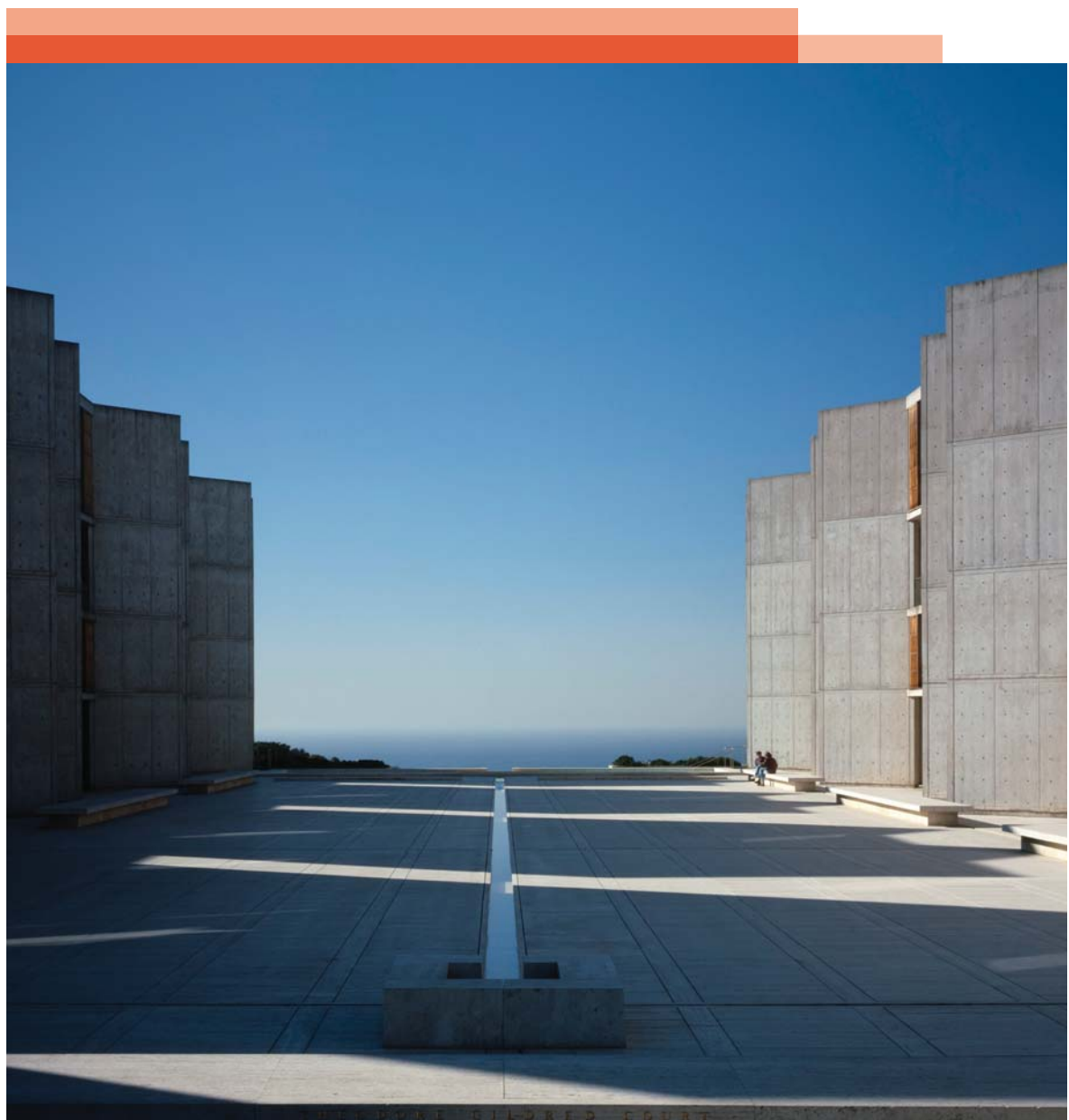


# ***IFRS and US GAAP: similarities and differences***

*IFRS readiness series  
October 2011*





---

## ***Table of contents***

---

***The heart of the matter*** **2**

***US financial reporting will  
change significantly within  
the next several years***

---

***An in-depth discussion*** **4**

***Examining the implications***

IFRS affects US businesses in multiple ways

---

***What this means for your business*** **10**

***Anticipate and manage the change***

What companies can and should do now

---

*The heart of the matter*

US financial reporting  
will change significantly  
within the next  
several years

International Financial Reporting Standards (IFRS) continue to affect US companies as a result of cross-border mergers and acquisitions (M&A), through business dealings with non-US customers and vendors, and as a consequence of the adoption of IFRS for statutory purposes by non-US subsidiaries. US companies are becoming increasingly aware of IFRS as key aspects of US generally accepted accounting principles (US GAAP) and IFRS are the focus of ongoing convergence projects by the US and international standard setters.

In February 2010, the Securities and Exchange Commission (SEC or the Commission) published a statement of continued support for a single set of high-quality global accounting standards and acknowledged that IFRS is best positioned to serve that role. The SEC also introduced a work plan designed to consider concerns raised by respondents to the SEC's 2008 proposed road map for the potential use of IFRS by US domestic issuers. Since then, the SEC issued its first progress report (October 2010), containing only an update on the SEC staff's work to date. In December 2010, SEC Chairman Mary Schapiro confirmed the SEC would be in a position to make its decision on whether, when, and how to incorporate IFRS into the financial reporting system for US public companies by the end of 2011. In May 2011, the SEC's Office of the Chief Accountant published a Staff Paper (the Staff Paper) exploring one possible method to incorporate IFRS into the US financial reporting system. The Staff Paper discussed a potential transition method, the role of the SEC and Financial Accounting

Standards Board (FASB), and the perceived benefits and risks of the possible method. It did not discuss an option to voluntarily adopt full IFRS nor communicate the Commission's decision on incorporation of IFRS into the US financial reporting system.

While time lines remain uncertain regarding the near-term use of IFRS in the United States, we continue to support the vision of a single set of high-quality, global accounting standards, consistently applied. We believe that the incorporation approach described in the Staff Paper is a fair starting point from which to develop a plan that will facilitate continued progress toward achieving the vision.

The recent economic crisis highlighted the interdependent nature of global business, and financial and capital markets, which makes the need for global accounting standards more apparent. Among current accounting standards, IFRS is best positioned to be the global accounting standard. However, in the United States, companies are still focusing on recovering from the recent economic crisis, and the business environment remains difficult. Couple this with the challenges relating to the inconsistent application of IFRS outside the United States, and the costs of implementation inside the United States, and there is increased uncertainty how, if, and when IFRS will be incorporated into the US financial reporting system.

### **Converge → Adopt**

In the meantime, approximately a dozen new accounting standards are under development that will advance the convergence of US

GAAP and IFRS. Convergence will affect topical areas such as financial instruments, revenue, leasing, and insurance. The timing of the convergence projects continues to evolve as the FASB and the International Accounting Standards Board (IASB) respond to constituent requests by taking the time necessary to develop high-quality standards. In this light, the FASB and IASB (collectively the boards) plan to re-expose the revenue and leases exposure drafts and have made significant tentative changes to other exposure drafts. We support the boards' continued focus on quality.

Regardless of the SEC's decision to incorporate IFRS into the US financial reporting system, ongoing convergence and new standards will result in significant changes. The impact of changes caused by convergence will go well beyond financial reporting. Contract terms, tax policy, financial planning, systems requirements, communications with stakeholders, credit agreements, and compensation structures are just some of the areas that may be affected. This, together with continued global adoption of IFRS and new regulations caused by the financial crisis, will result in an extended period of substantial change for companies.

This publication is designed to help readers develop a broad understanding of the major differences between IFRS and US GAAP 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 we generally consider to be the most significant and/or most common.

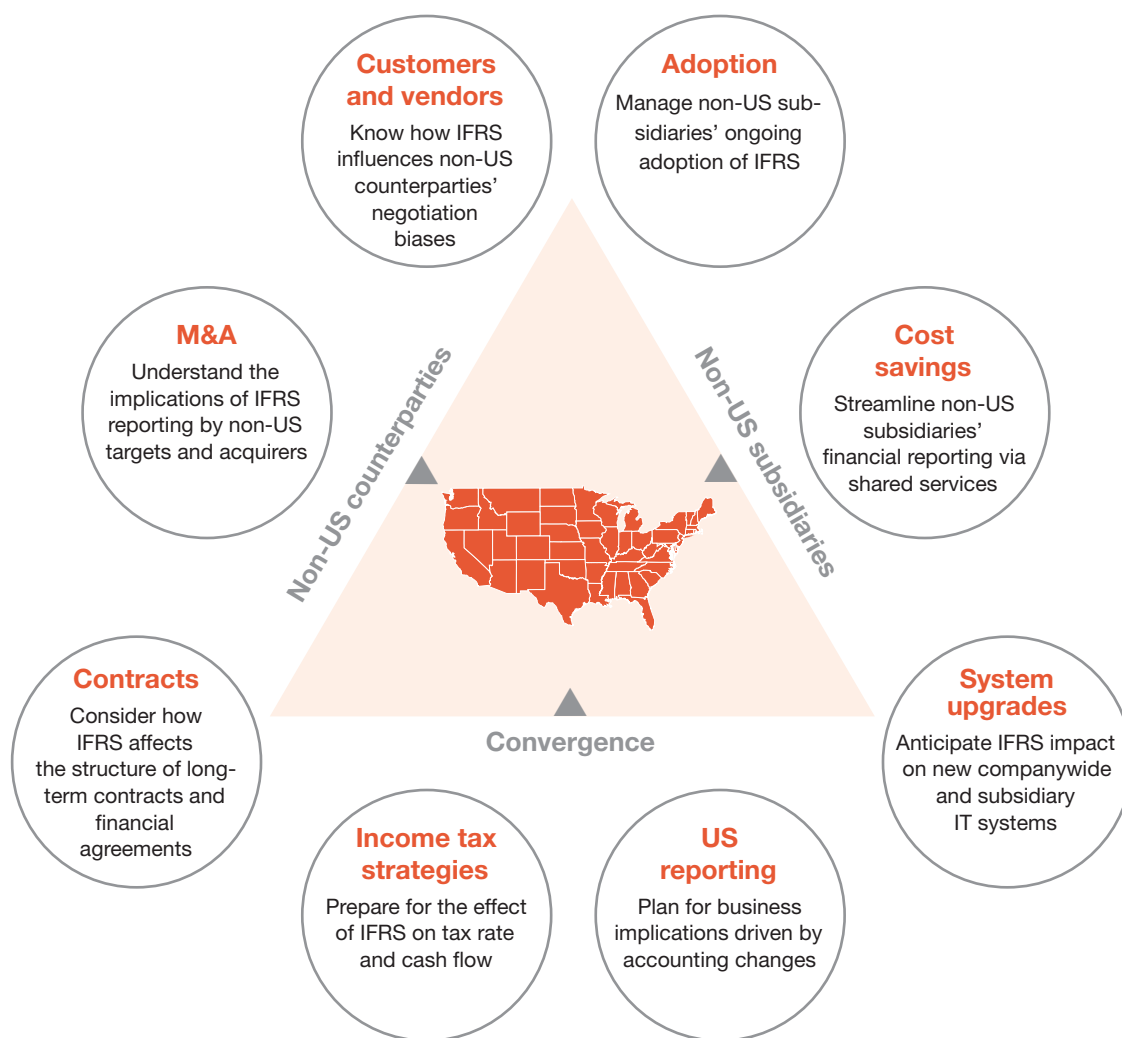
---

*An in-depth discussion*

Examining the  
implications

## IFRS affects US businesses in multiple ways

The near-term use of IFRS in the United States remains uncertain, but it is clear that continued convergence of US GAAP and IFRS will result in significant change that will impact financial reporting throughout the world. The graphic below illustrates ways that IFRS may affect US businesses. Each business will be affected by IFRS at different times and to different degrees, depending on factors such as size, industry, geographic makeup, and global expansion plans. The ensuing discussion expands on each of these impacts.



Many US multinational companies have already been dealing with the effects of IFRS as a result of their foreign subsidiaries doing business in countries that have or are in the process of adopting IFRS. A working understanding of IFRS and careful planning can help to avoid pitfalls and maximize the benefits.

### **Adoption**

Many countries currently require or permit IFRS for statutory financial reporting purposes, and more countries plan to follow suit. As a result, multinational companies should closely manage the process of IFRS adoption by their non-US subsidiaries. Adoption elections that subsidiaries deem best for themselves will not necessarily be best for their US parents. In addition, once a subsidiary makes an accounting policy election under IFRS (upon adoption), that decision typically cannot be undone for statutory reporting purposes, unless the change results in more relevant and reliable information.

US multinationals, therefore, need to pay attention to, and actively participate in, their subsidiaries' IFRS adoption to avoid the unnecessary reporting complexity that divergent policy elections will create, and ultimately to maximize the advantages of one common global accounting system. For more information on specific countries, see our interactive "IFRS adoption by country" map.

### **Cost savings**

If IFRS is incorporated into the US financial reporting system, taking a centralized approach to IFRS reporting (and thereby achieving consistent application across the organization—for both corporate external reporting and local statutory reporting) can potentially create significant cost savings for multinational companies. For example, parent companies might want to be prepared to use global shared services centers in the future to consolidate back-office operations and to facilitate reporting. Consequently, this will reduce the work that goes into financial statement processing, as well as the need to maintain separate sets of accounting records in multiple locations.

### **System upgrades**

As companies prepare to upgrade existing IT systems or implement new ones, they should carefully evaluate whether the systems can handle the new measurement and disclosure requirements under the proposed convergence standards, as well as under IFRS if it is incorporated into the US financial reporting system. Depending on whether and how IFRS is adopted in the United States, companies' IT systems may need the ability to handle dual-reporting requirements (companies might need to prepare financial information under both IFRS and US GAAP) during a transition period or after their non-US subsidiaries have begun reporting under IFRS. Identifying potential data gaps early will allow companies to design IT systems that deliver the necessary information efficiently.



## US reporting

The impact of the accounting changes caused by convergence or IFRS adoption will be significant and will have broad-based implications. Even without full IFRS adoption, IFRS has already influenced US GAAP through convergence. The effect of that influence will grow within the next several years.

Under the Memorandum of Understanding, the boards are working jointly to develop standards that will converge and improve IFRS and US GAAP in several areas. The standard setters modified their convergence strategy and time line several times during 2010 and into 2011, further prioritizing their

agendas, focusing on only a few projects and postponing several other projects, but not abandoning them. Although the listing of joint projects continues to evolve, the diagram below summarizes the boards' joint projects and our expectation of the respective time lines:



- (a) Although the FASB has not yet reached a decision about re-exposure, we expect that the FASB will issue an exposure draft on classification & measurement and impairment in Q4 2011, with a final standard expected in 2012. The IASB expects to finalize its project on hedging by Q4 2011, but the FASB's timing is expected to be later (2013).
- (b) The boards decided to re-expose revenue and leasing. Final standards are expected in the second half of 2012.
- (c) The FASB is working with the IASB to converge and improve US GAAP in the insurance contracts project. Re-exposure is expected, with a final standard possible in 2012.
- (d) The IASB issued its final consolidation standard in Q2 2011. The FASB plans to issue in September 2011 an ED with limited amendments to FAS 167 (ASU 2010-10). Discussions continue on the investment companies topic with the FASB to issue an ED in Q3 2011 (the IASB ED was issued in August 2011).
- (e) These projects have been delayed until the boards have further capacity.

Financial instruments, revenue recognition, and leases are considered the joint priority projects. During 2011, the boards reset the target for completion of the priority projects and seem to be taking the time necessary to further improve the final standards. The boards have agreed to re-expose the exposure drafts for revenue and leases, and now expect to issue final standards in the second half of 2012. The financial instruments project is effectively three projects (classification and measurement, impairment, and hedge accounting), for which convergence has been more difficult to attain. The financial instruments project is not expected to be completed until 2012 or later. The other joint projects will be revisited as the boards have further capacity.

Both US GAAP and IFRS will continue to change as a result of the convergence process. Consider revenue recognition: The proposed revenue recognition model is different from what many US companies have long been following. For instance, under current guidance, a company defers all of the revenue from a contract when it cannot be assured at the onset of the arrangement of collecting from the customer. Under the proposed model, this hurdle has been removed. Also under the proposed model, estimates of uncollectible amounts will offset gross revenue, instead of being recorded as bad debt expense. These changes will impact margins and will require a “day one” estimate of customer credit losses for all transactions.

Another example is sales-type incentives such as free products or customer loyalty programs, which are currently recognized as marketing expense in some circumstances. The proposed model generally would require that those incentives be considered performance obligations and revenue would be deferred until such obligations are satisfied, such as when a customer redeems loyalty points. This change would align US GAAP with the guidance for customer loyalty programs under IFRS. In general, the proposal may drive an increase in the identification and separation of performance obligations and might require greater use of estimates. How a company recognizes revenue can affect a host of other things, including sales contract terms, sales strategy, salesperson compensation, cash management, investor communications, and even information-system design.

The lease accounting model under both US GAAP and IFRS will significantly change as a result of the convergence agenda. The boards soon will re-expose a draft on the future of lease accounting. Under the expected proposal the operating lease accounting model would be eliminated for most leases. Generally, all rights and obligations under lease arrangements would be accounted for as assets and liabilities, representing a major change from current practice.

The recognition of assets and liabilities for all leases currently considered to be operating in nature would

impact balance sheet metrics/ratios, as well as profit and loss recognition and income statement presentation. Such treatment could cause companies to rethink their lease-versus-buy decisions and turn away from leasing to avoid accounting results they see as undesirable, or simply to avoid the complexity of the new standard. Others may try to shorten lease agreements to a maximum term of 12 months to qualify for operating lease accounting. The new standard could also cause companies to modify their business practices because they often have one budget for operating expenses and another budget for capital expenses, with responsibility for each budget overseen by different buyers in the organization.

The proposal also would require ongoing monitoring efforts as companies would be required to estimate lease terms, contingent rentals, and residual value guarantees and update those estimates as facts and circumstances change over the lease term.

Today’s models for the classification and measurement of financial instruments are also very different from the potential changes being considered by the boards. For classification and measurement, the FASB is considering changing the manner in which financial assets and liabilities are classified and how the changes in value of those instruments are measured and recorded (i.e., held at amortized cost, recorded in other comprehensive income, or recorded in income). For instance, today, loans held for

sale are valued at the lower of cost or market. Under the FASB's proposed approach, they would be classified as trading activities and changes in the fair value of such loans would be recorded in earnings each period. In the impairment phase of the project, the boards have been contemplating several new approaches to today's impairment models. Finally, the boards are working to simplify the accounting for hedging activities.

Although we have provided just a few examples, the convergence projects will significantly impact US GAAP and IFRS. The examples above are based on the latest information as of July 31, 2011, and are subject to change, based on further redeliberations and discussions among the standard setters and constituents. For more information on the convergence projects, see our publication "US GAAP convergence and IFRS: What you need to know about the FASB and IASB's joint projects" and its regular updates.

### **Income tax strategies**

Companies may need to assess how IFRS-driven changes in financial reporting (both US and local country statutory) will affect income taxes.

IFRS adoption can impact the effective tax rate. For example, in adopting IFRS, a company might find that its debt-equity levels are affected, thereby limiting, or increasing, the amount of interest that may be deductible in a jurisdiction, with a related impact on the company's effective tax rate. There are also potentially significant cash tax implications. In some jurisdictions,

tax reporting aligns with statutory reporting. When IFRS is adopted for statutory reporting purposes in such a location, the impact can be significant.

