has not yet been recognized in the financial statements) should be added to the proceeds. As part of the IASB's deliberations on amending IAS 33 in May 2008, the IASB stated that it did not intend for IAS 33 to exclude those tax benefits and, therefore, this would be clarified when IAS 33 is amended. Either treatment would currently be acceptable.

Foreign currency translation

14.16 *Trigger to release amounts recorded in the currency translation account*

Different recognition triggers for amounts captured in the currency translation account (CTA) could result in more instances where amounts included in CTA are released through the income statement under IFRS compared with US GAAP.

US GAAP**IFRS**

CTA is released through the income statement in the following situations where a parent sells its interest, sells the assets of its foreign operation, or its interest is diluted via the foreign operation's share issuance:

- When control of a foreign entity, as defined, is lost, the entire CTA balance is released.
- Complete or substantially complete liquidation of a foreign entity, as defined, results in full release of CTA.
- When a portion of an equity method investment which is itself a foreign entity, as defined, is sold but significant influence is retained, a portion of CTA is released, on a proportionate basis.

The triggers for sale and dilution noted in the US GAAP column apply for IFRS, except when significant influence or joint control is lost, the entire CTA balance is released into the income statement.

When there is a sale of a second-tier subsidiary, an entity has an accounting policy choice with regard to the release of CTA associated with that second-tier subsidiary even though ownership in the first-tier subsidiary has not been affected.

US GAAP**IFRS**

- When significant influence over an equity method investee is lost, a proportionate amount of CTA is released into the income statement (through the level at which significant influence is lost) and the remaining CTA balance becomes part of the cost basis of the investment retained.

When a reporting entity has an investment in a foreign entity accounted for by the equity method, and the reporting entity increases its stake in the subject foreign entity such that control is acquired, all CTA is released. It is treated as if the equity method investment were sold, and used to purchase a controlling interest in the foreign entity.

14.17 Translation in consolidated financial statements

IFRS does not require equity accounts to be translated at historical rates.

US GAAP**IFRS**

Equity is required to be translated at historical rates.

IFRS does not specify how to translate equity items. Management has a policy choice to use either the historical rate or the closing rate. The chosen policy should be applied consistently. If the closing rate is used, the resulting exchange differences are recognized in equity and thus the policy choice has no impact on the amount of total equity.

14.18 Determination of functional currency

Under US GAAP there is no hierarchy of indicators to determine the functional currency of an entity, whereas a hierarchy exists under IFRS.

US GAAP

IFRS

There is no hierarchy of indicators to determine the functional currency of an entity. In those instances in which the indicators are mixed and the functional currency is not obvious, management’s judgment is required so as to determine the currency that most faithfully portrays the primary economic environment of the entity’s operations.

Primary and secondary indicators should be considered in the determination of the functional currency of an entity. If indicators are mixed and the functional currency is not obvious, management should use its judgment to determine the functional currency that most faithfully represents the economic results of the entity’s operations by focusing on the currency of the economy that determines the pricing of transactions (not the currency in which transactions are denominated).

14.19 *Hyperinflation*

Basis of accounting in the case of hyperinflationary economies are different under US GAAP and IFRS.

US GAAP

IFRS

Under US GAAP inflation-adjusted financial statements are not permitted. Instead, the financial statements of a foreign entity in a highly inflationary economy shall be remeasured as if the functional currency were the reporting currency.

IFRS require financial statements prepared in the currency of a hyperinflationary economy to be stated in terms of the measuring unit current at the end of the reporting period.

Prior year comparatives must be restated in terms of the measuring unit current at the end of the latest reporting period.

Other

14.20 *Interim financial reporting—allocation of costs in interim periods*

IFRS requires entities to account for interim financial statements via the discrete-period method. The spreading of costs that affect the full year is not appropriate. This could result in increased volatility in interim financial statements.

The tax charge in both frameworks is based on an estimate of the annual effective tax rate applied to the interim results plus the inclusion of discrete income tax-related events during the quarter in which they occur.

US GAAP**IFRS**

US GAAP views interim periods primarily as integral parts of an annual cycle. As such, it allows entities to allocate among the interim periods certain costs that benefit more than one of those periods.

Interim financial statements are prepared via the discrete-period approach, wherein the interim period is viewed as a separate and distinct accounting period, rather than as part of an annual cycle.

14.21 *Definition of discontinued operations*

The definitions of discontinued operations under IFRS and US GAAP focus on similar principles and apply to a component of an entity that has either been disposed of or is classified as held for sale. Under US GAAP, to qualify as a discontinued operation, a disposal must result in a strategic shift that has a major effect on an entity's operations and financial results. While this concept may be implicit in the IFRS definition, the significance of the line of business or geographical area of operations will determine whether the disposal qualifies for discontinued operations presentation under US GAAP. US GAAP also includes several examples that provide guidance on how to interpret the definition of discontinued operations. IFRS does not contain similar examples. The definitions under IFRS and US GAAP are summarized in the table below.

US GAAP**IFRS**

A disposal of a component of an entity or a group of components of an entity shall be reported in discontinued operations if the disposal represents (a) a strategic shift that has (or will have) a major effect on an entity's operations and financial results or (b) a business that on acquisition meets the criteria to be classified as held for sale.

A discontinued operation is a component of an entity that either has been disposed of or is classified as held for sale and (a) represents a separate major line of business or geographic area of operations, (b) is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations, or (c) is a subsidiary acquired exclusively with a view to resale.

14.22 *Discontinued operations—unit of account upon which to perform a discontinued operations assessment*

IFRS and US GAAP both refer to a component of an entity when describing those operations that may qualify for discontinued operations reporting; however, the definition of “component of an entity” for purposes of applying the discontinued operations guidance differs under IFRS and US GAAP. In practice, this difference generally does not result in different conclusions regarding whether or not a component of an entity that either has been disposed of, or is classified as held for sale, qualifies for discontinued operations reporting.

US GAAP

IFRS

A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. A component of an entity may be a reportable segment or an operating segment, a reporting unit, a subsidiary, or an asset group.

A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. In other words, a component of an entity will have been a cash-generating unit or a group of cash-generating units while being held for use.

14.23 *Related parties—disclosure of commitments*

Disclosures of related party transactions under IFRS should include commitments to related parties.

US GAAP

IFRS

There is no specific requirement to disclose commitments to related parties under US GAAP.

Disclosure of related party transactions includes commitments if a particular event occurs or does not occur in the future, including recognized and unrecognized executory contracts. Commitments to members of key management personnel would also need to be disclosed.

14.24 *Related parties—disclosure of management compensation*

Under IFRS, a financial statement requirement exists to disclose the compensation of key management personnel.

US GAAP

IFRS

Disclosure of the compensation of key management personnel is not required within the financial statements. SEC regulations require key management compensation to be disclosed outside the primary financial statements.

The compensation of key management personnel is disclosed within the financial statements in total and by category of compensation. Other transactions with key management personnel also must be disclosed.

14.25 *Related parties—disclosure of transactions with the government and government-related entities*

There are exemptions from certain related party disclosure requirements under IFRS that do not exist under US GAAP.

US GAAP	IFRS
There are no exemptions available to reporting entities from the disclosure requirements for related party transactions with governments and/or government-related entities.	<p>A partial exemption is available to reporting entities from the disclosure requirements for related party transactions and outstanding balances with both:</p> <ul style="list-style-type: none"> □ A government that has control, joint control, or significant influence over the reporting entity □ Another entity that is a related party because the same government has control, joint control, or significant influence over both the reporting entity and the other entity

14.26 *Operating segments—segment reporting*

A principles-based approach to the determination of operating segments in a matrix-style organizational structure could result in entities disclosing different operating segments.

US GAAP	IFRS
Entities that utilize a matrix form of organizational structure are required to determine their operating segments on the basis of products or services offered, rather than geography or other metrics.	Entities that utilize a matrix form of organizational structure are required to determine their operating segments by reference to the core principle (i.e., an entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates).