Consequently, companies must consider how their current tax structuring might be affected, as well as future tax planning considerations. They also should assess the potential tax impact of upcoming new US accounting standards (not just the impact of potential IFRS adoption) and consider appropriate tax-planning alternatives.

### **Contracts**

Adopting IFRS will have an impact on long-term contracts and financial agreements. For example, a company's debt covenants might specify a certain debt-equity ratio, which may change once the company applies new US standards or adopts IFRS, hence making it necessary for the company to renegotiate or seek modifications to its debt agreements. Another example, as referenced above, is that rights and obligations resulting from current operating leases would need to be accounted for as assets and liabilities, thereby significantly changing the balance sheet, income statement, cash flow presentation, and key metrics that may be referenced in contracts.

Still another consideration is that compensation and bonus arrangements are often linked to financial metrics reported under US GAAP. These metrics may change when the proposed US GAAP standards take effect and if IFRS is adopted in the United States. Anticipating the effects

of these changes will help companies meet their compensation objectives.

### **Mergers and acquisitions**

Global consolidation is on the rise. As more countries adopt IFRS for capital market and statutory reporting purposes, knowledge and understanding of IFRS will be increasingly important to US companies as they conduct their due diligence in evaluating public and private non-US targets. Conversely, US companies that are targets may need to quickly share IFRS-based data with a potential buyer. Pre-deal regulatory filings and post-deal reporting often require conversions from one accounting framework to another—many times under tight time lines. Knowledge of IFRS and the potential impact of the convergence projects may be critical in ensuring that key stakeholders (e.g., analysts and investors), understand the impacts of proposed and recently completed acquisitions. Finally, carve-outs and spin-offs of non-US operations may necessitate knowledge of or conversions to IFRS.

### **Customers and vendors**

The vast majority of US companies transact business with global customers and suppliers, many of which are located in countries where IFRS is the primary reporting language. A sound understanding of how IFRS affects the behavior of customers and vendors will better position US companies in business negotiations with those counterparties.

---

*What this means for your business*

Anticipate and manage  
the change

## **What companies can and should do now**

Despite the uncertainty in the United States regarding the adoption of IFRS, the convergence projects are already having a significant impact on US businesses. The impact will only increase in the next several years as convergence continues and potential adoption of IFRS for reporting outside the United States gains momentum.

In the near term, three main challenges merit companies' attention:

- Keeping pace with an unprecedented rate of financial reporting change as converged US standards and new IFRS are deliberated and finalized
- Monitoring and managing subsidiaries' adoption of IFRS as more countries move to IFRS-based reporting standards
- Understanding how the structure of deals and transactions with non-US counterparties (particularly vendors and customers) may be influenced by those counterparties' increased interest in IFRS accounting outcomes

To successfully face these challenges, companies should:

- **Focus on the challenge.** The next several years will bring major changes to US financial reporting. Whether changes arrive through convergence, a SEC-mandated move to IFRS, regulation, or IFRS adoption by subsidiaries and counterparties, the effect on US businesses will be considerable.
- **Contemplate using scenario planning.** Incorporate likely convergence and IFRS adoption expectations into your strategic thinking and business planning. Consider the effects various alternative paths could have. Identify and consider the implications of business, accounting, tax structure, financing, long-term contractual commitment, investor, internal controls, systems, and workforce issues.
- **Maintain corporate oversight.** Many countries require or permit IFRS for statutory reporting purposes. For non-US subsidiaries that may be transitioning to some form of IFRS in the foreseeable future, plan to influence transition timing, strategies, and policy decisions.

- **Identify what you can do now.** Ensure you understand the significant impacts these financial reporting changes may have on your company, and communicate that understanding to key stakeholders. Stay engaged in the standard setting process by participating in roundtables and the comment letter process, as appropriate. Be mindful of aspects of convergence and conversion that will take the longest. If highly probable changes can be made efficiently and without waste, get started addressing those challenges. Consider smaller controlled one-off projects where desirable.

By staying focused on aspects of convergence and adoption that have a long lead time, companies can stay ahead of the game while also pursuing small one-off projects and “easy wins.”



---

A further study  
IFRS and US GAAP  
similarities and differences

## About this publication

This publication is designed to alert companies to the timing and scope of accounting changes that the US GAAP/IFRS convergence agenda and the eventual adoption of IFRS in the United States will bring. It is also designed to put into context how convergence with or adoption of IFRS has ramifications far beyond the accounting department.

With the stage having been set, the remainder of this publication contains “A further study” consisting, for each topical area, of:

- An executive summary of current IFRS and US GAAP differences and the potential implications thereof
- A more detailed analysis of current differences between the frameworks including an assessment of the impact embodied within the differences
- Commentary/insight with respect to recent/proposed guidance including developments in relation to the overall convergence agenda

In addition to the above, this publication also includes an overview of IFRS for SMEs.

This publication takes into account authoritative pronouncements and other developments under IFRS and US GAAP through July 31, 2011. This publication is not all-encompassing. When applying the individual accounting frameworks, companies should consult all of the relevant accounting standards and, where applicable, national law.

## Updates since the previous edition

The 2011 edition incorporates commentary for developments in multiple areas, including the following:

### Revenue recognition

- FASB/IASB Joint Exposure Draft, *Revenue from Contracts with Customers*

### Expense recognition—share-based payments

- IFRS Interpretations Committee—Share-Based Payment Awards Settled Net of Tax Withholdings

### Expense recognition—employee benefits

- IASB Amendment to IAS 19, *Employee Benefits*
- FASB Proposed Accounting Standards Update—Compensation—Retirement Benefits—Multiemployer Plans (Subtopic 715-80), *Disclosure about an Employer’s Participation in a Multiemployer Plan*
- US Patient Protection and Affordable Care Act

### Assets—nonfinancial assets

- Joint FASB/IASB Exposure Draft, *Leasing*
- FASB Expected Exposure Draft, *Investment Properties*



### **Assets—financial assets**

- FASB Accounting Standards Update No. 2011-03, *Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements*
- IASB Exposure Draft, *Derecognition: Proposed Amendments to IAS 39* and IASB Amendments to IFRS 7, *Disclosures: Transfers of Financial Assets*
- FASB Proposed Accounting Standards Update, *Balance Sheet Offsetting*, and IASB Exposure Draft, *Offsetting Financial Assets and Financial Liabilities*
- FASB Accounting Standards Update No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRSs*, and IASB IFRS 13, *Fair Value Measurement*
- Joint FASB/IASB Financial Instruments Project

### **Liabilities—taxes**

- IASB Amendment to IAS 12, *Deferred Tax: Recovery of Underlying Assets*

### **Liabilities—other**

- IASB Amendment to IAS 19, *Employee Benefits*
- FASB Accounting Standards Update No. 2010-27, *Fees Paid to the Federal Government by Pharmaceutical Manufacturers*
- IASB Exposure Draft, *Measurement of Liabilities in IAS 37*, and Working Draft, IFRS X, *Liabilities*
- FASB Expected Exposure Draft, *Disclosure of Certain Loss Contingencies*

### **Financial liabilities and equity**

- Joint FASB/IASB Financial Instruments with Characteristics of Equity Project
- Joint FASB/IASB Financial Instruments Project

### **Derivatives and hedging**

- FASB Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*
- IASB Exposure Draft, *Hedge Accounting*

### **Consolidation**

- IFRS 10, *Consolidated Financial Statements*
- IFRS 11, *Joint Arrangements*
- IFRS 12, *Disclosure of Interests in Other Entities*
- IAS 28 (Amended), *Investments in Associates and Joint Ventures*
- FASB Proposed Accounting Standards Update, *Consolidation (Topic 810)—Agent/Principal Analysis*
- Joint FASB/IASB Investment Entities Project

### **Business combinations**

- FASB Accounting Standards Update No. 2010-28, *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*
- FASB Proposed Accounting Standards Update, *Testing Goodwill for Impairment*

### **Other accounting and reporting topics**

- FASB Accounting Standards Update No. 2011-05, *Presentation of Comprehensive Income*, and IASB Amendment to IAS 1, *Presentation of Financial Statements*
- IASB Amendment to IAS 24, *Related Party Disclosures*
- Joint FASB/IASB Staff Draft, *Preliminary Views on Financial Statement Presentation*
- Joint FASB/IASB Exposure Draft, *Discontinued Operations*
- Joint FASB/IASB Project, *Conceptual Framework*
- Joint FASB/IASB Exposure Draft, *Simplifying Earnings per Share*



---

## Table of contents

IFRS first-time adoption	19
Revenue recognition	23
Expense recognition—share-based payments	42
Expense recognition—employee benefits	53
Assets—nonfinancial assets	74
Assets—financial assets	95
Liabilities—taxes	120
Liabilities—other	128
Financial liabilities and equity	139
Derivatives and hedging	155
Consolidation	173
Business combinations	195
Other accounting and reporting topics	205
IFRS for small and medium-sized entities	221
FASB/IASB project summary exhibit	225
Index	229



---

## ***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.

### ***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. 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 and apply those policies retrospectively to all of the periods presented in the first IFRS financial statements
- Consider whether to apply any of the optional exemptions from retrospective application
- Apply the four mandatory exceptions from retrospective application
- Make extensive disclosures to explain the transition to IFRS

IFRS 1 is regularly updated to address first-time adoption issues. There are currently 18 long-term optional exemptions 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 two such short-term exemptions. There are also certain mandatory exceptions for which retrospective application is not permitted.

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.

## **When to apply IFRS 1**

Companies will apply IFRS 1 when they transition from their previous generally accepted accounting principles (GAAP) to IFRS and prepare their first IFRS financial statements. These are the first financial statements to contain an explicit and unreserved statement of compliance with IFRS.

## **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, 2015, would have a transition date of January 1, 2013. 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.

## **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 timely. 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. The SEC currently envisions, for example, 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, and those differences might cause some companies 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 policies 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.







## Revenue recognition

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 project 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, for illustrative purposes only, we note that US GAAP guidance on software revenue recognition requires the use of vendor-specific objective evidence (VSOE) in determining an estimate of the selling price. IFRS does not have an equivalent requirement. We also observe that industry-specific US GAAP guidance can produce conflicting results for economically similar transactions. For example, 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:

Pricing contingencies and how they factor 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 way revenue gets allocated to the different components. US GAAP guidance in this area has recently changed. The historical non-software-specific guidance, which may be used only for fiscal years beginning prior to June 15, 2010, indicates that VSOE of fair value is preferable in all circumstances in which it is available. When VSOE is not available, third-party vendor objective evidence may be used. Consideration should be allocated based on relative fair value but may be allocated based on the residual method if the fair value of the delivered item is unknown. New US GAAP non-software guidance in this area (effective for fiscal years beginning on or after June 15, 2010) requires the use of a best estimated selling price in transactions in which VSOE or third-party evidence of selling prices does not exist. The residual method of allocating arrangement consideration is no longer permitted, and consideration must be allocated based on relative selling prices. Estimated selling prices may be derived in a variety of ways, including cost plus a reasonable margin. Estimating fair value via cost plus a reasonable margin has not historically been acceptable under US GAAP, although it has been and continues to be acceptable under IFRS. Although the new guidance eliminates a current difference between US GAAP and IFRS (i.e., the ability to estimate value based on cost plus a reasonable margin), another new difference is created (i.e., the elimination of the residual method under US GAAP).

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). Diversity in application of the percentage-of-completion method may 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.

While the standard setters continue to make isolated changes to their individual accounting frameworks, they are focused on developing a single converged revenue recognition standard. To that end, the FASB and IASB released, in June 2010, a joint exposure draft on revenue recognition, *Revenue from Contracts with Customers*. The comment period on the exposure draft ended in October 2010 and redeliberations commenced in January 2011. The boards decided to re-expose the proposed revenue standard and expect to release this document in September 2011, with a 120-day comment period. The new model is expected to significantly impact revenue recognition under both US GAAP and IFRS. Every industry having contracts within the scope of the project might be affected, and some will see pervasive changes. Refer to the Recent/proposed guidance section for a further discussion of the joint revenue recognition project.

Further details on the foregoing and other selected current differences are described in the following table.

Impact	US GAAP	IFRS
<p><b>Revenue recognition—general</b></p> <p>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.</p> <p>This fundamental difference requires a detailed, transaction-based analysis to identify potential GAAP differences.</p> <p>Differences may have ramifications on how companies operate, including, for example, how they bundle various products and services in the marketplace.</p>	<p>Revenue recognition guidance is extensive and includes a significant volume of literature issued by various US standard setters.</p> <p>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.</p> <p>These rather straightforward concepts are augmented with detailed rules.</p> <p>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.</p>	<p>Two primary revenue standards capture all revenue transactions within one of four broad categories:</p> <ul style="list-style-type: none"> <li>• Sale of goods</li> <li>• Rendering of services</li> <li>• Others' use of an entity's assets (yielding interest, royalties, etc.)</li> <li>• Construction contracts</li> </ul> <p>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.</p> <p>The principles laid out within each of the categories are generally to be applied without significant further rules and/or exceptions.</p> <p>The concept of VSOE of fair value does not exist under IFRS, thereby resulting in a lower fair value separation threshold for software under IFRS.</p> <p>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 margin) may, in certain circumstances, be acceptable alternatives.</p>

Impact	US GAAP	IFRS
<p><b>Contingent consideration—general</b></p> <p>Revenue may be recognized earlier under IFRS when there are contingencies associated with the price/level of consideration.</p>	<p>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.</p> <p>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.</p>	<p>For the sale of goods, one looks to the general recognition criteria as follows:</p> <ul style="list-style-type: none"> <li>• The entity has transferred to the buyer the significant risks and rewards of ownership;</li> <li>• The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;</li> <li>• The amount of revenue can be measured reliably;</li> <li>• It is probable that the economic benefits associated with the transaction will flow to the entity; and</li> <li>• The costs incurred or to be incurred with respect to the transaction can be measured reliably.</li> </ul> <p>As such, assuming that the other revenue recognition criteria are met, 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 not probable that the economic benefits would flow to the entity or if the amount of revenue could not be reliably measured, recognition of any contingent consideration would be postponed until all of the criteria are met.</p>

Impact	US GAAP	IFRS
<p><b>Multiple-element arrangements—general</b></p> <p>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.</p> <p>With the changes to US GAAP now fully effective, US GAAP may result in larger amounts being allocated to delivered units of accounting.</p>	<p>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.</p> <p>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 in a manner consistent with that used to determine the price to sell the deliverable on a stand-alone basis. No estimation methods are prescribed; however, examples include the use of cost plus a reasonable margin.</p> <p>Given the requirement to use a best estimated selling price 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.</p> <p>The residual method is precluded.</p> <p>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.</p>	<p>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. When identifiable components have standalone value and their fair value can be measured reliably, separation is required.</p> <p>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.</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Multiple-element arrangements—contingencies</b></p> <p>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.</p>	<p>The guidance includes a strict limitation on the amount of revenue otherwise allocable to the delivered element in a multiple-element arrangement.</p> <p>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.</p>	<p>IFRS maintains its general principles and would look to key concepts including, but not limited to, the following:</p> <ul style="list-style-type: none"> <li>• Revenue should not be recognized before it is probable that economic benefits would flow to the entity.</li> <li>• The amount of revenue can be measured reliably.</li> </ul> <p>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.</p>

Impact	US GAAP	IFRS
<p data-bbox="110 464 459 569"><b>Multiple-element arrangements—customer loyalty programs</b></p> <p data-bbox="110 590 521 806">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.</p> <p data-bbox="110 827 537 888">Where differences exist, revenue recognition is likely to be delayed under IFRS.</p>	<p data-bbox="570 590 992 709">Currently, divergence exists under US GAAP in the accounting for customer loyalty programs. Two very different models generally are employed.</p> <p data-bbox="570 730 1003 1010">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.</p> <p data-bbox="570 1031 1000 1092">The two models can result in significantly different accounting.</p>	<p data-bbox="1032 590 1458 932">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.</p> <p data-bbox="1032 953 1466 1360">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.</p>



Impact	US GAAP	IFRS
<p><b>Multiple element arrangements—loss on delivered element only</b></p> <p>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.</p>	<p>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.</p> <p>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.</p>	<p>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.</p> <p>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 approaches. 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.</p> <p>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.</p> <p>There is not, under IFRS, support for deferring the loss on the first element akin to the US GAAP approach.</p>

Impact	US GAAP	IFRS
<p><b>Sales of services—general</b></p> <p>A fundamental difference in the guidance surrounding how service revenue should be recognized has the potential to significantly impact the timing of revenue recognition.</p>	<p>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.</p> <p>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.</p> <p>Revenue is deferred if a service transaction cannot be measured reliably.</p>	<p>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.</p> <p>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.</p> <p>Revenue may have to be deferred in instances where a specific act is much more significant than any other acts.</p>
<p><b>Sales of services—right of refund</b></p> <p>Differences within the models provide the potential for revenue to be recognized earlier under IFRS when services-based transactions include a right of refund.</p>	<p>A right of refund may preclude recognition of revenue from a service arrangement until the right of refund expires.</p> <p>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.</p>	<p>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.</p> <p>When reliable estimation is not possible, revenue is recognized only to the extent of the costs incurred that are probable of recovery.</p>

Impact	US GAAP	IFRS
<p><b>Construction contracts</b></p> <p>There are a variety of differences between the two frameworks with potentially far-reaching consequences.</p> <p>Differences ranging from the transactions scoped into the construction contract accounting guidance to the application of the models may have significant impacts.</p>	<p>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.</p> <p>The scope of this guidance generally has been limited to specific industries and types of contracts.</p> <p><b>Completed-contract method</b></p> <p>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.</p> <p>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.</p>	<p>The guidance applies to fixed-price and cost-plus construction contracts of contractors 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.</p> <p>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.</p> <p>Construction accounting guidance is generally not applied to the recurring production of goods.</p> <p><b>Completed-contract method</b></p> <p>The completed-contract method is prohibited.</p>

Impact	US GAAP	IFRS
<p><b>Construction contracts (continued)</b></p>	<p><b>Percentage-of-completion method</b>            Within the percentage-of-completion model there are two acceptable approaches: the revenue approach and the gross-profit approach.</p> <p><b>Combining and segmenting contracts</b>            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><b>Percentage-of-completion method</b>            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><b>Combining and segmenting contracts</b>            Combining and segmenting contracts is required when certain criteria are met.</p>
<p><b>Sale of goods—continuous transfer</b></p> <p>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.</p>	<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 achieved 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>Achieving the continuous transfer requirements for the sale of goods is expected to be relatively rare in practice.</p>

Impact	US GAAP	IFRS
<p><b>Barter transactions</b></p> <p>The two frameworks generally require different methods for determining the value ascribed to barter transactions.</p>	<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><b>Non-advertising-barter transactions</b></p> <p>The fair value of goods or services received can be used if the value surrendered is not clearly evident.</p> <p><b>Accounting for advertising-barter transactions</b></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><b>Accounting for barter-credit transactions</b></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>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>	<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><b>Non-advertising-barter transactions</b></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><b>Accounting for advertising-barter transactions</b></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><b>Accounting for barter-credit transactions</b></p> <p>There is no further/specific guidance for barter-credit transactions. The broad principles outlined above should be applied.</p>

Impact	US GAAP	IFRS
<p><b>Extended warranties</b></p> <p>The IFRS requirement to separately attribute relative fair value to each component of an arrangement has the potential to impact the timing of revenue recognition for arrangements that include a separately priced extended warranty or maintenance contract.</p>	<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 selling 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>
<p><b>Discounting of revenues</b></p> <p>Discounting of revenue (to present value) is more broadly required under IFRS than under US GAAP.</p> <p>This may result in lower revenue under IFRS because the time value portion of the ultimate receivable is recognized as finance/interest income.</p>	<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>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.</p>	<p>Discounting of revenue to present value is required in instances where the inflow of cash or cash equivalents is deferred.</p> <p>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.</p>
<p><b>Technical references</b></p> <p><b>IFRS</b> IAS 11, IAS 18, IFRIC 13, IFRIC 15, IFRIC 18, SIC 31</p> <p><b>US GAAP</b> 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</p>		

#### Note

The foregoing 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.