14.27 *Service concession arrangements*

Service concession arrangements may be in the scope of ASC 853, *Service Concession Arrangements*, for US GAAP or IFRIC 12, *Service Concession Arrangements*, for IFRS if they meet certain criteria. The above authoritative literature provides guidance on the accounting by private entity operators for public-to-private service concession arrangements (for example, airports, roads, and bridges) that are controlled by the

public sector entity grantor. The operator also may provide construction, upgrading, or maintenance services in addition to operations. Under both US GAAP and IFRS, the infrastructure used in these arrangements should not be recognized as property, plant, and equipment by the operator. ASC 853 does not specify how an operator should account for the various aspects of a service concession arrangement other than to refer the operator to follow other applicable US GAAP. IFRIC 12 requires the operator to follow specific existing IFRS for various aspects of a service concession arrangement and provides additional guidance for other aspects.

US GAAP

IFRS

The operator should not account for these arrangements as leases.

For the operator's revenue and costs relating to the construction, upgrade, or operation services, the standard refers the operator to ASC 605 on revenue recognition.

If there are multiple services in the arrangement, the operator should consider the multiple element revenue guidance, including determining if the services are separate units of account and performing the revenue allocation based on their relative selling price. Refer to SD 3.4 for further information on this difference.

The multiple element revenue guidance includes the concept of not recognizing any amounts of contingent revenue, which differs from IFRS. Refer to SD 3.4.1 for further information on this difference.

In the absence of specific guidance, the operator needs to determine if it is able to recognize an asset for the consideration to be received by the operator in exchange for construction and upgrade services, and/or defer the costs associated with such services. An intangible asset would not be recognized as the consideration received for construction services.

Additionally, in some of these arrangements the operator will pay the grantor to enter into an operating agreement, which would generally be considered consideration payable to a customer under US GAAP, if the grantor is determined to be the customer. This may result in an asset that will be amortized against revenue over the term of the operating agreement.

Generally, the operator would not account for these arrangements as leases, unless the operator has a right to use some physically separable, independent, and cash generating portion of the infrastructure, or if the facilities are used to provide purely ancillary unregulated services. In these cases, there may in substance be a lease from the grantor to the operator, which should be accounted for in accordance with IAS 17.

The operator will account for revenue and costs for construction or upgrade services in accordance with IAS 11 and for operation services in accordance with IAS 18.

IFRIC 12 includes guidance that if the operator performs more than one service under the arrangement, consideration received or receivable shall be allocated by reference to the relative fair values of the services delivered, when the amounts are separately identifiable.

The consideration to be received by the operator in exchange for construction or upgrade services may result in the recognition of a financial asset, an intangible asset or a combination of both. It is necessary to account for each component separately.

The operator recognizes a financial asset to the extent that it has an unconditional right to receive a specified or determinable amount of cash or other financial assets for the construction services.

The operator recognizes an intangible asset to the extent that it has a right to charge fees to users of the public services.

US GAAP**IFRS**

The operator may have a contractual obligation to maintain or restore the infrastructure to a specified condition before it is returned to the grantor at the end of the arrangement, which should be recognized and measured in accordance with IAS 37.

14.28 Recent/proposed guidance

14.28.1 IASB Exposure Draft, Classification of Liabilities (Proposed amendments to IAS 1)

In February 2015, the IASB issued an exposure draft to amend IAS 1. The proposed amendments attempt to clarify that the classification of a liability as either current or noncurrent is based on the entity's rights at the end of the reporting period, and make a clear link between the settlement of the liability and the outflow of resources from the entity. The FASB has a similar topic on their technical agenda that is in the initial deliberations phase called *Simplifying the Balance Sheet Classification of Debt*.

14.28.2 FASB Accounting Standards Update No. 2015-01, Income Statement – Extraordinary and Unusual Items

On January 9, 2015, the FASB issued Accounting Standards Update 2015-01, *Income Statement—Extraordinary and Unusual Items*, to simplify income statement classification by removing the concept of extraordinary items from U.S. GAAP.

Under the existing guidance, an entity is required to separately disclose extraordinary items, net of tax, in the income statement after income from continuing operations if an event or transaction is of an unusual nature and occurs infrequently. This separate, net-of-tax presentation (and corresponding earnings per share impact) will no longer be allowed.

The existing requirement to separately present items that are of an unusual nature or occur infrequently on a pre-tax basis within income from continuing operations has been retained. The new guidance also requires similar separate presentation of items that are both unusual and infrequent.

The standard is effective for both public and private companies for periods beginning after December 15, 2015. Early adoption is permitted, but only as of the beginning of the fiscal year of adoption. Upon adoption, a reporting entity may elect prospective or retrospective application. If adopted prospectively, both the nature and amount of any subsequent adjustments to previously reported extraordinary items must be disclosed.

Chapter 15:
IFRS for small and
medium-sized entities

15.1 *IFRS for small and medium-sized entities*

In July 2009, the IASB released IFRS for Small and Medium-sized Entities (SMEs), which provides an alternative accounting framework for entities meeting certain eligibility criteria. IFRS for SMEs is a self-contained, comprehensive standard specifically designed for entities that do not have public accountability.

This section is intended to provide an overview of IFRS for SMEs, its eligibility criteria, and some examples of the differences between IFRS for SMEs, full IFRS, and US GAAP.

15.1.1 *What companies can use IFRS for SMEs?*

The IASB has determined that any entity that does not have public accountability may use IFRS for SMEs. An entity has public accountability if (1) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market, or (2) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance entity, pension fund, or securities broker/dealer. The definition of a SME is, therefore, based on the nature of the entity rather than on its size.

To clarify, a subsidiary of a listed company that uses full IFRS is eligible to use IFRS for SMEs when preparing its own separate financial statements, provided that the subsidiary itself is not publicly accountable. However, for consolidation purposes, a subsidiary using IFRS for SMEs would need to convert its financial statements to full IFRS, as there are differences between the two accounting frameworks.

Beyond the scope of eligibility determined by the IASB, companies are also subject to the laws of their local jurisdiction. Many countries require statutory reporting, and each country will individually decide whether IFRS for SMEs is an acceptable basis for such reporting. Some countries that use full IFRS for public company reporting have replaced their local GAAP with IFRS for SMEs (e.g., South Africa), or with a standard based on the IFRS for SMEs (e.g., the United Kingdom), while others currently have no plans to allow use of IFRS for SMEs for statutory purposes (e.g., France). Companies will need to understand on a country-by-country basis where IFRS for SMEs will be allowed or required for statutory reporting.

15.1.2 *What are some of the differences between full IFRS and IFRS for SMEs?*

IFRS for SMEs retains many of the accounting principles of full IFRS but simplifies a number of accounting principles that are generally less relevant for small and medium-sized entities. In addition, IFRS for SMEs significantly streamlines the volume and depth of disclosures required by full IFRS, yielding a complement of disclosures that are more user-friendly for private entity stakeholders.

Certain more complex areas of full IFRS deemed less relevant to SMEs, including earnings per share, segment reporting, insurance, and interim financial reporting, are omitted from the IFRS for SMEs guidance. In other instances, certain full IFRS

principles are simplified to take into account the special needs of SMEs. Some examples of the differences between full IFRS and IFRS for SMEs include:

Business combinations—Under full IFRS, transaction costs are excluded from the purchase price allocation (i.e., expensed as incurred), and contingent consideration is recognized regardless of the probability of payment. Under IFRS for SMEs, transaction costs are included in the purchase price allocation (i.e., cost of acquisition), and contingent consideration is recognized only if it is probable the amount will be paid and its fair value can be reliably measured.

Investments in associates—Under full IFRS, investments in associates are accounted for using the equity method. Under IFRS for SMEs, investments in associates may be accounted for under the cost method, equity method, or at fair value through profit and loss.

Goodwill and indefinite-lived intangibles—Under full IFRS, goodwill and indefinite-lived intangible assets must be tested at least annually for impairment, or when an indicator of impairment exists. Under IFRS for SMEs, there is no concept of indefinite-lived intangible assets. Therefore, goodwill and intangible assets are amortized over the useful life of the asset (or 10 years if the useful life cannot be determined). Goodwill and intangible assets are also tested for impairment only when an indicator of impairment exists.

Deferred tax assets—Under full IFRS, a deferred tax asset is recognized for all temporary differences to the extent that it is probable that future taxable profit will be available against which the temporary difference can be utilized. Under IFRS for SMEs, all deferred tax assets are generally recognized. A valuation allowance is recognized so that the net carrying amount of the deferred tax asset equals the highest amount that is more likely than not to be recovered. This treatment is similar to US GAAP.