## Recent/proposed guidance

### Joint FASB/IASB Revenue Recognition Project

In June 2010 the FASB and IASB released an exposure draft, *Revenue from Contracts with Customers*, proposing a model that would have a significant impact on current revenue recognition under both US GAAP and IFRS.

Comments on the exposure draft were due in October 2010. Redeliberations began in January 2011. The boards have focused their discussions on common themes in the comment letters received from constituents, and have reached several tentative decisions. Some decisions confirm conclusions in the exposure draft and others significantly change direction from what was proposed previously. Tentative decisions made during redeliberations address several key areas, including transfer of control, identification of performance obligations, determining the transaction price, accounting for warranties, accounting for licenses of intellectual property, and transition. A few of the more significant changes from the proposals in the exposure draft include a clarified separation principle, the ability to use a “most likely amount” approach in measuring variable consideration (along with a requirement to constrain recognition unless such amounts are reasonably assured of being received), a separate assessment for when control of a good transfers versus when control of a service transfers, a change to warranty accounting, and increased contract cost guidance.

The following discussion reflects tentative board decisions through July 2011.

The proposed model employs an asset and liability approach, the cornerstone of the FASB’s and IASB’s conceptual frameworks. Current revenue guidance focuses on an “earnings process,” but difficulties often arise in determining when revenue is earned. The boards believe a more consistent application can be achieved by using a single, contract-based model where revenue recognition is based on changes in contract assets (rights to receive consideration) and liabilities (obligations to provide a good or perform a service). Under the proposed model, revenue is recognized based on the satisfaction of performance obligations. In applying the proposed model, entities would follow this five-step process:

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

#### 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. That is, 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 should be accounted for as a separate contract if it is for the addition of a distinct good or service at a price that is commensurate with that additional good or service. In all other circumstances, the entity should combine the modification with the original contract, reevaluate its performance obligation(s), and reallocate the transaction price to each separate performance obligation. While aspects of this proposal are similar to existing literature, careful consideration will be needed to ensure the model is applied to the appropriate unit of account.

### **Identify the separate 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.” The proposal broadens the existing definition. Performance obligations may be explicitly stated in the contract but may also arise in other ways. Legal or statutory requirements to deliver a good or perform a service may 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. The result is an increased identification of obligations within an arrangement, possibly changing the timing of revenue recognition. 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 are performance obligations under the proposed model; thus, 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.

### **Determine the transaction price**

Once an entity identifies all the performance obligations in a contract, the obligations will be measured using a “transaction price approach.” The transaction price is the amount of expected consideration to be received for delivering a good or performing a service. 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, (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. Inclusion of variable consideration may represent a significant change in the timing of revenue recognition. Such consideration is recognized as the entity satisfies its related performance obligations, provided such payments are reasonably assured of being received. Revenue may therefore be recognized earlier than under existing guidance if an entity is reasonably assured of obtaining the expected amount of consideration. This could result in increased volatility as estimates change, including a reduction of revenue for estimates adjusted downward.

### **Allocate the transaction price to the separate performance obligations**

For contracts with multiple performance obligations (deliverables), the obligations should be separately accounted for to the extent that (1) the pattern of transfer of goods and services is different and (2) they are distinct from other goods or services promised in the contract. A good or service is distinct and should be accounted for separately if the entity regularly sells the good or service separately, or the customer can use the good or service on its own or together with readily available resources.

An entity should account for two or more performance obligations as a single performance obligation if the risks to the entity of providing these goods or services are inseparable. In making this determination, an entity should consider whether (1) the goods are highly interrelated, (2) the entity provides a significant integration service (e.g., combining goods or services for which the customer has contracted), and (3) the entity significantly modifies the goods in the contract.

These determinations will require a significant amount of judgment and may increase the number of obligations that require separation as compared to today. For example, those that currently account for deliverables at the contract level (such as certain long-term construction or service contracts) may be significantly impacted by these proposed separation principles.

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, entities may use a residual technique 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 the transaction price entirely to one (or more) performance obligations if certain conditions are met.

### **Recognize revenue when each performance obligation is satisfied**

Revenue should be recognized when a promised good or service is transferred to the customer, which 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. Indicators that may be considered in determining whether the customer has obtained control of a good include (1) the customer has an unconditional obligation to pay, (2) the customer has legal title, (3) the customer has physical possession, and (4) the customer has the risks and rewards of ownership of the good. These indicators are not a checklist; nor are they all-inclusive. All relevant facts and circumstances should be considered to determine whether the customer has obtained control of a good. The customer has satisfied a performance obligation over time for services when (1) the entity's performance creates or enhances an asset that the customer controls, or (2) the entity's performance does not create an asset with alternative use to the entity and the customer receives a benefit as the entity performs each task, another entity would not need to reperform the tasks performed to date, or the entity has a right to payment for performance to date.

If control is transferred continuously over time, an entity may use output methods (e.g., units delivered), input methods (e.g., costs incurred), or the 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.

### **Select other considerations**

#### *Contract cost guidance*

The proposed 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 should be recognized as an asset if they are expected to be recovered. Entities should evaluate whether direct costs incurred in fulfilling a contract are in the scope of other standards (i.e., 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 probable of recovery 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.

#### *Onerous performance obligations*

Contracts should be assessed at inception and each reporting period thereafter to determine whether the remaining performance obligations have become onerous. This assessment is required only for contracts that have performance obligations that are satisfied continuously. A contract is onerous when the direct costs to satisfy all remaining performance obligations exceed the consideration allocated to those performance obligations. The excess should be recognized as a contract loss with a corresponding liability that is remeasured at each reporting period. This proposal may represent a significant change for US GAAP preparers. The recognition of onerous provisions for executory contracts generally is not currently permitted in US GAAP outside of certain specific guidance (e.g., construction contract guidance).

### **Summary observations and anticipated timing**

The above commentary is not all-inclusive. The effect of the new revenue recognition guidance will be extensive. Every industry may be affected, and some will see pervasive changes as the proposed model will replace all existing US GAAP and IFRS revenue recognition guidance, including industry-specific guidance, with the exception of rate-regulated guidance in US GAAP. The boards

decided to re-expose the proposed revenue standard and expect to release this document in September 2011, with a 120-day comment period. The revised exposure draft will include questions that request feedback on the more significant changes from the June 2010 exposure draft. These questions are expected to address the following: (1) performance obligations satisfied over time (i.e., service arrangements), (2) presentation of the effects of credit risk adjacent to revenue, (3) the “reasonably assured” constraint on revenue recognition, and (4) applying the onerous test. A final standard is now expected in September 2012, with an effective date likely no earlier than 2015. Entities should continue to evaluate how the model might change current business activities, including contract negotiations, key metrics (including debt covenants), budgeting, controls and processes, information technology requirements, and accounting. The proposed standard will permit either full or limited retrospective application, including application to those contracts that do not affect current or future periods but affect reported historical periods. Limited retrospective application would reduce the burden on preparers by (1) not requiring the restatement of contracts that begin and end within the same prior accounting period, (2) allowing the use of hindsight in estimating variable consideration, (3) not requiring the onerous test to be performed in comparative periods unless an onerous contract liability was recognized previously, and (4) not requiring disclosure of the maturity analysis of remaining performance obligations in the first year of application. Although the proposed standard does not address early adoption, the FASB prefers to prohibit early adoption; the IASB proposes to allow first-time adopters of IFRS to adopt early.



## **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 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, but move counter to, 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. The variability is driven by the requirement to remeasure and record through earnings (within certain limits) the deferred tax attributes of share-based payments each reporting period.

The following table provides further details on the foregoing and other selected current differences.

Impact	US GAAP	IFRS
<p><b>Scope</b></p> <p>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 as compared with IFRS.</p> <p>Companies that adopt IFRS will apply a single standard to all share-based payment arrangements, regardless of whether the counterparty is a nonemployee.</p>	<p>The guidance is focused on/driven by the legal definition of an employee with certain specific exceptions/exemptions.</p> <p>ASC 718, <i>Compensation—Stock Compensation</i>, applies to awards granted to employees and Employee Stock Ownership Plans. ASC 505-50 applies to grants to nonemployees.</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> <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><b>Measurement of awards granted to employees by nonpublic companies</b></p> <p>Companies that adopt IFRS will not have alternatives in choosing a measurement method.</p>	<p><b>Equity-classified</b></p> <p>The guidance allows nonpublic companies to measure stock-based-compensation awards by using the fair-value (preferred) method or the calculated-value method.</p> <p><b>Liability-classified</b></p> <p>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.</p>	<p>IFRS does not include such alternatives for nonpublic companies and requires the use of the fair-value method in all circumstances.</p>

Impact	US GAAP	IFRS
<p><b>Measurement of awards granted to nonemployees</b></p> <p>Both the measurement date and the measurement methodology may vary for awards granted to nonemployees.</p> <p>In addition, the concept of unidentifiable goods or services may lead to earlier expense recognition under IFRS.</p>	<p>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.</p> <p>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.</p>	<p>Transactions with parties other than employees 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.</p> <p>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), fair value of the award should be measured indirectly by reference to the fair value of the equity instrument granted as consideration.</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Classification of certain instruments as liabilities or equity</b></p> <p>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.</p>	<p>In certain situations, puttable shares may be classified as equity awards.</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>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>Puttable shares are always classified as liabilities.</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> <p>IFRS 2 follows a similar principle of equity/liability classification as ASC 718. However, while IAS 32 has similar guidance to ASC 480, companies applying 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><b>Awards with conditions other than service, performance, or market conditions</b></p> <p>Certain awards classified as liabilities under US GAAP may be classified as equity under IFRS.</p>	<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, performance, or market vesting conditions, it is still 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>
<p><b>Service-inception date, grant date, and requisite service</b></p> <p>Because of the differences in the definitions, there may be differences in the grant date and the period over which compensation cost is recognized.</p>	<p>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.</p>	<p>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.</p>

Impact	US GAAP	IFRS
<p><b>Attribution—awards with service conditions and graded-vesting features</b></p> <p>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.</p>	<p>Companies are permitted to make an accounting policy election regarding the attribution method for awards with service conditions and graded-vesting features. The choice in attribution method is not linked to the valuation method that the company uses. For awards with graded vesting and performance or market conditions, the graded-vesting attribution approach is required.</p>	<p>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.</p>
<p><b>Certain aspects of modification accounting</b></p> <p>Differences between the two standards for improbable to probable modifications may result in differences in the compensation costs that are recognized.</p>	<p>An improbable to probable Type III modification can result in recognition of compensation cost that is less than the estimated 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, the grant-date fair value of the award would not be a floor for the amount of compensation cost recognized.</p>	<p>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 options that are expected to vest (from zero to a new amount of shares), and the award's full original grant-date fair value would be recognized over the remainder of the service period. That result is the same as if the modified performance condition had been in effect on the grant date.</p>
<p><b>Alternative vesting triggers</b></p> <p>It is likely that awards that become exercisable based on achieving one of several conditions would result in a revised expense recognition pattern (as the awards would be bifurcated under IFRS).</p>	<p>An award that becomes exercisable based on the achievement of either a service condition or a market condition is treated as a single award. Because such an award contained a market condition, compensation cost associated with the award would not be reversed if the requisite service period is met.</p>	<p>An award that becomes exercisable based on the achievement of either a service condition or a market condition is treated as two awards with different service periods, fair values, etc. Any compensation cost associated with the service condition would be reversed if the service was not provided. The compensation cost associated with the market condition would not be reversed.</p>



Impact	US GAAP	IFRS
<p><b>Cash-settled awards with a performance condition</b></p> <p>For a cash-settled award where the performance condition is not probable, liability and expense recognition may occur earlier under IFRS.</p>	<p>For cash-settled awards with a performance condition, where the performance condition is not probable, there may be no liability recognized under US GAAP.</p>	<p>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 is recognized under IFRS based on the fair value of the instrument (considering the likelihood of earning the award).</p>
<p><b>Derived service period</b></p> <p>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.</p>	<p>US GAAP contains the concept of a derived service period for awards that contain market conditions. Where an award containing a market condition is fully vested and deep out of the money at 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 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.</p>	<p>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.</p>

Impact	US GAAP	IFRS
<p><b>Tax withholding arrangements—impact to classification</b></p> <p>There could be a difference in award classification as a result of tax withholding arrangements.</p>	<p>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.</p>	<p>IFRS does not contain a similar exception. Under IFRS, for an award to be wholly classified as equity-settled, the entity should settle the transaction by issuing the gross number of shares under option upon exercise. Conversely, where an employer settles an employee's tax withholding liability using its own 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.</p>
<p><b>Accounting for income tax effects</b></p> <p>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.</p> <p>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.</p> <p>There are also differences in the presentation of the cash flows associated with an award's tax benefits.</p>	<p>The US GAAP model for accounting for income taxes requires companies to record deferred taxes as compensation cost is recognized. The measurement of the deferred tax asset is based on an estimate of the future tax deduction, if any, 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).</p>	<p>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).</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Accounting for income tax effects (continued)</b></p>	<p>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.</p> <p>In addition, the excess tax benefits upon settlement of an award would be reported as cash inflows from financing activities.</p>	<p>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.</p> <p>In addition, all tax benefits or shortfalls upon settlement of an award generally are reported as operating cash flows.</p>
<p><b>Recognition of social charges (e.g., payroll taxes)</b></p> <p>The timing of recognition of social charges generally will be earlier under IFRS than US GAAP.</p>	<p>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).</p>	<p>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 compensation expense is recognized. The guidance in IFRS for cash-settled share-based payments would be followed in recognizing an expense for such charges.</p>
<p><b>Valuation—SAB Topic 14 guidance on expected volatility and expected term</b></p> <p>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” provided by SAB Topic 14. As a result, there could be differences in estimated fair values.</p>	<p>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.</p>	<p>IFRS does not include comparable guidance.</p>

Impact	US GAAP	IFRS
<p><b>Employee stock purchase plan (ESPP)</b></p> <p>ESPPs generally will be deemed compensatory more often under IFRS than under US GAAP.</p>	<p>ESPPs are compensatory if terms of the plan:</p> <ul style="list-style-type: none"> <li>• 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);</li> <li>• Do not allow all eligible employees to participate on an equitable basis; or</li> <li>• Include any option features (e.g., look-backs).</li> </ul>	<p>ESPPs are compensatory and treated like any other equity-settled share-based payment arrangement. IFRS does not allow any safe-harbor discount for ESPPs.</p>
<p><b>Group share-based payment transactions</b></p> <p>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.</p>	<p>Generally, push-down accounting of the expense recognized at the parent level would apply to the separate financial statements of the subsidiary.</p> <p>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.</p>	<p>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.</p> <p>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.</p> <p>The accounting for a group equity-settled share-based payment transaction is dependent on which entity has the obligation to settle the award.</p>

Impact	US GAAP	IFRS
Group share-based payment transactions (continued)		<p>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”) 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.</p> <p>Hence, measurement could vary between the two sets of accounts.</p>

### Technical references

**IFRS** IFRS 2, IFRIC 8, IFRIC 11

**US GAAP** ASC 480, ASC 505–50, ASC 718, ASC 815–40, SAB Topic 14–D

### Note

The foregoing 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.

## Recent/proposed guidance

### IFRS Interpretations Committee—Share-Based Payment Awards Settled Net of Tax Withholdings

In 2010, the IFRS Interpretations Committee (the Committee) was asked how to classify a share-based payment transaction in which an entity withholds a specified portion of the shares that would otherwise be issued to the counterparty upon exercise (or vesting) of the share-based payment award to settle the counterparty's tax withholding obligation associated with the share-based payment. The request received by the Committee asked whether the portion of the share-based payment that is withheld should be classified as cash-settled or equity-settled. The Committee discussed the issue several times. At its March 2011 meeting the Committee decided not to add the issue to its agenda because addressing the Committee's concerns would require an amendment to IFRS 2. Instead, the Committee decided to recommend to the IASB that this issue should be included in a future IASB agenda proposal for IFRS 2.

Under US GAAP, a stock-based compensation plan may permit shares that are issued upon an employee's exercise of an option to be withheld as a means of meeting tax withholding requirements. As long as the plan does not permit the option holder to require that the employer withhold taxes in excess of statutory minimums and the employer, as a matter of practice, does not withhold taxes in excess of statutory minimums, then the entire arrangement does not require liability classification. This is an exception within US GAAP that would otherwise require liability classification of an award when any portion thereof is settled in cash.

### FASB Accounting Standards Update No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRSs*, and IASB IFRS 13, *Fair Value Measurement*

On May 12, 2011, the FASB issued Accounting Standards Update No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRSs* and the IASB issued IFRS 13, *Fair Value Measurement*. The new guidance amends US GAAP and is a new standard under IFRS creating a converged definition of fair value. The new fair value guidance specifically indicates, however, that it does not apply to share-based payment transactions under either US GAAP or IFRS. Both US GAAP and IFRS share-based payments guidance include definitions of fair value that are specific to share-based payment transactions. These definitions have not changed. For a discussion of the new general fair value guidance refer to the Recent/proposed guidance section of the Assets—financial assets chapter.

---

## ***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 company. Further differences could have a significant impact on presentation, operating metrics, and key ratios. 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 (OPEB) to include postretirement benefits, other than pensions and other postemployment benefits, and the term postemployment benefits to include benefits before retirement.

A selection of differences is summarized below.

Under IFRS, a company can adopt a policy that would allow recognition of gains/losses in other comprehensive income. Gains/losses treated in accordance with this election would not be subsequently recycled through the income statement. This election generally reduces the volatility of pension expense recorded within a company's income statement because gains/losses would be recorded only within other comprehensive income. Other policy elections available under IFRS for gain/loss recognition (i.e., corridor approach or immediate recognition within the income statement) are similar to those under US GAAP.

Under IFRS, companies are not required to present the full-funded status of their postemployment benefit plans on the balance sheet. However, companies are required to disclose the full-funded status within the notes to the financial statements. US GAAP permits the use of a calculated asset value (to spread market movements over periods of up to five years) in the determination of expected returns on plan assets. IFRS prohibits the use of a calculated value and requires that the actual fair value of plan assets at each measurement date be used.

Under IFRS there is no requirement to present the various components of pension cost as a net amount. As such, companies are permitted to present components of net pension cost within different line items on the income statement. The flexibility provided under IFRS would enable companies to record the interest cost and return on plan assets components of pension expense as part of financing within the income statement. 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.

In June 2011, the IASB issued amendments to IAS 19 (the new IFRS guidance) that significantly change the recognition, presentation, and disclosures of defined benefit plans. The effective date for the amendments is January 1, 2013, with early application permitted. As further discussed in the Recent/proposed guidance section below, under the revised standard, gains and losses will be recognized immediately in other comprehensive income, eliminating both the delayed recognition (corridor and spreading method) and immediate profit and loss recognition options in the current guidance. Prior service cost, both vested and unvested, also will be recognized immediately in operating income. Net interest expense or income will be calculated by applying the discount rate to the net surplus or deficit recognized on the balance sheet. Additional changes, including new disclosures, also will be required. The FASB's project on accounting for pension and other postemployment benefits is not active, but the board will determine the next steps on its project as a result of the IASB changes.