Uncertain tax positions (UTPs)—There is no specific guidance on UTPs within the full IFRS income tax standard. However, under the general principles of the full IFRS income tax standard, the UTP liability is recorded if it is more likely than not that a payment will be made (generally considered to be a greater than 50 percent likelihood) and is measured as either the single best estimate or a weighted average probability of the possible outcomes. Under IFRS for SMEs, the liability is measured using the probability-weighted average amount of all possible outcomes. There is no probable recognition threshold.

Research and development costs—Under full IFRS, research costs are expensed but development costs meeting certain criteria are capitalized. Under IFRS for SMEs, all research and development costs are expensed.

Recognition of exchange differences—Under full IFRS, exchange differences that form part of an entity's net investment in a foreign entity (subject to strict criteria of what qualifies as net investment) are recognized initially in other comprehensive income and are recycled from equity to profit or loss on disposal of the foreign operation. Under IFRS for SMEs, recycling through profit or loss of any cumulative

exchange differences that were previously recognized in OCI on disposal of a foreign operation is not permitted.

15.1.3 What are some of the differences between US GAAP and IFRS for SMEs?

In areas where US GAAP and IFRS are mostly converged (e.g., business combinations), the differences between US GAAP and IFRS for SMEs likely will seem similar to the differences noted above between full IFRS and IFRS for SMEs. However, there are other examples of differences between US GAAP and IFRS for SMEs:

Inventory—Under US GAAP, last in, first out (LIFO) is an acceptable method of valuing inventory. In addition, impairments to inventory value are permanent. Under IFRS for SMEs, use of LIFO is not allowed, and impairments of inventory may be reversed under certain circumstances.

Provisions—Under US GAAP, a provision is recorded if it is probable (generally regarded as 75 percent or greater) that an outflow will occur. If no best estimate of the outflow is determinable but a range of possibilities exists, then the lowest point of the range is the value that should be recorded. Under IFRS for SMEs, a provision is recorded if it is more likely than not (generally considered to be greater than 50 percent) that an outflow will occur. If no best estimate of the outflow is determinable but a range of possibilities exists, and each point in that range is as likely as any other, the midpoint of the range should be recorded.

Capitalization of interest—Similar to full IFRS, US GAAP requires capitalization of interest directly attributable to the acquisition, construction, or production of qualifying assets. Under IFRS for SMEs, all interest must be expensed.

Equity instruments—Under US GAAP, complex equity instruments, such as puttable stock and certain mandatorily redeemable preferred shares, may qualify as equity (or mezzanine equity). Under IFRS for SMEs, these types of instruments are more likely to be classified as a liability, depending on the specifics of the individual instrument.

Revenue on construction-type contracts—Under existing US GAAP, the percentage-of-completion method is preferable, though the completed-contract method is required in certain situations. Under IFRS for SMEs, the completed-contract method is prohibited.

Finally, the Private Company Council (“PCC”) was established in 2012. The PCC is a sister entity to the FASB and is tasked with (1) identifying, deliberating and voting on proposed alternatives within existing US GAAP for private companies and (2) acting as the primary advisory body to the FASB for private company matters on its current technical agenda. Contrary to IFRS for SMEs, the alternatives proposed by the PCC do not represent a single comprehensive standard but separate individual accounting alternatives for private companies that are optional to adopt. As additional alternatives to existing US GAAP for private companies are proposed by the PCC and endorsed by the FASB, additional differences may be created for private companies between US GAAP and full IFRS or IFRS for SMEs.

While the PCC alternatives create optional simplifications to existing US GAAP, entities applying the IFRS for SMEs may not generally elect to revert to full IFRS if they do not like the simplified accounting required by the SME standard. The one exception is in the area of financial instruments where the IFRS for SMEs specifically allows entities to choose to apply IAS 39 as a policy election.

The FASB has issued four accounting standards updates to US GAAP for private companies. These standards represent alternatives for private companies to existing US GAAP related to the accounting for goodwill subsequent to a business combination, the accounting for certain types of interest rate swaps, the application of variable interest entities guidance to common control leasing arrangements, and the accounting for identifiable intangible assets in a business combination. These alternatives to US GAAP are presented in each relevant chapter of this publication.

15.2 Recent/proposed guidance

15.2.1 IASB update to IFRS for SMEs

In May 2015, the IASB completed its first update of the IFRS for SMEs since its original publication back in 2009. The Board intends to update the IFRS for SMEs periodically (i.e., every three years or so) to minimize the impact of changing accounting standards on private company financial statement preparers and users.

In this first update, the more significant changes are as follows:

- The introduction of an option to revalue property, plant and equipment (which aligns the IFRS for SMEs with full IFRS).
- The modification of the amortization guidance in respect of goodwill and intangible assets. Where an entity cannot make a reliable estimate of the useful economic life of these assets, the amortization period should not exceed 10 years. At present a fixed term of 10 years is imposed.
- The introduction of an ‘undue cost or effort’ exemption in respect of identifying intangible assets in a business combination.
- The guidance on the main recognition and measurement requirements for deferred income taxes has been aligned with the requirements of full IFRS.

The updated guidance is effective for annual periods beginning on or after January 1, 2017 with earlier adoption permitted.

As IFRS for SMEs is designed to be a stable, stand-alone standard it was decided not to incorporate some significant changes in new or amended IFRS standards, including those in IFRS 10, *Consolidated financial statements*, and IAS 19, ‘Employee benefits’.

In addition to the IASB’s periodic updates to the IFRS for SMEs, the SME Implementation Group (“SMEIG”) considers implementation questions raised by users of IFRS for SMEs. When deemed appropriate, the SMEIG develops proposed guidance in the form of questions and answers (Q&As) which, if approved by the

IASB, are issued as non-mandatory guidance. Over time these Q&As are generally incorporated into either the IFRS for SMEs (and made mandatory) and/or the IFRS Foundation's educational material (remains non-mandatory).

***Chapter 16:
FASB/IASB project
summary exhibit***

16.1 FASB/IASB project summary exhibit

The following table presents a summary of the most notable projects on the agenda of the FASB and IASB, and the related discussion papers, exposure drafts, and final standards expected to be issued in 2015. Although preliminary in some cases, the topics under consideration provide an overview of and insight into how each set of standards may further evolve. More information on the status of these projects can be found on each board's website. For the FASB, visit www.fasb.org. For the IASB, visit www.ifrs.org.

Standards and amendment to standards	2015 Issuance anticipated	
Joint projects		
Leases	F	
IASB projects		
Conceptual framework	ED	
Disclosure initiative – changes in accounting policies and estimates	ED	
Disclosure initiative – materiality practice statement	ED	
Disclosure initiative – principles of disclosure	DP	
Insurance contracts ¹		
Macro hedging ¹		
Rate regulated activities ¹		
Annual improvements – 2014–2016 cycle	ED	
FASB projects		
Conceptual framework ¹		
Disclosure framework ¹		
Insurance contracts ¹		
Financial Instruments – classification and measurement	F	
Financial Instruments – impairment	F	
Financial Instruments – Hedging ¹		
Explanation of symbols:		
DP = Discussion Paper	ED = Exposure Draft	F = Final

¹ Timing to be determined

Appendix A: Noteworthy updates since the previous edition

The 2015 edition incorporates commentary for developments in multiple areas, including the following:

Chapter 3: Revenue recognition

- **3.11.1:** Latest developments on the Joint FASB/IASB Standard, Revenue from Contracts with Customers

Chapter 4: Expense recognition—share-based payments

- **4.19.1:** IASB Exposure Draft, Proposed amendments to IFRS 2, Share-based Payment
- **4.19.2:** FASB Proposed Accounting Standards Update, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*

Chapter 5: Expense recognition—employee benefits

- **5.18.1:** IASB Exposure Draft, Proposed amendments to IAS 19 and IFRIC 14, Remeasurement on a Plan Amendment, Curtailment or Settlement/ Availability of a Refund from a Defined Benefit Plan
- **5.18.2:** FASB Accounting Standards Update No. 2015-04, *Compensation—Retirement Benefits (Topic 715): Practical Expedient for the Measurement Date of an Employer’s Defined Benefit Obligation and Plan Assets*