Further details on the foregoing and other selected current differences are described in the following table.

Impact	US GAAP	IFRS
<p><b>Expense recognition—actuarial gains/losses</b></p> <p>Under IFRS, companies can adopt a policy that would allow recognition of gains/losses in other comprehensive income. Gains/losses treated in accordance with such election are not subsequently recorded within profit or loss.</p> <p>Such election generally would reduce the volatility of pension expense in a company's income statement because these gains/losses would be recorded only within other comprehensive income.</p> <p>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. These are similar to actuarial gains and losses referenced under IFRS. Within this publication we have used the term “gains and losses” when referencing actuarial gains and losses.</p> <p>Under the new IFRS guidance, actuarial gains and losses will be recognized immediately in other comprehensive income and are not subsequently recorded within profit or loss. The new guidance will increase balance sheet volatility for IFRS reporting companies that currently use delayed recognition methods for gains and losses. Significant differences to US GAAP will remain.</p>	<p>The literature 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).</p> <p>Whether gains/losses are recognized immediately or are amortized in a systematic fashion, they are ultimately recorded within the statement of operations as components of net periodic pension expense.</p>	<p>In addition to the choices available under US GAAP, IFRS allows companies to recognize all gains/losses immediately in other comprehensive income (OCI). Once recognized in OCI, gains/losses are not subsequently recorded within profit or loss.</p> <p>In June 2011, the IASB issued amendments to IAS 19, <i>Employee Benefits</i>.</p> <p>Under the new IFRS guidance, actuarial gains and losses will be renamed “remeasurements” and 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 actuarial gains and losses—will be prohibited.</p> <p>Once recognized in OCI, gains/losses are not subsequently recorded within profit or loss. The new standard will no longer require that the amounts recognized in OCI be immediately taken to retained earnings.</p>



Impact	US GAAP	IFRS
<p><b>Income statement classification</b></p> <p>Under IFRS, companies have the option to present different components of pension/OPEB costs within different line items on the income statement.</p> <p>This could result in companies recording interest cost and expected return on plan assets as part of financing.</p> <p>The new IFRS guidance limits some but not all of the flexibility in classification. Therefore, differences may continue in income statement classification.</p>	<p>All components of net pension/OPEB cost must be aggregated and presented as a net amount in the income statement.</p> <p>Although it is appropriate to allocate a portion of net pension expense to different line items (such as cost of goods sold if other employee costs are included in this caption), the disaggregation and separate reporting of different components of net pension expense are precluded.</p>	<p>There is no requirement to present the various components of net pension cost as a single item or a set of items all presented on a net basis within the income statement. Rather, the guidance allows for the potential disaggregation of the component pieces of pension/OPEB cost.</p> <p>In June 2011, the IASB issued amendments to IAS 19, <i>Employee Benefits</i>.</p> <p>The new guidance will give the employer flexibility to either (1) present all components recognized in determining net income (i.e., service and finance costs but not actuarial gains and losses) as a single net amount (similar to US GAAP) or (2) separately display those components.</p>

Impact	US GAAP	IFRS
<p><b>Expense recognition— prior-service costs and credits</b></p> <p>IFRS has the potential to accelerate expense/credit recognition in income for the effects of plan amendments that create an increase (or decrease) to the benefit obligation (i.e., prior-service cost).</p> <p>The new IASB requirement will continue to be significantly different from US GAAP, which requires prior service costs to be initially recognized in OCI and then amortized through net income.</p>	<p>Prior-service cost 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:</p> <ul style="list-style-type: none"> <li>• The participant’s remaining years of service (for pension plans except where all or almost all plan participants are inactive)</li> <li>• The participant’s service to full eligibility date (for other postretirement benefit plans except where all or almost all plan participants are inactive)</li> <li>• The participant’s life expectancy (for plans that have all or almost all inactive employees)</li> </ul> <p>Negative prior-service cost should be recognized as a prior-service credit to 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 remaining service period of the active employees unless all or almost all plan participants are inactive, in which case the amortization period would be the plan participants’ life expectancies.</p>	<p>For active employees not yet vested, prior-service cost should be recognized, in income, on a straight-line basis over the average period from the date of the amendment until the benefits become vested.</p> <p>To the extent that the incremental benefits are vested as of the date of the plan amendment, the cost of those benefits should be recognized immediately in the income statement.</p> <p>Negative prior-service cost is accounted for the same as positive prior service costs.</p> <p>In June 2011, the IASB issued amendments to IAS 19, <i>Employee Benefits</i>.</p> <p>The new IFRS guidance requires recognition of all past service costs in the period of a plan amendment. Unvested past service cost cannot 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.</p>

Impact	US GAAP	IFRS
<p><b>Expected return on plan assets</b></p> <p>Under IFRS, companies are not permitted to use a calculated value of plan assets (reflecting changes in fair value over a period up to five years) in the determination of expected return on plan assets and in the related accounting for asset gains and losses.</p> <p>US GAAP currently uses an expected return on plan assets and a separate discount rate on the liability; therefore, the new IFRS guidance will create a new difference.</p>	<p>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 asset 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.</p>	<p>Plan assets should always be measured at fair value, and fair value should be used to determine the expected return on plan assets.</p> <p>In June 2011, the IASB issued amendments to IAS 19, <i>Employee Benefits</i>.</p> <p>The new guidance replaces the expected return on plan assets and the interest cost on the defined benefit obligation with a single net interest cost or income component.</p> <p>Net interest expense or income will be calculated by applying the discount rate (as described below) to the defined benefit asset or liability 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.</p>

Impact	US GAAP	IFRS
<p data-bbox="110 464 441 533"><b>Expense recognition— measurement frequency</b></p> <p data-bbox="110 554 535 611">IFRS requires interim remeasurements in more circumstances than US GAAP.</p> <p data-bbox="110 632 526 785">The requirement in the new IFRS guidance to recognize all gains/losses in OCI may increase the complexity of interim reporting, if the corridor method was used in the past.</p>	<p data-bbox="571 554 1003 835">The measurement of plan assets and benefit obligations is required as of the entity'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 plan amendment, curtailment, or settlement.</p>	<p data-bbox="1036 554 1468 1087">An entity must measure plan assets and benefit obligations with sufficient regularity that the amounts recognized do not differ materially from the amounts that would be determined at the end of the reporting period. Entities using the corridor method typically remeasure at an interim point only in the event of a plan amendment, curtailment, or settlement. Entities recognizing actuarial gains and losses in OCI typically remeasure the benefit obligation and plan assets at an interim point to establish a gain or loss recognized in OCI, but do not rebase service cost, interest cost, or expected return on assets (unless there was a plan amendment, curtailment, or settlement).</p> <p data-bbox="1036 1108 1419 1165">In June 2011, the IASB issued amendments to IAS 19, <i>Employee Benefits</i>.</p> <p data-bbox="1036 1186 1471 1467">Under the new guidance, as the corridor method is no longer permitted, entities will typically remeasure the benefit obligation and plan assets for each interim period to determine the 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).</p>

Impact	US GAAP	IFRS
<p><b>Balance sheet recognition</b></p> <p>Under IFRS, companies are not required to present the full funded status of their postemployment benefit plans on the balance sheet. However, companies are required to present the funded status within the footnotes.</p> <p>If, under IFRS, the company elects to recognize all gains and losses in other comprehensive income or immediately within profit or loss, then generally the only difference with US GAAP on the balance sheet is unrecognized prior service cost.</p> <p>Under the new IFRS guidance, this difference will largely be eliminated and the full funded status is presented under US GAAP and IFRS.</p>	<p>Companies are required to record on the balance sheet the full funded status (i.e., the differences between the fair value of the plan assets and the benefit obligation/accumulated postretirement benefit obligation) of pension/postretirement plans. This guidance does not have an impact on the recognition of net periodic pension costs.</p>	<p>Companies are required to recognize on the balance sheet the difference between the defined benefit obligation (as defined) and the fair value of plan assets, plus or minus any unrecognized actuarial gains/losses or prior-service costs (if any). This amount would be subject to the asset ceiling test (refer to the asset ceiling discussion below).</p> <p>In June 2011, the IASB issued amendments to IAS 19, <i>Employee Benefits</i>.</p> <p>Under the new guidance, there will no longer be any unrecognized actuarial gains/losses or unrecognized past service costs off balance sheet, and hence, the statement of financial position will reflect the funded status (surplus or deficit) of defined benefit plans subject to the asset ceiling.</p>
<p><b>Substantive commitment to provide pension or other postretirement benefits</b></p> <p>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.</p>	<p>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 a company's past practice or communication of intended changes, for example in the area of setting caps on cost-sharing levels.</p>	<p>In certain circumstances, a history of regular increases may indicate:</p> <ul style="list-style-type: none"> <li>• a present commitment to make future plan amendments, and</li> <li>• that additional benefits will accrue to prior service periods.</li> </ul> <p>In such cases, a constructive obligation (to increase benefits) is the basis for determining the obligation.</p>

Impact	US GAAP	IFRS
<p><b>Defined benefit versus defined contribution plan classification</b></p> <p>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 changes to the expense recognition model as well as to balance sheet presentation.</p>	<p>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.</p> <p>Multiemployer plans are treated similarly 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.</p>	<p>An arrangement qualifies as a defined contribution plan if a company'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.</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Curtailments</b></p> <p>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.</p> <p>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.</p> <p>The new IFRS guidance may create 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.</p>	<p>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.</p> <p>Curtailment gains are recognized when realized (i.e., once the terminations have occurred or the plan amendment is adopted).</p> <p>The guidance permits certain offsets of unamortized gains/losses but does not permit pro rata recognition of the remaining unamortized gains/losses in a curtailment.</p>	<p>The definition of a curtailment also captures situations in which current employees will qualify only for significantly <i>reduced</i> (not necessarily eliminated) benefits.</p> <p>Curtailment gains should be recorded when the company is demonstrably committed to making a material reduction (as opposed to once the terminations have occurred).</p> <p>IFRS requires the curtailment gain/loss to include a pro rata share of related unamortized gains/losses (relevant if the company applies the corridor method) and prior service costs previously not recognized (relevant for all plans).</p> <p>In June 2011, the IASB issued amendments to IAS 19, <i>Employee Benefits</i>.</p> <p>Under the new guidance, the gain or loss related to plan amendments, curtailments, and termination benefits that occur in connection with a restructuring will be required to be recognized when the related restructuring cost is recognized, if that is earlier than the normal IAS 19 recognition date.</p>

Impact	US GAAP	IFRS
<p><b>Settlements</b></p> <p>Fewer settlements may be recognized under US GAAP (because of an accounting policy choice that is available under US GAAP but not IFRS).</p> <p>Different definitions of partial settlements may lead to more settlements being recognized under IFRS.</p> <p>Varying settlement calculation methodologies can result in differing amounts being recognized in income and other comprehensive income.</p>	<p>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 cost and interest cost components of net periodic pension cost for that period.</p> <p>A partial settlement does not occur if a portion of the obligation for vested benefits to all plan participants is satisfied and the employer remains liable for the balance of the participants' vested benefits.</p> <p>Settlement accounting requires complex calculations unique to US GAAP to determine how much is recognized in current period earnings as compared to other comprehensive income.</p>	<p>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.</p> <p>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.</p> <p>Settlement accounting requires complex calculations unique to IFRS to determine how much is recognized in current period earnings as compared to other comprehensive income.</p>



Impact	US GAAP	IFRS
<p><b>Asset ceiling</b></p> <p>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 and impact the asset ceiling test.</p>	<p>There is no limitation on the size of the net pension asset that can be recorded on the balance sheet.</p>	<p>Under the guidance, 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 sum of any cumulative unrecognized net losses, unrecognized prior-service cost, and 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 unrecoverable surplus.</p> <p>Although the asset ceiling test was not changed under the new guidance, the calculation no longer needs to consider unrecognized prior-service cost as there will no longer be any unrecognized prior-service cost.</p>

Impact	US GAAP	IFRS
<p><b>Measurement of defined benefit obligation when both employers and employees contribute</b></p> <p>Under the new IFRS guidance, the accounting for plans where an employer's exposure may be limited by employee contributions may differ under the two frameworks. The benefit obligation may be smaller under IFRS than US GAAP.</p>	<p>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 to help meet a deficit. Contributions are recorded as a reduction in the benefit obligation only when received.</p>	<p>In June 2011, the IASB issued amendments to IAS 19, <i>Employee Benefits</i>.</p> <p>The new guidance clarifies accounting for plans where risks associated with the benefit are shared between employers and employees. The measurement of plan obligations 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.</p> <p>Entities will have to assess whether the clarification around risk/cost-sharing will impact the measurement of the defined benefit obligation. Only entities where the employer's risk is limited or when employees have to pay further future contributions to cover a deficit will be affected by the clarification.</p>

Impact	US GAAP	IFRS
<p><b>Deferred compensation arrangements—employment benefits</b></p> <p>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 methodology.</p>	<p>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 an 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).</p> <p>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.</p>	<p>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.</p> <p>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), with the exception that all prior-service costs and gains and losses are recognized immediately in profit or loss.</p>

Impact	US GAAP	IFRS
<p data-bbox="110 464 383 491"><b>Plan asset valuation</b></p> <p data-bbox="110 516 513 604">There are differences in the determination of fair value of plan assets under each framework.</p> <p data-bbox="110 627 537 810">The new IFRS fair value guidance will eliminate the difference as it relates to the measurement of the fair value of plan assets; however, a difference will remain because US GAAP is measured at fair value less cost to sell and IFRS is not.</p>	<p data-bbox="570 516 1000 638">Plan assets should be measured at fair value less cost to sell. Fair value should reflect an exit price at which the asset could be sold to another party.</p> <p data-bbox="570 661 1000 844">For markets in which dealer-based pricing exists, the price that is most representative of fair value—regardless of where it falls on the fair value hierarchy—should be used. As a practical expedient, the use of midmarket pricing is permitted.</p> <p data-bbox="570 867 1000 1178">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.</p>	<p data-bbox="1032 516 1455 669">Plan assets should be measured at fair value, which is defined as the amount for which an asset could be exchanged in an arm's-length transaction between knowledgeable and willing parties.</p> <p data-bbox="1032 693 1455 749">For securities quoted in an active market, the bid price should be used.</p> <p data-bbox="1032 772 1455 1178">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.</p> <p data-bbox="1032 1201 1455 1480">Under IFRS 13, which is effective from January 1, 2013, fair value 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. An entity shall apply the price within the bid-ask spread that is most representative of fair value.</p>

Impact	US GAAP	IFRS
<p><b>Discount rates</b></p> <p>Differences in the selection criteria for discount rates could lead companies to establish different discount rates under IFRS.</p>	<p>The discount rate is based on the rate at which the pension 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).</p> <p>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 bond yield is determined based on a spread added to representative government bond yields.</p>	<p>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.</p> <p>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.</p> <p>A synthetically constructed bond yield designed to mimic a high-quality corporate bond may not be used to determine the discount rate.</p>
<p><b>Accounting for termination indemnities</b></p> <p>US GAAP allows for more options in accounting for termination indemnity programs.</p>	<p>When accounting for termination indemnities, there are two acceptable alternatives to account for the obligation: (1) full defined benefit plan accounting or (2) 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).</p>	<p>Defined benefit accounting is required for termination indemnities. Gains and losses are recognized following the company’s accounting policy for its other defined benefit plans.</p>

Impact	US GAAP	IFRS
<p><b>Accounting for costs</b></p> <p>The new IFRS guidance will create differences in the accounting for investment management costs and taxes related to benefit plans.</p>	<p>Administrative or claims payment costs are reflected in the benefit obligation. However, administration costs of record keeping, actuarial valuations and payment of benefits are expensed as incurred.</p> <p>A contribution tax should be recognized as a component of net periodic pension cost in the period in which the contribution is made.</p>	<p>In June 2011, the IASB issued amendments to IAS 19, <i>Employee Benefits</i>.</p> <p>Under the new guidance, investment management costs should be deducted from the return on plan assets. 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.</p>
<p><b>Technical references</b></p> <p><b>IFRS</b> IAS 19, IAS 37, IAS 39, IFRIC 14</p> <p><b>US GAAP</b> ASC 710, ASC 712, ASC 715, ASC 820, ASC 835–30</p>		

#### Note

The foregoing 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.

## Recent/proposed guidance

### IASB Amendment to IAS 19, *Employee Benefits*

In June 2011, the IASB issued an amendment to IAS 19 with significant changes to the recognition, presentation, and disclosure of long-term employee benefit plans. The key provisions are as follows:

#### Recognition of gains and losses

Gains and losses will be recognized immediately in other comprehensive income (OCI). The corridor and spreading option in IAS 19, which allows delayed recognition of gains and losses for postemployment benefits, will be prohibited. Immediate recognition of gains and losses in profit and loss, which is currently permitted for postemployment benefits and required for other long-term benefits, also will be prohibited. Gains and losses recognized in OCI will not be recycled through profit or loss in subsequent periods.

Gains and losses arise from changes in the assumptions used to measure the obligation for benefits. These include assumptions about salary increases, mortality rates, and the discount rate. The amendments will increase balance sheet volatility for IFRS reporting companies that currently use delayed recognition methods for gains and losses. Significant differences to US GAAP will remain. While both frameworks will require that the funded status of their defined benefit plans be recorded on the balance sheet, the method of recognizing gains and losses will vary, as US GAAP requires recognition of gains and losses in the income statement. US GAAP still provides a policy choice between either (1) immediate recognition within the income statement or (2) delayed recognition through the use of the corridor approach. Neither of the US GAAP options would exist under the new IFRS model.

#### Recognition of past-service cost (referred to as prior-service cost under US GAAP)

All past-service costs (positive or negative) will be recognized in profit or loss when the employee benefit plan is amended. Past-service cost arises when the terms of a defined benefit plan are amended to provide additional benefits for service the employee has already delivered. These additional benefits are sometimes conditional on the employee providing future service (i.e., over a vesting period). IAS 19 currently requires past-service cost to be recognized on a straight-line basis until the future service has been delivered, or recognized immediately if no future service is required. This new guidance will no longer allow past-service cost to be spread over the future-service period, which will increase volatility in profit or loss.

This will create a further difference 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.

#### Measurement of pension expense

The expected return on plan assets and the interest cost on the pension obligation will be replaced by a new method of calculating the finance cost associated with a funded defined benefit obligation. The new guidance requires that net interest expense or income would be calculated by applying the discount rate to the recognized net surplus or deficit of the plan (the plan assets less the defined benefit obligation, allowing for any asset ceiling restriction). The discount rate would be a high-quality corporate bond rate in markets where there is a deep market in such bonds, and a government bond rate in other markets. The effect of this is that the expected earnings on plan assets will be determined using the same discount rate that is used to calculate the obligation. Currently, the expected return on plan assets is generally higher than the discount rate, so the change will increase the pension cost recognized in profit or loss for most entities with funded plans. The measurement of the interest cost for an unfunded plan will remain unchanged.

US GAAP currently uses an expected return on plan assets and a separate discount rate on the liability; therefore, this will create a new difference.

**Presentation of pension expense**

IAS 19 was amended to remove some of the flexibility around where in profit and loss the components of pension expense will be recognized. All 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. The new guidance limits some but not all of the flexibility in classification. Therefore, differences may continue in income statement classification.

**Termination benefits**

The guidance for termination benefits in IAS 19 was amended in a manner that aligns the treatment of termination benefits with US GAAP guidance for one-time termination benefits. See further discussion in the Recent/proposed guidance section of the Liabilities—other chapter.

**Disclosure requirements**

Additional disclosures will be required with regard to the characteristics of the company's benefit plans, the amounts recognized in the financial statements, and the amount, timing, and uncertainty of future cash flows arising from defined benefit plans and multi-employer plans. The disclosures are presented as objectives that the disclosures should achieve rather than a checklist of required disclosures. The new requirements likely will increase the volume of disclosure for many companies.

The increased disclosures are generally consistent with disclosures already required under US GAAP, though some will be additional disclosures.

**Timing**

A final standard was issued June 2011. The effective date for the amendments is January 1, 2013, with early application permitted. The FASB's project in this area is not active, but the board is monitoring the work of the IASB as it contemplates next steps. The IASB has indicated an intention to perform a comprehensive review of defined benefit accounting including measurement issues. The review will be performed in the future as part of a next phase for which a timetable has not yet been set. The IASB would consider conducting such a review with the FASB.

**FASB Accounting Standards Update No. 2011-05, *Presentation of Comprehensive Income*, and IASB Amendment to IAS 1, *Presentation of Financial Statements***

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, *Presentation of Comprehensive Income*, which requires entities to present net income and other comprehensive income in either a single continuous statement or in two separate, but consecutive, statements of net income and other comprehensive income. The option to present items of other comprehensive income in the statement of changes in equity is eliminated. At the same time, the IASB issued a similar amendment to IAS 1, *Presentation of Financial Statements*. With the changes to what is recognized in OCI under IAS 19, as discussed above, the amendments are seen as linked. See further discussion of the statement of profit or loss and other comprehensive income in the Other accounting and reporting topics chapter.

**FASB Proposed Accounting Standards Update—Compensation—Retirement Benefits—Multiemployer Plans (Subtopic 715-80), *Disclosure about an Employer's Participation in a Multiemployer Plan***

On July 27, 2011, the FASB approved a revised accounting standard intended to provide more information about an employer's financial obligations to a multiemployer pension plan. Currently, employers are required to disclose only their total contributions to all multiemployer plans in which they participate and certain year-to-year changes in circumstances. However, the recent economic crisis brought to light the lack of information disclosed about the commitments and funding risks involved with an employer's participation in a multiemployer plan.



The enhanced disclosures will provide additional information to shareholders, employees, and others regarding the overall financial health of the plans (e.g., the certified zone status as required by the Pension Protection Act of 2006 for US plans or the funding level) and the level of the employer's participation in the plans (e.g., an indication of whether the employer contributed 5 percent or more of the total contributions). If the increased information is not available, as may be the case for some foreign plans, employers may instead include more qualitative information about the plan. Based on the feedback received, the board decided to remove certain of the quantitative disclosures proposed in its September 2010 exposure draft, including the estimated withdrawal liability, the total assets and the accumulated benefit obligation of the plan, and the employer's contribution to a plan as a percentage of total contributions. The revisions are expected to be finalized in an Accounting Standards Update to be issued in September 2011. The enhanced disclosures will be effective in 2011 for public companies with calendar year-ends, with a one-year deferral for nonpublic entities.

As discussed above, the IASB amended IAS 19, *Employee benefits*, in June 2011, which included incremental disclosure requirements for multiemployer pension plans. Although disclosures will be more closely aligned, certain differences will remain, such as the requirement in IAS 19 to disclose expected contributions for the next annual period. Further, the FASB update addresses disclosures only and will not eliminate differences between US GAAP and IFRS accounting for multiemployer pension plans.

#### **US Patient Protection and Affordable Care Act**

President Obama signed the Patient Protection and Affordable Care Act (PPACA) into law on March 23, 2010, and on March 30, 2010, signed the Health Care and Education Reconciliation Act of 2010, which amends certain aspects of the PPACA. Many of the specifics associated with the new legislation remain unclear. Because postretirement benefits accounting requires current-period measurements of benefit obligations, which incorporate the effects of future benefit levels as a result of recently enacted laws, this new legislation will have a number of implications.

For example, the PPACA changes the tax treatment of federal subsidies paid to sponsors of retiree healthcare plans that provide a benefit that is at least actuarially equivalent to the benefits under Medicare Part D. As a result of the PPACA, these subsidy payments will become taxable effective in tax years beginning after December 31, 2012. The impact of the change in tax law will be treated differently under US GAAP and IFRS. US GAAP requires the impact of the change in tax law to be recognized immediately in continuing operations in the income statement in the period that includes the enactment date. IFRS requires the change in deferred tax balances to be allocated to the account(s) where the original pre-tax transaction or event was initially recorded (sometimes referred to as "backwards tracing"). US GAAP prohibits backwards tracing. See the Liabilities—taxes chapter for further discussion on the differences in accounting for subsequent changes to deferred taxes.

In addition, the PPACA will require certain conforming changes to be made to individual plans in order for them to comply with the new legislation. Companies need to determine whether to account for the effect of those changes as a plan amendment that gives rise to prior service cost or an actuarial gain/loss. Plan amendments are typically the result of an economic decision by the employer to grant increased benefits, which results in future economic benefits to the company. A decision to accept the requirements of the legislation and amend the plan accordingly may reflect economic decision making by the company, thus supporting plan amendment accounting. On the other hand, a company might conclude that the amendment is being driven solely by a need to comply with the new legislation and is not the result of an economic decision. In that case, the change could be accounted for as a loss (gain). Under US GAAP, either treatment is viewed as acceptable. However, under IFRS, specific guidance indicates that the underlying reason for the plan amendment is not considered relevant, and plan amendment accounting would be required (with no resulting gain/loss). Therefore, there may be differences in accounting for the impact of this legislation between US GAAP and IFRS.





## 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.

As it relates to the fundamental carrying basis of nonfinancial assets, IFRS permits the revaluation of certain nonfinancial assets to fair value, whereas US GAAP generally does not.

Differences in testing for the potential impairment of long-lived assets held for use might lead to earlier impairment recognition under IFRS. IFRS requires the use of entity-specific discounted cash flows or a fair value measure in tests for the recoverability of an asset. By comparison, US GAAP uses a two-step model that begins with undiscounted cash flows. This fundamental distinction between the impairment models can make a difference in whether an asset is impaired. Additional differences exist, such as what qualifies as an impairment indicator or how recoveries in previously impaired assets are treated.

The recognition and measurement of intangible assets could differ significantly under IFRS. With limited exceptions, US GAAP prohibits the capitalization of development costs, whereas development costs under IFRS are capitalized if certain criteria are met. Even where US GAAP allows for the capitalization of development costs (e.g., software development costs), differences exist. In the area of software development costs, US GAAP provides different 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.

The level at which indefinite-lived intangible assets are tested for impairment might vary significantly between the two frameworks. When identifying a unit of account under US GAAP, indefinite-lived intangible assets shall be grouped only with other indefinite-lived intangible assets; those assets may not be tested in combination with goodwill or with a finite-lived asset. Under IFRS, the impairment test likely will be performed at the cash-generating unit (CGU) level.

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 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, 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 are expected to issue a final standard in 2012 that would significantly change lease accounting. These changes are expected to impact almost all entities.

Spin-off transactions can result in significantly different income statement implications under the two frameworks. US GAAP accounts for spin-off transactions based on the carrying value of the nonmonetary assets, with the distributions recorded against owner's equity and no gain/loss recorded in income (assuming that the assets were not impaired prior to the spin-off transaction). IFRS requires that dividends payable be recorded at the fair value of the nonmonetary assets to be distributed. Upon settlement, the difference between the carrying value of the dividend payable and the carrying amount of the nonmonetary assets, if any, is recorded in the income statement.

The following table provides further details on the foregoing and other selected current differences.

Impact	US GAAP	IFRS
<b>General</b>		
<p data-bbox="155 520 589 585"><b>Impairment of long-lived assets held for use</b></p> <p data-bbox="155 611 589 730">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.</p> <p data-bbox="155 751 589 871">There are also differences related to such matters as what qualifies as an impairment indicator and how recoveries in previously impaired assets get treated.</p> <p data-bbox="155 892 589 1270">In May 2011, the FASB and IASB issued new guidance on fair value measurement. The new guidance results in a consistent definition of fair value between IFRS and US GAAP and substantially converged requirements for the measurement of and disclosure about fair value when it is required or permitted to be used. Once effective, the guidance on measuring fair value will be substantially converged. Refer to the Financial assets chapter for more information.</p>	<p data-bbox="618 611 1044 667">US GAAP requires a two-step impairment test and measurement model as follows:</p> <ol data-bbox="618 682 1044 1354" style="list-style-type: none"> <li data-bbox="618 682 1044 934">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.</li> <li data-bbox="618 949 1044 1354">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.</li> </ol> <p data-bbox="618 1375 1044 1564">The calculation of fair value does not default to a present value technique. Although present value techniques might be appropriate, the reporting entity must consider all appropriate valuation techniques for its given circumstance.</p> <p data-bbox="618 1711 1044 1768">Changes in market interest rates are not considered impairment indicators.</p>	<p data-bbox="1073 611 1498 793">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 to sell or (2) the asset's value in use.</p> <p data-bbox="1073 814 1498 970">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 data-bbox="1073 991 1498 1270">Fair value less cost to sell represents the amount obtainable from the sale of an asset or CGU in an arm's-length transaction between knowledgeable, willing parties less the costs of disposal. The IFRS reference to knowledgeable, willing parties is generally viewed as being consistent with the market participant assumptions noted under US GAAP.</p> <p data-bbox="1073 1291 1498 1411">IFRS does not contain guidance about which market should be used as a basis for measuring fair value when more than one market exists.</p> <p data-bbox="1073 1432 1498 1684">Value in use represents entity-specific future 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 for which the cash flow estimates have not been adjusted.</p> <p data-bbox="1073 1705 1498 1795">Changes in market interest rates can potentially trigger impairment and, hence, are impairment indicators.</p>

Impact	US GAAP	IFRS
<p>Impairment of long-lived assets held for use (continued)</p>	<p>The reversal of impairments is prohibited.</p> <p><b>Determining the appropriate market—</b> A reporting entity is required to identify and evaluate the markets into which an asset may be sold or a liability transferred. In establishing fair value, a reporting entity must determine whether there is a principal market or, in its absence, a most advantageous market. However, in measuring the fair value of nonfinancial assets and liabilities, in many cases, there will not be observable data or a reference market. As a result, management will have to develop a hypothetical market for the asset or liability.</p> <p><b>Application of valuation techniques—</b> 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.</p> <p>If the asset is recoverable based on undiscounted cash flows, the discounting or fair value type determinations are not applicable.</p> <p>New fair value measurement guidance was issued in May 2011. Refer to the related commentary on the new fair value measurement guidance within the impact column.</p>	<p>If certain criteria are met, the reversal of impairments, other than those of goodwill, is permitted.</p> <p>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.</p> <p>New fair value measurement guidance was issued in May 2011. This new guidance defines “fair value” as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The revised definition aligns with current US GAAP. IFRS preparers must also consider costs of disposal when calculating impairment charges.</p> <p>Once effective, fair value measurement under IFRS will change to require the determination of fair value based on the principal or most advantageous market for the asset.</p> <p>Refer to related commentary within the impact column.</p>

Impact	US GAAP	IFRS
<p><b>Cash flow estimates</b></p> <p>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.</p>	<p>Future cash flow estimates used in an impairment analysis should include:</p> <ul style="list-style-type: none"> <li>• 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</li> <li>• Any cash outflows necessary to obtain those cash inflows, including future expenditures to maintain (but not improve) the long-lived asset (asset group)</li> <li>• Cash flows associated with the eventual disposition, including selling costs, of the long-lived asset (asset group)</li> </ul>	<p>Cash flow estimates used to calculate value in use under IFRS should include:</p> <ul style="list-style-type: none"> <li>• Cash inflows from the continuing use of the asset or the activities of the CGU</li> <li>• 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</li> <li>• 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</li> <li>• Cash flows expected to be received (or paid) for the disposal of assets or CGUs at the end of their useful lives</li> <li>• Cash outflows to maintain the operating capacity of existing assets, including, for example, cash flows for day-to-day servicing</li> </ul>

Impact	US GAAP	IFRS
Cash flow estimates (continued)	<p>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.</p> <p>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.</p>	<p>Cash flow projections used to measure value in use should be based on reasonable and supportable assumptions of the set of economic conditions that will exist over the asset’s remaining useful life.</p> <p>Cash flows expected to arise from future restructurings or from improving the asset’s performance should be excluded.</p> <p>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.</p>



Impact	US GAAP	IFRS
<p><b>Asset groupings</b></p> <p>Determination of asset groupings is a matter of judgment and could result in differences between IFRS and US GAAP.</p>	<p>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.</p> <p>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.</p>	<p>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 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.</p>
<p><b>Carrying basis</b></p> <p>The ability to revalue assets (to fair market value) under IFRS might create significant differences in the carrying value of assets as compared with US GAAP.</p>	<p>US GAAP generally utilizes historical cost and prohibits revaluations except for certain categories of financial instruments, which are carried at fair value.</p>	<p>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).</p> <p>IFRS also requires that biological assets and certain categories of financial instruments be reported at fair value.</p>

Impact	US GAAP	IFRS
<b>Intangible assets</b>		
<p data-bbox="110 520 542 552"><b>Internally developed intangibles</b></p> <p data-bbox="110 573 526 695">US GAAP prohibits, with limited exceptions, the capitalization of development costs. Development costs are capitalized under IFRS if certain criteria are met.</p> <p data-bbox="110 716 542 1026">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.</p>	<p data-bbox="570 573 997 695">In general, both research costs and development costs are expensed as incurred, making the recognition of internally generated intangible assets rare.</p> <p data-bbox="570 716 997 963">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.</p> <p data-bbox="570 984 997 1203">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.</p>	<p data-bbox="1027 573 1455 791">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:</p> <ul data-bbox="1027 804 1455 1346" style="list-style-type: none"> <li data-bbox="1027 804 1455 863">• The technical feasibility of completing the intangible asset</li> <li data-bbox="1027 875 1455 934">• The intention to complete the intangible asset</li> <li data-bbox="1027 947 1455 1005">• The ability to use or sell the intangible asset</li> <li data-bbox="1027 1018 1455 1173">• How the intangible asset will generate future economic benefits (the entity should demonstrate the existence of a market or, if for internal use, the usefulness of the intangible asset)</li> <li data-bbox="1027 1186 1455 1245">• The availability of adequate resources to complete the development</li> <li data-bbox="1027 1257 1455 1346">• The ability to measure reliably the expenditure attributable to the intangible asset during its development</li> </ul> <p data-bbox="1027 1367 1455 1585">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.</p> <p data-bbox="1027 1606 1455 1694">Development costs initially recognized as expenses may not be capitalized in a subsequent period.</p>

Impact	US GAAP	IFRS
<p><b>Indefinite-lived intangible assets—level of assessment for impairment testing</b></p> <p>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.</p>	<p>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.</p> <p>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.</p> <p>US GAAP literature provides a number of indicators that an entity should consider in making a determination of whether to combine intangible assets.</p>	<p>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.</p>
<p><b>Indefinite-lived intangible assets—impairment charge measurement</b></p> <p>Even when there is an impairment under both frameworks, the amount of the impairment charge may differ.</p>	<p>Impairments of indefinite-lived intangible assets are measured by comparing fair value to carrying amount.</p>	<p>Indefinite-lived intangible asset impairments are calculated by comparing the recoverable amount to the carrying amount. The recoverable amount is the higher of fair value less costs to sell or value in use. The value in use calculation uses the present value of future cash flows.</p>

Impact	US GAAP	IFRS
<p><b>Impairments of software costs to be sold, leased, or otherwise marketed</b></p> <p>Impairments might be recognized sooner under IFRS. Furthermore, under IFRS, when impairments are recognized they generally will be for larger amounts.</p>	<p>When assessing potential impairment, the unamortized capitalized costs of a computer software product shall be compared with the net realizable value of that product. The amount by which the unamortized capitalized costs of a computer 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.</p> <p>The net realizable value calculation does not utilize discounted cash flows.</p>	<p>Under IFRS, intangible assets not yet available for use are tested annually for impairment.</p> <p>The higher of either (1) fair value less costs to sell or (2) value in use are used to determine the recoverable amount, which is then compared with the carrying amount. The value in use calculation uses the present value of future cash flows.</p>
<p><b>Advertising costs</b></p> <p>Under IFRS, advertising costs may need to be expensed sooner.</p>	<p>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.</p> <p>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).</p> <p>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.</p>	<p>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.</p> <p>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.</p> <p>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.</p>

Impact	US GAAP	IFRS
<b>Property, plant and equipment</b>		
<p><b>Depreciation</b></p> <p>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.</p>	<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>
<p><b>Overhaul costs</b></p> <p>US GAAP may result in earlier expense recognition when portions of a larger asset group are replaced.</p>	<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) deferred 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>

Impact	US GAAP	IFRS
<p><b>Asset retirement obligations</b></p> <p>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.</p>	<p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p>	<p>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 long-lived 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.</p> <p>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.</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Borrowing costs</b></p> <p>Borrowing costs under IFRS are broader and can include more components than interest costs under US GAAP.</p> <p>US GAAP allows for more judgment in the determination of the capitalization rate, which could lead to differences in the amount of costs capitalized.</p> <p>IFRS does not permit the capitalization of borrowing costs in relation to equity-method investments, whereas US GAAP may allow capitalization in certain circumstances.</p>	<p>Capitalization of interest costs is required while a qualifying asset is being prepared for its intended use.</p> <p>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.</p> <p>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.</p>	<p>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.</p> <p>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.</p> <p>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.</p>
<b>Leases</b>		
<p><b>Lease scope</b></p> <p>IFRS is broader in scope and may be applied to certain leases of intangible assets</p>	<p>The guidance for leases applies only to property, plant, and equipment.</p> <p>Although the guidance is restricted to tangible assets, entities can analogize to the lease guidance for leases of software.</p>	<p>The scope of IFRS lease guidance is not restricted to property, plant, and equipment. Accordingly, it may be applied more broadly.</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Lease classification—general</b></p> <p>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.</p>	<p>The guidance 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:</p> <ul style="list-style-type: none"> <li>• Ownership transfer of the property to the lessee</li> <li>• Bargain purchase option</li> <li>• Lease term in relation to economic life of the asset</li> <li>• Present value of minimum lease payments in relation to fair value of the leased asset</li> </ul> <p>The criteria contain certain specific quantified thresholds such as whether the present value of the minimum lease payments equals or exceeds 90 percent of the fair value of the leased property.</p> <p>For a lessor to classify a lease as a direct financing or sales-type lease under the guidance, two additional criteria must be met.</p>	<p>The guidance 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.</p> <p>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).</p> <p>A lease of special-purpose assets that only the lessee can use without major modification generally would be classified as a finance lease. This also would 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.</p> <p>Importantly, 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.</p>