Chapter 6: Assets—nonfinancial assets

- **6.23.1:** Latest developments on the Joint FASB/IASB Project, *Leases*
- **6.23.2:** FASB Accounting Standards Update No. 2015-05, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement*
- **6.23.4:** IASB Annual Improvements to IFRS 2012–2014: IFRS 5, Non-current Assets Held for Sale and Discontinued Operations: Changes in methods of disposal
- **6.23.5:** IASB amendments to IAS 16, Property, Plant, and Equipment and IAS 38 Intangible Assets: Clarification of Acceptable Methods of Depreciation and Amortization

Chapter 7: Assets—financial assets

- **7.16.1.3:** FASB Proposed Accounting Standards Update, *Financial Instruments—Credit Losses (Subtopic 825.15)*
- **7.16.3:** IASB Exposure Draft, proposed amendments to IFRS 10, Consolidated Financial Statements, IFRS 12, Disclosures of Interests in Other Entities, IAS 27, Separate Financial Statements, IAS 28, Investments in Associates and Joint Ventures, IAS 36, Impairment of Assets, and Illustrative Examples for IFRS 13, Fair Value Measurements: Measuring Quoted Investments in Subsidiaries, Joint Ventures, and Associates at Fair Value
- **7.16.4:** FASB Accounting Standards Update No. 2014-11, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*

Chapter 8: Liabilities—taxes

- **8.19.2:** FASB Proposed Accounting Standards Update, *Income Taxes (Topic 740), Intra-entity asset transfers & balance sheet classification of deferred taxes*
- **8.19.4:** IASB Exposure Draft, Accounting for uncertainties in income taxes

Chapter 10: Financial liabilities and equity

- **10.13.4:** FASB Accounting Standards Update No. 2015-03, *Simplifying the Presentation of Debt Issue Costs*

Chapter 11: Derivatives and hedging

- **11.21.1:** FASB Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*
- **11.21.2:** IASB amendments to IFRS 9, Financial Instruments (hedge accounting requirements)

Chapter 12: Consolidation

- **12.19.1:** FASB Accounting Standards Update No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*
- **12.19.2:** FASB Accounting Standards Update No. 2014-13, *Consolidation (Topic 810): Measuring the Financial Assets and Financial Liabilities of a Consolidated Collateralized Financing Entity*
- **12.19.3:** FASB Accounting Standards Update No. 2014-10, *Development Stage Entities (Topic 915): Elimination of Certain Financial Reporting*

*Requirements, Including an Amendment to Variable Interest Entities
Guidance in Topic 810, Consolidations*

- **12.19.5:** IASB amendments to IFRS 10, Consolidated Financial Statements, IFRS 12, Disclosures of Interests in Other Entities, and IAS 28, Investments in Associates and Joint Ventures: Investment Entities: Applying the Consolidation Exception
- **12.19.6:** IASB amendments to IFRS 10, Consolidated Financial Statements, and IAS 28, Investments in Associates and Joint Ventures: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture
- **12.19.7:** IASB proposed amendments to IFRS 10, Consolidated Financial Statements, IFRS 12, Disclosures of Interests in Other Entities, IAS 27, Separate Financial Statements, IAS 28, Investments in Associates and Joint Ventures, IAS 36, Impairment of Assets, and Illustrative Examples for IFRS 13, Fair Value Measurements: Measuring Quoted Investments in Subsidiaries, Joint Ventures, and Associates at Fair Value

Chapter 13: Business combinations

- **13.9:** FASB Accounting Standards Update No. 2014-17, *Business Combinations (Topic 805): Pushdown Accounting*

Chapter 14: Other accounting and reporting topics

- **14.21 and 14.22:** FASB Accounting Standards Update No. 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*
- **14.27:** FASB Accounting Standards Update No. 2014-05, *Service Concession Arrangements*
- **14.28.1:** IASB Exposure Draft, Proposed amendments to IAS 1, Classification of Liabilities
- **14.28.2:** FASB Accounting Standards Update No. 2015-01, Income Statement—Extraordinary and Unusual Items

Chapter 15: IFRS for small and medium-sized entities

- **15.2.1:** IASB update to IFRS for Small and Medium-sized Entities

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