Impact	US GAAP	IFRS
<p><b>Sale-leaseback arrangements</b></p> <p>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.</p>	<p>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 minor, as defined.</p> <p>If the leaseback is more than minor but less than substantially all of the asset life, a gain is recognized immediately to the extent that the gain exceeds the present value of the minimum lease payments.</p> <p>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.</p> <p>When a sale-leaseback transaction results in a capital lease, the gain is amortized in proportion to the amortization of the leased asset.</p> <p>There are onerous rules for determining when sale-leaseback accounting is appropriate for transactions involving real estate. 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 recharacterized as debt service.</p>	<p>When a sale-leaseback transaction results in a lease classified as an operating lease, the full gain on the sale normally would be recognized if the sale was executed at the fair value of the asset. It is not necessary for the leaseback to be minor.</p> <p>If the sale price is below fair value, any profit or loss should be recognized immediately, except that if there is a loss that is compensated for by future lease payments at below-market rates, 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.</p> <p>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.</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Leases involving land and buildings</b></p> <p>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.</p>	<p>Land and building elements generally are accounted for as a single unit, unless the land represents 25 percent or more of the total fair value of the leased property.</p>	<p>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.</p> <p>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 normally 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.</p> <p>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.</p>
<p><b>Lease classification—other</b></p> <p>The exercise of renewal/extension options within leases might result in a new lease classification under US GAAP, but not under IFRS.</p>	<p>The renewal or extension of a lease beyond the original lease term, including those based on existing provisions of the lease arrangement, normally triggers a fresh lease classification.</p>	<p>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.</p>

Impact	US GAAP	IFRS
<p data-bbox="159 464 574 489"><b>Lease classification—other (continued)</b></p> <p data-bbox="159 512 574 632">Leveraged lease accounting is not available under IFRS, potentially resulting in delayed income recognition and gross balance sheet presentation.</p> <p data-bbox="159 800 574 888">Immediate income recognition by lessors on leases of real estate is more likely under IFRS.</p>	<p data-bbox="618 464 1050 772">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.</p> <p data-bbox="618 800 1050 1171">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.</p>	<p data-bbox="1076 464 1494 678">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.</p> <p data-bbox="1076 800 1494 1077">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).</p>

Impact	US GAAP	IFRS
<b>Other</b>		
<p><b>Distributions of nonmonetary assets to owners</b></p> <p>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.</p>	<p>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.</p>	<p>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.</p>
<p><b>Inventory costing</b></p> <p>Companies that utilize the LIFO costing methodology under US GAAP might experience significantly different operating results as well as cash flows under IFRS.</p> <p>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.</p>	<p>A variety of inventory costing methodologies such as LIFO, FIFO, and/or weighted-average cost are permitted.</p> <p>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.</p> <p>Reversals of write-downs are prohibited.</p>	<p>A number of costing methodologies such as FIFO or weighted-average costing are permitted. The use of LIFO, however, is precluded.</p> <p>Reversals of inventory write-downs (limited to the amount of the original write-down) are required for subsequent recoveries.</p>
<p><b>Inventory measurement</b></p> <p>The measurement of inventory might vary when cost is greater than market (US GAAP) or net realizable value (IFRS).</p>	<p>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.</p>	<p>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.</p>

Impact	US GAAP	IFRS
<p><b>Biological assets—fair value versus historical cost</b></p> <p>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).</p>	<p>Historical cost generally is used for biological assets. These assets are tested for impairment in the same manner as other long-lived assets.</p>	<p>The accounting treatment for biological assets requires measurement at fair value less costs to sell at initial recognition of biological assets and at each subsequent reporting date.</p> <p>It is possible to avoid the use of fair value on initial recognition only when the measurement of fair value is “clearly unreliable.”</p> <p>All changes in fair value are recognized in the income statement in the period in which they arise.</p>
<p><b>Investment property</b></p> <p>Alternative methods or options of accounting for investment property under IFRS could result in significantly different asset carrying values (fair value) and earnings.</p>	<p>There is no specific definition of investment property.</p> <p>The historical-cost model is used for most real estate companies and operating companies holding investment-type property.</p> <p>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.</p> <p>The fair value alternative for leased property does not exist.</p>	<p>Property (land and/or buildings) held in order to earn rentals and/or for capital appreciation is separately defined. The definition does not include owner-occupied property, property held for sale in the ordinary course of business, or property being constructed or developed. Properties under construction or development for future use as investment properties are within the scope of investment properties.</p> <p>Investment property may be accounted for on a historical-cost basis or on a fair value basis. 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.</p> <p>The election to account for investment property at fair value may also be applied to leased property.</p>

### Technical references

**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

**US GAAP** ASC 205, ASC 250, ASC 330, ASC 360–10, ACS 360-20, ASC 410–20, ASC 410–20–25, ASC 835–20, ASC 840, ASC 840–40, ASC 908–30, ASC 976

**Note**

The foregoing 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.

**Recent/proposed guidance****Joint FASB/IASB Exposure Draft, *Leasing***

The FASB and IASB are carrying out a joint project with the objective of recording assets and liabilities arising from leasing transactions on the balance sheet. This project comprehensively reconsiders the guidance in ASC 840 on accounting for leases, and IAS 17, *Leases*, along with subsequent amendments and interpretations. The boards issued an exposure draft in August 2010 and the comment period ended in December 2010. The boards have been redeliberating the exposure draft since January 2011. Based on the feedback received, the boards have made tentative decisions to change the proposals in a number of key areas including the definition of a lease, lease term, and contingent payments. The boards also appeared poised to address the profit and loss recognition issue for certain leases not deemed to be primarily financing transactions. However, ultimately the boards elected to retain the exposure draft model, which treats all leases as financing transactions. The tentative proposals as of July 31, 2011, are summarized below.

**Lessee accounting**

Under the boards' tentative decisions on lessee accounting made to date, major aspects of the final standard are expected to include the following:

- Lease accounting would significantly change, with lessees recording the rights and obligations of all leases on the balance sheet, with the exception of short-term leases, including those in effect when the new standard is issued. The model being considered would significantly change the accounting for leases and impact financial statement presentation and financial metrics, including many that tie directly to debt covenants or compensation arrangements.
- A lessee would be permitted to account for short-term leases—those with a maximum possible lease term of 12 months or less—in a manner consistent with the current requirements for operating leases. The short-term lease guidance would be an accounting policy choice made on an asset class basis.
- Renewal options would be included in the estimated lease term when the company has a significant economic incentive to exercise an option to extend the lease, or not to exercise an option to terminate the lease.
- Contingent payments that are (1) based on a rate or an index, (2) in-substance fixed lease payments structured as variable lease payments, and (3) a residual value guarantee expected to be paid would be included in the lease asset and obligation using a best estimate approach.
- The asset and lease obligation would be initially calculated as the present value of the lease payments discounted using the company's incremental borrowing rate. Alternatively, the rate the lessor is charging in the lease can be used if known. The proposal would require lessees to reassess the lease term, contingent rentals, residual value guarantees, and corresponding lease obligation as facts and circumstances change.
- Straight-line rent expense generally would be replaced by amortization of the leased asset and interest expense on the lease obligation. Interest expense will be front-loaded similar to mortgage amortization.
- For leases that contain lease and non-lease components (including services and executory costs), the lessee must identify the non-lease component and account for it separately. Lessees should allocate payments between lease and non-lease components based on their relative standalone purchase prices.

### Lessor accounting

The boards tentatively agreed to use a single model for lessor accounting, a departure from the hybrid approach proposed in the exposure draft. The boards have preliminarily agreed to the following for lessor accounting:

- Lessors should account for leases using a “receivable and residual” approach (previously called the “derecognition” approach). A lessor would derecognize the underlying asset and record a lease receivable and residual asset. The lessor would allocate the carrying value of the underlying asset being leased between the portion related to the lessee’s right-of-use asset and the portion retained by the lessor (the residual).
- A lessor would recognize profit on the leased asset at lease commencement if it is “reasonably assured.” Profit would be recognized for the difference between the lease receivable recognized and the portion of the carrying amount of the underlying asset derecognized.
- When not “reasonably assured,” the timing and recognition pattern of profit would extend over the life of the asset.
- Consistent with the proposal in the exposure draft, lessors will be allowed to account for short term leases (a maximum lease term of 12 months or less) similar to current operating lease accounting.
- The lease standard, when finalized, will exclude from the scope investment property measured at fair value, which currently exists internationally under IAS 40, *Investment Property*. Under US GAAP, a similar exemption is expected for those entities that qualify for fair value accounting pursuant to the Investment Properties Project.

### Select other considerations

The tentative decisions in the leasing project have far-reaching business and operational impacts. Some of the business implications include:

- The proposed accounting model for leases is expected to have the greatest impact on lessees of significant amounts of “large-ticket” items, such as real estate, manufacturing equipment, power plants, aircraft, railcars, and ships. However, the proposed accounting model also would affect virtually every company across all industries to varying degrees since nearly all companies enter into leasing arrangements.
- The tentative decisions affect both balance sheet ratios and income statement metrics. For example, EBITDA (earnings before interest, taxes, depreciation, and amortization) would increase, perhaps dramatically, with rent expense being replaced by amortization and interest expense. At the same time, balance sheet leveraged ratios will be impacted by the associated increase in the outstanding lease liability. These may affect key contracts and other arrangements that depend on financial statement measures such as loan covenants, credit ratings, and other external measures of performance and financial strength. Internal measurements used for budgeting, incentive and compensation plans, and other financial decisions might be similarly affected.
- Companies would need additional time to develop, document, and support necessary accounting estimates. Incremental effort would be necessary to develop estimates at inception of the lease and to reassess those estimates when necessary.
- Enhanced systems likely would be needed to capture and continually track individual contract information, support the process of developing and reassessing estimates, and report certain newly required information.

The boards have made changes to their exposure draft proposals in a number of key areas based on the feedback received from constituents, and they continue to redeliberate the leasing standard. Due to these changes, the boards expect to re-expose the standard in late 2011, with a final standard expected in 2012. To date the boards have remained aligned in their decisions on the leasing standard and convergence is expected to be achieved in the majority of areas.

**FASB Expected Exposure Draft, *Investment Properties***

In the Investment Properties Project, the FASB has tentatively agreed to require qualifying entities to measure an investment property at fair value through earnings. Entities that meet the following criteria would be required to apply the guidance:

- Nature of business activities—The primary business activities must relate to investing in real estate properties.
- Express business purpose—The entity must invest in real estate properties for a total return, including realizing capital appreciation, through disposal of its properties.
- Unit ownership—Ownership is represented by units of investments, such as shares of stock or partnership interests.
- Pooling of funds—The entity investor's funds are pooled to avail the investors of professional investment management. The entity has investors who are unrelated to the parent and hold a significant ownership interest in the entity.
- Reporting entity—The entity conducts activities and reports results to its investors. The entity does not necessarily need to be a legal entity.

In addition to traditional real estate properties, other non-traditional real estate such as power plants and integral equipment (e.g., pipelines and cellular towers) are also expected to be within the scope of the guidance. Fair value measurement would also be required for right-of-use assets arising from leasing transactions when the entity is a lessee.

Investment property entities would measure investment property at fair value with the asset and related debt presented on a gross basis. Rental income and related property expenses would be presented separately. Any changes in fair value of the investment property would be recognized in net income.

The FASB's proposal differs from IFRS. The FASB's expected proposal is applied at the entity level—for entities that meet the criteria as an investment property entity (as noted above). In contrast, under IAS 40, *Investment Property*, the guidance is applied at the asset level—for assets that meet the definition of investment properties. In addition, the FASB's expected proposal would require entities to apply fair value accounting, whereas IFRS allows the option to measure investment properties at either fair value or cost. The FASB expects to issue an exposure draft for investment properties in the third quarter of 2011.



---

## Assets—financial assets

The FASB and IASB are working on a joint project on financial instruments that is intended to address the recognition and measurement of all financial instruments, including impairment and hedge accounting. Once finalized, the new guidance will replace all of the FASB's and IASB's respective financial instrument guidance. The two boards have, however, been working on different timetables. The IASB has been conducting its work in separate phases, the first of which resulted in the November 2009 issuance of IFRS 9, *Financial Instruments* (subsequently updated in October 2010). Based on recent deliberations, the effective date of IFRS 9 could be changed to annual periods beginning on or after January 1, 2015, with early application permitted. It is currently effective for annual periods on or after January 2013. These standards 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).

A detailed discussion of industry-specific differences is beyond the scope of this publication. However, for illustrative purposes only, we note that the accounting under US GAAP for unlisted equity securities can differ substantially depending on industry-specific requirements. US GAAP accounting by general corporate entities that do not choose the fair-value option, for example, differs significantly from the accounting by broker/dealers, investment companies, and insurance companies. In contrast, the guidance in relation to unlisted equity securities under IFRS is the same regardless of the entity's industry.

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. Additional differences involve financial assets that are carried at amortized cost. For such assets, both IFRS and US GAAP use the effective interest method to calculate amortized cost and allocate interest income over the relevant period. The effective interest method is based on the effective interest rate calculated at initial recognition of the financial instrument. Under IFRS, the effective interest rate is calculated based on estimated future cash payments or receipts through the expected life of the financial instrument. Under US GAAP, although certain exceptions apply, the effective interest rate generally is calculated based on the contractual cash flows through the contractual life of the financial assets. Under IFRS, changes in the estimated cash flows due to a closely related embedded derivative that is not bifurcated results in a cumulative catch-up reflected in the current-period income statement. US GAAP does not have the equivalent of a cumulative catch-up-based approach for these scenarios.

For available-for-sale debt instruments, the impairment models for financial assets may result in different impairment triggers and different impairment measurement criteria. In considering whether a decline in fair value is other than temporary, US GAAP looks to (1) management's intent and ability to hold the security and (2) expectations of recovery of the cost basis in the security. The impairment trigger drives the measurement of the impairment loss. Under IFRS, the impairment triggers for available-for-sale debt instruments and loans and receivables are the same; however, the available-for-sale impairment loss is based on fair value while impairment of loans and receivables is calculated by discounting estimated cash flows (excluding credit losses that have not been incurred) by

the original effective interest rate. Additional differences around reversals of impairment losses and impairment of equities also must be considered.

There are fundamental differences in the way US GAAP and IFRS currently assess the potential derecognition of financial assets. The 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. The fundamental differences are as follows:

- Under US GAAP, 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.
- Under IFRS, full derecognition can be achieved only if substantially all of the risks and rewards are transferred or the entity has neither retained nor transferred substantially all of the risks and rewards and the transferee has the practical ability to sell the transferred asset.
- Under IFRS, if the entity has neither retained nor transferred substantially all of the risks and rewards and if the transferee does not have the practical ability to sell the transferred asset, the transferor continues to recognize the transferred asset with an associated liability in a unique model known as the continuing involvement model, which has no equivalent under US GAAP.

The IFRS model does not permit many factoring transactions (e.g., sale of receivables with recourse) to qualify for derecognition. Most factorings include some ongoing involvement by the transferor that causes the transferor to retain some of the risks and rewards related to the transferred assets—a situation that may preclude full derecognition under IFRS, but not under US GAAP.

Further details on the foregoing and other selected current differences (pre-IFRS 9 and IFRS 13) are described in the following table.

Impact	US GAAP	IFRS
<b>Classification and measurement</b>		
<p><b>Available-for-sale financial assets—fair value versus cost of unlisted equity instruments</b></p> <p>More investments in unlisted equity securities are recorded at fair value under IFRS.</p>	<p>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.</p> <p>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, defined benefit plans).</p>	<p>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).</p> <p>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.</p>
<p><b>Available-for-sale debt financial assets—foreign exchange gains/losses on debt instruments</b></p> <p>The treatment of foreign exchange gains and losses on available-for-sale debt securities will create more income statement volatility under IFRS.</p>	<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.</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 other comprehensive income, net of tax effect.</p>

Impact	US GAAP	IFRS
<p><b>Effective interest rates—expected versus contractual cash flows</b></p> <p>Differences between the expected and contractual lives of financial assets carried at amortized cost have different implications under the two frameworks.</p> <p>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.</p>	<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"> <li>• Loans if the entity holds a large number of similar loans and the prepayments can be reasonably estimated</li> <li>• Certain structured notes</li> <li>• Certain beneficial interests in securitized financial assets</li> <li>• Certain loans or debt securities acquired in a transfer</li> </ul>	<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 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>

Impact	US GAAP	IFRS
<p><b>Effective interest rates—changes in expectations</b></p> <p>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.</p>	<p>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).</p> <p>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.</p>	<p>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.</p> <p>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).</p> <p>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).</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Fair-value option for equity-method investments</b></p> <p>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.</p>	<p>The fair-value option exists for US GAAP entities under ASC 825, <i>Financial Instruments</i>, wherein the option is unrestricted. Therefore, any investor's equity-method investments are eligible for the fair-value option.</p>	<p>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.</p>
<p><b>Fair-value measurement—bid-ask spreads</b></p> <p>Differences in the ways bid-ask spreads are treated may affect financial asset valuations.</p>	<p>If an input used for measuring fair value is based on bid and ask prices, the price within the bid-ask spread that is most representative of fair value in the circumstances is used. At the same time, US GAAP does not preclude the use of midmarket pricing or other pricing conventions as practical expedients for fair-value measurements within a bid-ask spread. As a result, financial assets may, in certain situations, be valued at a bid or ask price, at the last price, at the mean between bid and ask prices, or at a valuation within the range of bid and ask prices.</p>	<p>The appropriate quoted market price for an asset held or a liability to be issued is the current bid price and, for an asset to be acquired or a liability held, is the ask price. However, when the entity has assets and liabilities with offsetting market positions, the entity may use the midpoint for the offsetting positions and apply the bid or ask price to the net open position.</p> <p>It is to be noted that the use of bid or ask price will no longer be required under IFRS 13. Instead, the price within the bid-ask spread that is most representative of fair value should be used. Please refer to the Recent/proposed guidance section for further details.</p>

Impact	US GAAP	IFRS
<p><b>Loans and receivables</b></p> <p>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.</p> <p>Loans and receivables may be carried at different amounts under the two frameworks.</p>	<p>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.</p> <p>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:</p> <ul style="list-style-type: none"> <li>• Classified as loans held for investment, in which case they are measured at amortized cost</li> <li>• Classified as loans held for sale, in which case they are measured at the lower of cost or fair value (market), or</li> <li>• Carried at fair value if the fair value option is elected</li> </ul>	<p>IFRS defines loans and receivables as nonderivative financial assets with fixed or determinable payments not quoted in an active market other than:</p> <ul style="list-style-type: none"> <li>• 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</li> <li>• Those that the entity upon initial recognition designates as available for sale</li> <li>• 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</li> </ul> <p>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.</p> <p>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.</p> <p>IFRS does not have a category of loans and receivables that is carried at the lower of cost or market.</p>

Impact	US GAAP	IFRS
<p><b>Reclassifications</b></p> <p>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).</p>	<p>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.</p>	<p>Financial assets may be reclassified between categories, albeit with conditions.</p> <p>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.</p> <p>Also, a financial asset can be transferred from trading to available for sale in rare circumstances.</p> <p>Reclassification is prohibited for instruments where the fair-value option is elected.</p>

#### Impairments and subsequent loss treatment

<p><b>Impairment principles — available-for-sale debt securities</b></p> <p>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.</p> <p>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.</p>	<p>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.</p> <p>In a determination of whether impairment is other than temporary, the following factors are assessed for available-for-sale securities:</p> <p><b>Step 1</b>—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.</p>	<p>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:</p> <ul style="list-style-type: none"> <li>• Significant financial difficulty of the issuer</li> <li>• High probability of bankruptcy</li> <li>• Granting of a concession to the issuer</li> </ul>
--	--	--



Impact	US GAAP	IFRS
<p>Impairment principles—available-for-sale debt securities (continued)</p>	<p><b>Step 2</b>—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.</p> <p>Once it is determined that impairment is other than temporary, the impairment loss recognized in the income statement depends on the impairment trigger:</p> <ul style="list-style-type: none"> <li>• 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.</li> <li>• 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 other comprehensive income.</li> </ul>	<ul style="list-style-type: none"> <li>• Disappearance of an active market because of financial difficulties</li> <li>• Breach of contract, such as default or delinquency in interest or principal</li> <li>• Observable data indicating there is a measurable decrease in the estimated future cash flows since initial recognition</li> </ul> <p>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.</p> <p>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.</p> <p>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.</p> <p>Once impairment of a debt instrument is determined to be triggered, the cumulative loss recognized in other comprehensive income due to changes in fair value is released into the income statement.</p>

Impact	US GAAP	IFRS
<p data-bbox="110 464 545 533"><b>Impairment principles—held-to-maturity debt instruments</b></p> <p data-bbox="110 554 545 772">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.</p> <p data-bbox="110 793 545 947">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.</p>	<p data-bbox="570 554 1000 772">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.</p> <p data-bbox="570 793 1000 1073">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 other comprehensive income and accreted from OCI to the carrying value of the debt security over its remaining life prospectively.</p>	<p data-bbox="1032 554 1446 674">Impairment is triggered for held-to-maturity investments based on objective evidence of impairment described above for available-for-sale debt instruments.</p> <p data-bbox="1032 695 1446 884">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.</p>

Impact	US GAAP	IFRS
<p data-bbox="159 464 586 533"><b>Impairment of available-for-sale equity instruments</b></p> <p data-bbox="159 554 586 674">Impairment on available-for-sale equity instruments may be triggered at different points in time under IFRS compared with US GAAP.</p>	<p data-bbox="618 554 1045 642">US GAAP looks to whether the decline in fair value below cost is other than temporary. The factors to consider include:</p> <ul data-bbox="618 653 1045 1205" style="list-style-type: none"> <li data-bbox="618 653 1045 741">• The length of the time and the extent to which the market value has been less than cost</li> <li data-bbox="618 758 1045 1041">• 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</li> <li data-bbox="618 1052 1045 1205">• 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</li> </ul> <p data-bbox="618 1226 1045 1509">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 the decline and the greater the decline, the more difficult it is to overcome the presumption that the available-for-sale equity is other than temporarily impaired.</p>	<p data-bbox="1081 554 1508 768">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:</p> <ul data-bbox="1081 779 1508 947" style="list-style-type: none"> <li data-bbox="1081 779 1508 842">• Significant or prolonged decline in fair value below cost, or</li> <li data-bbox="1081 852 1508 947">• Significant adverse changes in technological, market, economic, or legal environment</li> </ul> <p data-bbox="1081 968 1508 1089">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).</p> <p data-bbox="1081 1110 1508 1232">For example, if a decline has persisted for more than 12 consecutive months, then the decline is likely to be considered “prolonged.”</p> <p data-bbox="1081 1253 1508 1404">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.</p>
<p data-bbox="159 1535 586 1640"><b>Losses on available-for-sale equity securities subsequent to initial impairment recognition</b></p> <p data-bbox="159 1661 586 1782">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.</p>	<p data-bbox="618 1661 1045 1814">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).</p>	<p data-bbox="1081 1661 1508 1814">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.</p>

Impact	US GAAP	IFRS
<p data-bbox="110 464 500 533"><b>Impairments—measurement and reversal of losses</b></p> <p data-bbox="110 554 545 835">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.</p>	<p data-bbox="570 554 1003 737">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.</p> <p data-bbox="570 758 1003 978">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.</p> <p data-bbox="570 999 1003 1058">Reversals of impairments on equity investments are prohibited.</p>	<p data-bbox="1036 554 1463 869">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.</p> <p data-bbox="1036 890 1451 1110">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.</p> <p data-bbox="1036 1131 1468 1188">Reversals of impairments on equity investments are prohibited.</p>

Impact	US GAAP	IFRS
<p><b>Financial asset derecognition</b></p>		
<p><b>Derecognition</b></p> <p>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.</p> <p>Full derecognition under US GAAP is more common than under IFRS. Having said that, the IFRS model includes continuing involvement presentation that has no equivalent under US GAAP.</p>	<p>The guidance focuses on an evaluation of the transfer of control. The evaluation is governed by three key considerations:</p> <ul style="list-style-type: none"> <li>• Legal isolation of the transferred asset from the transferor</li> <li>• 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)</li> <li>• No right or obligation of the transferor to repurchase</li> </ul> <p>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.</p> <p>ASC 860 must be considered with the consolidation guidance.</p> <p>Therefore, even if the transfer criteria are met, the transferor may not achieve derecognition as the assets may be, in effect, transferred to the consolidated entity.</p> <p>There is no concept of continuing involvement/partial derecognition under US GAAP.</p>	<p>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.</p> <p>The transferor first applies the consolidation guidance and consolidates any and all subsidiaries or special purpose entities it controls.</p> <p>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).</p> <p>Under IAS 39, full derecognition is appropriate once both of the following conditions have been met:</p> <ul style="list-style-type: none"> <li>• The financial asset has been transferred outside the consolidated group.</li> <li>• The entity has transferred substantially all of the risks and rewards of ownership of the financial asset.</li> </ul> <p>The first condition is achieved in one of two ways:</p> <ul style="list-style-type: none"> <li>• When an entity transfers the contractual rights to receive the cash flows of the financial asset, or</li> <li>• 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)</li> </ul>

Impact	US GAAP	IFRS
Derecognition (continued)	<p>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.</p> <p>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.</p>	<p>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.</p> <p>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.</p> <p>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).</p> <p>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.</p> <p>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.</p>

Impact	US GAAP	IFRS
Derecognition (continued)		<p>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.</p> <p>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).</p>

### Technical references

**IFRS** IAS 39, SIC 12

**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

### Note

The foregoing 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.

## Recent/proposed guidance

### **FASB Accounting Standards Update No. 2011-03, *Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements***

In April 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-03, *Transfers and Servicing (Topic 860):*

*Reconsideration of Effective Control for Repurchase Agreements*, to improve the accounting for repurchase agreements (also known as “repos”) and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. Currently, sale accounting is only achieved if certain criteria are met, including demonstrating that the transferor has surrendered effective control over the transferred asset. When assessing effective control, one of the conditions a transferor has to meet is the ability to repurchase or redeem the financial assets even in the event of default of the transferee. For repos and other similar agreements, this ability is demonstrated through obtaining cash or other collateral sufficient to fund substantially all of the cost to purchase a replacement asset should the transferee fail to return the transferred asset. The ASU removes from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in default by the transferee. This makes the level of cash collateral received by the transferor in a repo or other similar agreement irrelevant in determining if it should be accounted for as a sale. As a result, more agreements will be accounted for as financings.

Consideration of the transferor’s ability to repurchase the same or substantially the same financial assets as those transferred is not a requirement under IFRS. Although ASU 2011-03 eliminates one of the differences in the accounting for repurchase agreements between IFRS and US GAAP, other differences still exist and the accounting model for repurchase agreements is not converged between the two frameworks.

### **IASB Exposure Draft, *Derecognition: Proposed Amendments to IAS 39 and IASB Amendments to IFRS 7, Disclosures: Transfers of Financial Assets***

In March 2009, the IASB issued ED 2009/3, *Derecognition*, which would amend the existing derecognition provisions of IAS 39. The main purpose of the exposure draft was to address the perceived complexities within IAS 39 and the resulting difficulty of application in practice. The draft included two approaches to derecognition of financial assets: the “proposed model” and the “alternative view.”

Comments were due July 31, 2009. Based on the feedback received from respondents on the ED and from the outreach program undertaken by the staff, the IASB pursued the alternative derecognition approach for financial assets. However, the IASB agreed in June 2010 that the near-term priority should be on increasing transparency and comparability around disclosures and therefore are not going forward with any amendment to the accounting model.

The amendments to IFRS 7 broadly align the relevant disclosure requirements with US GAAP. However, the accounting models for these types of transactions remain very different between IFRS and US GAAP. Currently, IFRS 7 requires certain disclosures related to transfers of financial assets that do not qualify for derecognition in their entirety. The amendment not only enhances disclosures for those transfers, but also adds a new set of disclosures for transfers of financial assets where derecognition is achieved in their entirety.

These amendments are effective from July 1, 2011, with earlier application permitted.

### **FASB Proposed Accounting Standards Update, *Balance Sheet Offsetting*, and IASB Exposure Draft, *Offsetting Financial Assets and Financial Liabilities***

In response to stakeholders’ concerns, the boards decided to jointly issue a separate exposure draft proposing changes to address differences in their standards on balance sheet netting of derivative contracts and other financial instruments that can result in material differences in financial reporting by financial institutions.



In January 2011, the FASB issued a proposed Accounting Standards Update, *Balance Sheet Offsetting*, jointly with the IASB's exposure draft, *Offsetting Financial Assets and Financial Liabilities*. Under the proposed guidance, a reporting entity would be required to offset a recognized financial asset and a recognized financial liability if (and only if) it has the unconditional right of offset and intends to either settle the asset and liability on a net basis or realize the asset and settle the liability simultaneously. The proposal also clarifies that a right to offset must be legally enforceable in all circumstances (including default by or bankruptcy of a counterparty). The comment period on the exposure draft ended in April 2011.

In June 2011, the boards discussed their project on offsetting financial assets and financial liabilities, specifically considering whether to permit netting of derivatives and related collateral subject to master netting agreements. The FASB supported (by a narrow margin) an exception that would permit netting of these items under US GAAP. The IASB, however, unanimously decided not to permit a similar exception under IFRS. As a result, the requirements are not expected to be converged.

The boards have, however, decided to converge the disclosure requirements, noting that users have consistently asked that information be provided to help reconcile any differences in the offsetting requirements under US GAAP and IFRS.

**FASB Accounting Standards Update No. 2011-04, *Fair Value Measurement (topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRSs*, and IASB IFRS 13, *Fair Value Measurement***

In May 2011, the boards completed their joint project on fair-value measurement. The FASB issued Accounting Standard Update No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRSs* (the ASU), and the IASB issued IFRS 13, *Fair Value Measurement* (together, the new guidance). The new guidance amends US GAAP and is a new standard under IFRS.

The ASU is effective for fiscal years beginning after December 15, 2011, including interim periods within those fiscal years. For nonpublic companies that apply US GAAP, the ASU is effective only for fiscal years beginning after December 15, 2011. IFRS 13 is effective for fiscal years beginning on or after January 1, 2013.

Despite the boards' alignment on most aspects of the project, certain differences were not resolved through this project. Those differences include the recognition of gains and losses at the inception of a transaction that result from differences between fair value and transaction price (day one gains and losses), the valuation of certain investments that report a net asset value (NAV), and certain disclosure requirements.

The key provisions of the new fair-value guidance are as follows:

- *Highest and best use and the valuation premise*  
Under existing guidance, the valuation premise incorporates two approaches for determining the highest and best use of an asset: "in-use" and "in-exchange." In-use refers to a valuation premise for an asset that provides maximum value to market participants principally through its use with other assets as a group. In-exchange refers to a valuation premise for an asset that provides maximum value to market participants principally on a stand-alone basis. The boards have eliminated the terms in-use and in-exchange and instead now describe the objectives of the valuation premise.

Under the new guidance, the concepts of the valuation premise and highest and best use are relevant only when measuring the fair value of nonfinancial assets (and therefore will not apply to financial assets and to liabilities except in the limited circumstances described below).

The boards decided to restrict the highest and best use valuation premise based on the view that financial assets do not have alternative uses, that disposing of financial assets in different ways (such as in a group) represents an entity-specific decision, and that the concept of highest and best use was originally developed for valuing non-financial assets, such as land.

- *Portfolio of financial assets and liabilities*

The new guidance includes an exception to the principle around the valuation premise described above when an entity manages its market risks and/or counterparty credit risk exposure within a group (portfolio) of financial instruments on a net basis.

The exception allows for the fair value of those financial assets and financial liabilities to be measured based on the net positions of the portfolios (i.e., the price that would be received to sell a net long position or transfer a net short position for a particular market or credit risk exposure), rather than the individual values of financial instruments within the portfolio.

In order to qualify for either the exception related to market risk(s) or credit risk, the reporting entity must meet the following criteria:

- It manages the group of financial assets and financial liabilities on the basis of its net exposure to a particular market risk (or risks) or to the credit risk of the counterparty, in accordance with the reporting entity's documented risk management or investment strategy. Market risks refer to interest rate risk, currency risk, or other price risk (for example, market price risk).
- It provides information on that basis about the group of financial assets and financial liabilities to management.
- It is required to or has elected to measure the financial assets and financial liabilities at fair value in the balance sheet at each reporting date.

- *Blockage factors and other premiums or discounts*

A blockage factor is a discount applied in measuring the value of a security to reflect the impact on its quoted price of selling a large block of the security at one time. An entity will often receive a different price per unit for the sale of a holding than if it were to sell each financial instrument individually.

The new guidance is intended to clarify the application of blockage factors and other premiums or discounts in a fair-value measurement. It specifies that premiums or discounts that represent an adjustment relating to the size of an entity's holding of the asset or a liability (specifically, blockage factors) are not permitted. On the other hand, discounts related to other attributes of an asset, such as the absence of liquidity of a particular security, are appropriate in a fair-value measurement. The new guidance therefore prohibits the use of blockage factors in all levels in the fair-value hierarchy, on the basis that the incurrence of a blockage factor is an entity-specific decision (which does not form part of a fair-value measurement). However, it may permit the incorporation of a control or concentration premium in Levels 2 and 3 of the fair-value hierarchy.

## Joint FASB/IASB Financial Instruments Project

### Overview

The FASB and IASB's joint project on financial instruments is intended to address the recognition and measurement of financial instruments, including impairment and hedge accounting. Once finalized, the new guidance will replace the FASB's and IASB's respective financial instrument guidance. Although the project is a joint project, the FASB and IASB have been working on different timetables. The IASB has 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 elected to issue one comprehensive exposure draft on financial instruments.

In November 2009, the IASB issued IFRS 9, *Financial Instruments*, which reflects the decisions it reached in the classification and measurement phase for financial assets. In October 2010, the requirements for classifying and measuring financial liabilities were added to IFRS 9. In November 2010, the IASB issued its exposure draft on hedge accounting. In January 2011, the IASB also issued a second exposure draft on impairment of financial assets carried at amortized cost, together with the FASB.

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*, and, as mentioned above, subsequently issued a joint supplemental impairment document together with the IASB to gather input on new impairment approaches.

Although the FASB and IASB are coordinating efforts in their projects to reduce complexity in reporting financial instruments, the final standards may not be fully converged.

### **Joint FASB/IASB Impairment Project**

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. For these financial assets, credit impairment would be recognized in net income when an entity does not expect to collect all of the contractually promised cash flows (which include both principal and interest). An entity no longer would wait for a probable event to recognize a loss; instead, it would need to consider the impact of past events and existing conditions on the collectability of contractual cash flows.

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. The proposed model was built upon the premise that interest charged on financial instruments includes a premium for expected losses, which should not be included as part of interest revenue/income. This resulted in an allocation of the initial estimate of expected credit losses over the expected life of the financial asset. Comments on the exposure draft were due on June 30, 2010.

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. This document contained three credit impairment approaches, a common proposal and two alternatives.

In July 2011, the boards discussed approaches for classifying and transferring financial assets into and between three categories (or “buckets”): Bucket 1 for assets not affected by observable events indicating a direct relationship to a possible future default, Bucket 2 for assets affected by observable events (but the specific assets that will default are not identified), and Bucket 3 for individual assets expected to default or that have defaulted. The boards agreed to develop an approach based on credit risk management systems, recognizing that credit risk management is a holistic process that includes evaluating all available information.

The boards considered whether an “absolute” or a “relative” credit risk model should underpin the transfer and classification of financial assets between the three buckets and decided to develop the relative credit risk model. The overall objective of this approach is to reflect the deterioration or improvement in the credit quality of financial assets, thus making the maximum use of credit risk management practices. Under this approach, all originated and purchased financial assets would initially start in Bucket 1 and move into Bucket 2 and Bucket 3 as credit loss expectations deteriorate, affecting the uncertainty in collectability of cash flows.

The FASB and IASB will continue to work on refining this new approach as it would still pose some operational concerns. An exposure draft of the revised impairment proposal is expected in the fourth quarter of 2011.

### **IFRS 9, *Financial Instruments***

IFRS 9 replaces the multiple classification and measurements bases in IAS 39 with a single model that has two classification categories: amortized cost and fair value. Classification under IFRS 9 is driven by the entity’s business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. A financial asset is measured at amortized cost if the objective of the business model is to hold the financial asset for the collection of the contractual cash flows and such contractual cash flows solely represent payments of principal and interest, interest being the consideration for the time value of money and the credit risk of the principal amount outstanding; otherwise the financial asset is measured at fair value.

The new standard further indicates that all equity investments should 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 unrealized and realized fair-value gains and losses on equity investments that are not held for trading in OCI. 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, dividends from such investments will continue to be recognized in profit or loss.

Under the new model, management may still designate a financial asset at fair value through profit or loss on initial recognition but only if this significantly reduces an accounting mismatch. The designation at fair value through profit or loss will continue to be irrevocable. The new standard removes the requirement to separate embedded derivatives from financial asset hosts. It requires a hybrid contract to be classified in its entirety at either amortized cost or fair value. As many embedded derivatives introduce variability to cash flows, which is not consistent with the notion that the instrument's contractual cash flows solely represent the payment of principal and interest, most hybrid contracts with financial asset hosts will be measured at fair value in their entirety. The reclassification between categories is prohibited except in circumstances where the entity's business model changes.

The board recently issued an exposure draft that proposes delaying the effective date of IFRS 9 from January 1, 2013, to January 1, 2015, with early application permitted. The European Commission has decided to defer the endorsement of this standard until it has carried out an in-depth analysis. As a result, European companies were unable to adopt the new standard for their 2010 financial statements while companies in more than 80 countries outside the European Union were able to early adopt the new standard.

Refer to the table below for a comparison of IFRS 9 and the FASB's proposed model on classification and measurement, based on current redeliberations up to July 31, 2011.

***FASB Proposed ASU: Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities***

On May 26, 2010, the FASB issued a proposal to amend the accounting for financial instruments. The FASB's proposal addressed all aspects of financial instrument accounting, including classification and measurement, impairment, and hedge accounting. The proposal would have significantly changed the current accounting for many financial instruments by expanding the use of fair value and limiting amortized cost measurements to certain issuances of an entity's own debt. For example, financial instruments currently measured at amortized cost (such as held-for-investment loans, held-to-maturity securities, and debt instruments) would have been measured at fair value.

The FASB proposed that all financial instruments be measured at fair value with changes in fair value recognized in net income. However, changes in fair value of certain financial instruments would have been recognized in OCI if the instrument was held for the collection or payment of contractual cash flows, met certain cash flow characteristics, and did not contain embedded derivatives that required bifurcation. For financial liabilities, an entity could have irrevocably elected at inception to measure certain types of its own liabilities at amortized cost provided: (1) such financial liabilities were eligible for fair value through OCI accounting and (2) measuring the liabilities at fair value would have created or exacerbated a measurement mismatch. All equity securities would have been measured at fair value with changes in fair value recognized in income. Core deposits (without a stated maturity and considered by management as a stable source of funds) would have been recorded at remeasurement value through net income or OCI. Noncore/time deposits would have been carried at fair value. Further, loan commitments and standby letters of credit would have been measured at fair value and classified in a manner consistent with how the loan would be classified if and when it is funded. Comments were due by September 30, 2010.

After considering constituent input, the FASB significantly shifted its course of action. Based on the current redeliberations, the FASB tentatively decided that debt instrument assets would be classified and measured in one of the three categories: (1) amortized cost, (2) fair value with changes in fair value recognized in OCI, or (3) fair value with changes in fair value recognized in net income based on the individual instrument's characteristics and the entity's business activity. The FASB decided to retain the current guidance for hybrid instruments to identify and bifurcate any embedded derivative. Financial liabilities would be classified and measured in one of two categories: (1) amortized cost if they meet the instrument's characteristics criterion and certain other conditions or (2) fair value with changes in fair value recognized in net income. All equity investments not accounted for under the equity method are measured at fair value with changes in fair value recognized in net income. Loan commitments, revolving lines of credit, and standby letters of credit would follow the accounting for the loan when funded. The FASB reaffirmed its May 2010 proposal to prohibit reclassifications between categories after initial recognition.

The FASB's current timeline indicates that it plans to finalize its classification and measurement and impairment approach by the end of 2011, although this may be challenging given the project's current status.

Refer to the following table for a comparison of the FASB's proposed model on classification and measurement of financial assets and IFRS 9.

**Differences between the FASB’s proposed changes to the accounting for financial instruments based on current redeliberations up to July 31, 2011, and IFRS 9, *Financial Instruments***

Impact	US GAAP (Based on current redeliberations up to July 31, 2011)	IFRS (IFRS 9—Classification and Measurement of Financial Assets—and impairment proposal)
<p><b>Fixed-income instruments held</b></p> <p>The differences in the models may lead to different classifications of debt instruments under IFRS and US GAAP. The FASB allows debt instruments to be measured at fair value with changes in fair value recognized through OCI; the IASB does not.</p>	<p>Debt instrument assets would be classified and measured in one of three categories: (1) amortized cost, (2) fair value with changes in fair value recognized in OCI, and (3) fair value with changes in fair value recognized in profit or loss based on two criteria: the individual instrument’s characteristics and the entity’s business activities.</p> <p>Under the proposed model, debt instrument assets are classified based on the business activity used to manage these financial instruments as a portfolio, i.e., customer financing (amortized cost), investing (fair value with changes recognized in OCI), and trading activities (fair value with changes in fair value recognized in profit or loss), together with the individual instrument’s characteristics above.</p> <p>To be eligible for classification and measurement at either amortized cost or fair value with changes in fair value recognized in OCI, all of the following instrument characteristics would need to be met:</p> <ol style="list-style-type: none"> <li>1. The instrument is not a derivative subject to ASC 815.</li> <li>2. An amount is transferred to the issuer at inception that will be returned at maturity or settlement.</li> </ol>	<p>Fixed income instruments are required to be measured at amortized cost if the entity’s business model is to hold for collection of contractual cash flows and the instrument’s terms result solely in payment of principal and interest on specified dates. Otherwise the instruments are measured at fair value with changes in fair value recognized in net income.</p> <p>Debt instruments with contractually linked cash flows (e.g., asset-backed securities) are evaluated using a “look-through” approach and may qualify for amortized cost only if certain conditions are met.</p> <p>For assets at amortized cost, current period interest income, credit losses, and any realized gains or losses are recognized in net income.</p>

Impact	US GAAP (Based on current redeliberations up to July 31, 2011)	IFRS (IFRS 9—Classification and Measurement of Financial Assets—and impairment proposal)
Fixed-income instruments held (continued)	<p>3. The instrument cannot be contractually prepaid such that the investor would not recover substantially all of its initial investment other than due to its own choice.</p> <p>Companies would have to classify an instrument at origination or purchase based on its business activity for the portfolio and no default option could be applied.</p>	
<p>Reclassification</p> <p>IFRS is more permissive than the FASB's proposal with respect to the reclassification of financial instruments.</p>	Reclassifications between categories are prohibited after initial recognition.	When an entity changes its business model for managing financial assets, it is required to reclassify the affected financial assets prospectively from the reclassification date (i.e., when an entity reclassifies an asset currently measured at fair value so that it is measured at amortized cost, its fair value at the reclassification date becomes its new carrying amount).
<p>Equity instruments held (not under equity method)</p> <p>Differences with respect to the classification and measurement of equity instruments may result in greater volatility under the FASB's proposal.</p>	<p>All equity instruments not accounted for under the equity method would be required to be measured at fair value with changes in fair value recognized in net income with no option to elect for the changes in fair value to be recognized in OCI.</p> <p>The FASB decided to retain the current guidance for determining whether an equity investment should be accounted for under the equity method accounting.</p>	<p>All equity instruments will be measured at fair value with changes in fair value recognized in net income if held for trading. Investments in equity instruments not held for trading may be designated irrevocably at fair value with changes in fair value recognized in OCI (irrevocable instrument-by-instrument election at inception).</p> <p>If the irrevocable election is made, dividends are recognized through net income, and there is no impairment or realized gain or loss recognition in net income when sold.</p> <p>IFRS 9 does not change the scope of the equity method of accounting.</p>

Impact	US GAAP (Based on current redeliberations up to July 31, 2011)	IFRS (IFRS 9—Classification and Measurement of Financial Assets—and impairment proposal)
<p><b>Hybrid financial instruments</b></p> <p>Differences with respect to the treatment of embedded derivatives in hybrid financial assets may result in significantly different outcomes.</p>	<p>The FASB decided to retain the current guidance to identify any embedded derivative and determine whether it should be accounted for separately from the host contract. Any embedded derivative in a hybrid financial asset that is required to be accounted for separately would continue to be measured at fair value with changes in fair value recognized in net income.</p> <p>The instrument’s characteristics and business strategy criteria would then be applied to the remaining host contract to determine its appropriate classification and measurement.</p>	<p>A hybrid financial asset is not separated into an embedded derivative and host instrument, but instead the entire financial asset is classified based on the overall classification approach (i.e., business model and instrument terms).</p> <p>As non-closely related embedded derivatives generally introduce variability to cash flows, many hybrid contracts with financial asset hosts will be measured at fair value in their entirety.</p>
<p><b>Fair value option</b></p> <p>Based on the FASB’s current redeliberations, the fair-value option is not applicable to financial instruments as the model requires financial instruments to be evaluated through the above criteria. IFRS, on the other hand, continues to permit entities to irrevocably elect the limited fair-value option for instruments within the scope of IFRS 9.</p>	<p>The FASB decided to eliminate the unrestricted fair-value option on the basis that it undermines the business strategy approach to classification and measurement. The FASB will consider at a later date whether to allow a fair-value option for hybrid financial assets similar to the one provided for hybrid financial liabilities.</p>	<p>An irrevocable fair-value election at initial recognition can be made for financial assets if measuring them at fair value eliminates/significantly reduces an accounting mismatch.</p>





## **Liabilities—Taxes**

Although the two frameworks share many fundamental principles, they are at times conceptualized and applied in different manners. Differences in the calculations of liabilities and deferred taxes likely will result in a number of required adjustments in a company's tax accounts. After releasing an exposure draft in 2009 and receiving comments thereon, the IASB decided to amend and narrow its project on income tax accounting (see Recent/proposed guidance section below). The following are some of the more significant existing differences between the two frameworks.

US GAAP includes detailed guidance surrounding the accounting for uncertainty in income taxes. No similar guidance has been issued by the IASB, though in the IASB's amended project on income taxes, accounting for uncertain tax positions is included. As the standards currently exist, differences in both the unit-of-account methodology and the measurement methodology for uncertain tax positions may result in varying outcomes under the two frameworks.

Under US GAAP, any income tax effects resulting from intragroup profits are deferred at the seller's tax rate and recognized upon sale to a third party. IFRS requires the recording of deferred taxes based on the buyer's tax rate at the time of the initial transaction.

The tax rate applied when calculating deferred and current taxes might differ depending upon the framework used. In addition, under IFRS, a single asset or liability may have more than one tax basis, whereas there would generally be only one tax basis per asset or liability under US GAAP.

Differences in subsequent changes to deferred taxes recorded for certain equity-related items could result in less volatility in the income statement under IFRS. At the same time, the opposite impact (i.e., additional volatility) could result when share-based equity awards are considered. Under both US GAAP and IFRS, entities generally record their deferred taxes initially through the income statement unless the related item was recorded directly into equity or as an adjustment to goodwill. Under IFRS, all future increases or decreases in equity-related deferred tax asset or liability accounts are traced back to equity. Under US GAAP, however, subsequent changes arising as a result of tax rate and law changes on deferred taxes are recorded through the income statement even if the related deferred taxes initially arose in equity, except in limited circumstances.

Presentation differences related to deferred taxes could affect the calculation of certain ratios from the face of the balance sheet—including a company's current ratio—because IFRS requires all deferred taxes to be classified as noncurrent.

The following table provides further details on the foregoing and other selected current differences.

Impact	US GAAP	IFRS
<p><b>Uncertain tax positions</b></p> <p>Differences with respect to the unit-of-account methodology, the general measurement methodology and the treatment of subsequent events may result in varying outcomes under the two frameworks.</p>	<p>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.</p> <p>Uncertain tax positions are evaluated at the individual tax position level.</p> <p>The tax position 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.</p> <p>Relevant developments to uncertain tax positions occurring after the balance sheet date but before issuance of the financial statements (which would include the discovery of information that was not available as of the balance sheet date) should be considered a nonrecognized subsequent event for which no effect would be recorded in the current-period financial statements.</p>	<p>Accounting for uncertain tax positions is not specifically addressed within IFRS. The tax consequences of events should follow the manner in which an entity expects the tax position to be resolved (through either payment or receipt of cash) with the taxation authorities at the balance sheet date.</p> <p>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.</p> <p>Acceptable methods by which to measure tax positions include (1) the expected-value/probability-weighted-average approach and (2) the single-best-outcome/most-likely-outcome method. Use of the cumulative probability model required by US GAAP is not supported by IFRS.</p> <p>Relevant developments to uncertain tax positions occurring after the balance sheet date but before issuance of the financial statements (which would include discovery of information that was not available as of the balance sheet date) should be considered either an adjusting or nonadjusting event depending on whether the new information provides evidence of conditions that existed at the end of the reporting period.</p>

Impact	US GAAP	IFRS
<p><b>Unrealized intragroup profits</b></p> <p>The frameworks require different approaches when deferred taxes on unrealized intragroup activity are considered.</p>	<p>Any tax impacts to the seller as a result of the intercompany sale are deferred and are realized upon the ultimate third-party sale.</p> <p>The buyer is prohibited from recognizing deferred taxes resulting from the intra-group sale.</p>	<p>Any tax impacts to the seller as a result of the intercompany transaction are recognized as incurred.</p> <p>Deferred taxes resulting from the intra-group sale are recognized at the buyer's tax rate.</p>
<p><b>Intraperiod allocations</b></p> <p>Differences in subsequent changes to deferred taxes could result in less volatility in the statement of operations under IFRS.</p>	<p>Subsequent changes in deferred tax balances due to enacted tax rate and tax law changes are taken through the income statement regardless of whether the deferred tax was initially created through the income statement, through equity, or in purchase accounting.</p> <p>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.</p>	<p>Subsequent changes in deferred tax balances are recognized in the income statement, except to the extent that the tax arises from a transaction or event that is recognized, in the same or a different period, either in other comprehensive income or directly in equity or from a business combination.</p>
<p><b>Deferred taxes on investments in subsidiaries, joint ventures, and equity investees</b></p> <p>Differences in the recognition criteria surrounding undistributed profits and other outside basis differences could result in changes in recognized deferred taxes under IFRS.</p>	<p>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.</p> <p>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 unless the entity anticipates utilizing that method.</p>	<p>With respect to undistributed profits and other outside basis differences related to investments in subsidiaries, branches and associates, and joint ventures, deferred taxes are recognized except when a parent company (investor or venturer) 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.</p>

Impact	US GAAP	IFRS
<p data-bbox="159 464 570 548"><b>Deferred taxes on investments in subsidiaries, joint ventures, and equity investees (continued)</b></p>	<p data-bbox="618 464 1024 583">As it relates to investments in domestic corporate joint ventures, deferred tax liabilities are required on undistributed profits that arose after 1992.</p> <p data-bbox="618 604 1024 695">Deferred taxes are generally recognized on temporary differences related to investments in equity investees.</p> <p data-bbox="618 716 1052 1188">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 prior 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.</p> <p data-bbox="618 1209 1024 1329">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.</p>	<p data-bbox="1078 464 1495 678">There is no specific guidance under IFRS on the accounting for a deferred tax liability when there is a change in the status of an investment from an associate to a subsidiary. The general guidance regarding deferred taxes on undistributed profits should be applied.</p> <p data-bbox="1078 699 1495 852">Deferred tax assets for investments in subsidiaries, branches and associates, and joint ventures may be recorded only to the extent they will reverse in the foreseeable future.</p>
<p data-bbox="159 1354 532 1423"><b>Recognition of deferred tax assets</b></p> <p data-bbox="159 1444 594 1598">The frameworks take differing approaches to the presentation of deferred tax assets. It would be expected that net deferred tax assets recorded would be similar under both standards.</p>	<p data-bbox="618 1444 1052 1598">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 data-bbox="1078 1444 1511 1661">Deferred tax assets are recognized when it is considered probable (defined as “more likely than not”) that sufficient taxable profits will be available to utilize the temporary difference or unused tax losses. Valuation allowances are not allowed to be recorded.</p>
<p data-bbox="159 1686 578 1755"><b>Tax rate applied to current and deferred taxes</b></p> <p data-bbox="159 1776 545 1866">The rate applied when calculating deferred and current taxes may differ depending on the framework used.</p>	<p data-bbox="618 1776 1000 1866">US GAAP requires the use of enacted rates when calculating current and deferred taxes.</p>	<p data-bbox="1078 1776 1446 1866">Current and deferred tax is calculated using enacted or substantively enacted rates.</p>

Impact	US GAAP	IFRS
<p><b>Exemptions from accounting for temporary differences</b></p> <p>In certain situations, there will be no deferred tax accounting under IFRS that would exist under US GAAP and vice versa.</p>	<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 exemption exists in the accounting for deferred taxes from the initial recognition of an asset or liability in a transaction that neither is a business combination nor affects accounting profit or taxable profit/loss at the time of the transaction.</p> <p>No special treatment of leveraged leases exists under IFRS.</p>
<p><b>Measurement of foreign nonmonetary assets and liabilities where the local currency is not the functional currency</b></p> <p>The establishment of deferred taxes on exchange rate changes and tax indexing related to nonmonetary assets and liabilities under IFRS is likely to result in additional volatility in the income statement.</p>	<p>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).</p>	<p>Deferred taxes are recognized for the difference between the carrying amount determined by using the historical rate of exchange and the relevant tax basis at the balance sheet date, which may have been affected by exchange rate movements or tax indexing.</p>

Impact	US GAAP	IFRS
<p><b>Presentation</b></p> <p>Presentation differences related to deferred taxes could affect the calculation of certain ratios from the face of the balance sheet (including a company's current ratio) because IFRS requires all deferred taxes to be classified as noncurrent.</p>	<p>The classification of deferred tax assets and deferred tax liabilities follows the classification of the related, nontax 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.</p> <p>A liability for unrecognized tax benefits 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.</p> <p>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.</p>	<p>Generally, deferred tax assets and deferred tax liabilities are classified net (within individual tax jurisdictions and if there is a legally enforceable right to offset) as noncurrent on the balance sheet. Supplemental note disclosures are included to describe the components of temporary differences as well as the recoverable amount bifurcated between amounts recoverable less than or greater than one year from the balance sheet date.</p> <p>A liability for uncertain tax positions is generally classified as a current liability (because entities typically do not have the unconditional right to defer settlement of uncertain tax positions for at least 12 months after the reporting period).</p> <p>Interest and penalties related to taxation (e.g., uncertain tax positions) may be:</p> <ul style="list-style-type: none"> <li>classified as finance or other operating expenses when they can be clearly identified and separated from the related tax liability; or</li> <li>included in the tax line if they cannot be separated from the taxes, or as matter of accounting policy.</li> </ul> <p>The accounting policy decision should be consistently applied and disclosed.</p>
<p><b>Tax basis</b></p> <p>Under IFRS, a single asset or liability may have more than one tax basis, whereas there would generally be only one tax basis per asset or liability under US GAAP.</p>	<p>Tax basis is a question of fact under the tax law. It is determined by the amount that is depreciable for tax purposes as well as the amount that would be deductible upon sale or liquidation of the asset.</p>	<p>Tax basis is based on the expected manner of recovery. Assets and liabilities may have a dual manner of recovery (e.g., through use and through sale). 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.</p>

Impact	US GAAP	IFRS
<p><b>Interim reporting</b></p> <p>A worldwide effective tax rate is used to record interim tax provisions under US GAAP. Under IFRS, a separate effective tax rate is used for each jurisdiction.</p>	<p>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.</p>	<p>The interim tax provision is determined by applying an estimated annual effective tax rate to year-to-date pretax income. To the extent practicable, a separate estimated average annual effective income tax rate is determined for each taxing jurisdiction and applied individually to the interim period pretax income of each jurisdiction.</p>
<p><b>Technical references</b></p> <p><b>IFRS</b> IAS 1, IAS 12, IAS 34, IAS 37</p> <p><b>US GAAP</b> ASC 718-740, ASC 740</p>		

#### Note

The foregoing 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.

#### Recent/proposed guidance

##### IFRS

In March 2009, the IASB released an exposure draft that proposes changes to its income tax accounting standard. After reviewing comments received on the exposure draft, and giving further consideration to income tax guidance as a whole, the IASB indicated that a fundamental review of the scope of the current project on accounting for income taxes may occur after 2011. In the meantime, the IASB is developing proposals for more limited amendments. The revised project scope—which will address areas such as uncertain tax positions, valuation allowances, and allocation of taxes within a group filing a consolidated tax return, among others—has the potential to eliminate certain differences with US GAAP. However, deliberations on these topics have yet to commence in the midst of the joint priority projects. Furthermore, the IASB does not intend to consider uncertain tax positions until after the revisions to IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, are finalized (see Recent/proposed guidance section of the Liabilities—other chapter). Depending on the path taken, deliberations in these areas may simply change the nature of the differences with US GAAP rather than eliminate them.



**IASB Amendment to IAS 12, *Deferred Tax: Recovery of Underlying Assets***

In December 2010, the IASB amended IAS 12, *Income Taxes*, to introduce an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value. The amendments introduce a rebuttable presumption that investment property measured at fair value will be recovered entirely by sale. The rebuttable presumption also applies to deferred tax liabilities or assets that arise from investment properties acquired in a business combination, if the acquirer subsequently uses the fair value model to measure those properties. Accordingly, any associated deferred tax assets or liabilities would be measured based on the assumption that the investment property will be recovered through sale.

The presumption of recovery entirely by sale is rebutted if the investment property is depreciable (for example, buildings and land held under a lease) and is held with an objective to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale before the end of its economic life. The presumption cannot be rebutted for land that is an investment property, because land can be recovered only through sale.

IAS 40, *Investment Property*, allows an entity to make an accounting policy election to account for investment properties on a cost model or fair value model. As described above, the exception to the measurement of deferred taxes introduced by the amendment only applies to investment properties accounted for under the fair value model.

Under current US GAAP, entities do not have the option to measure investment properties at fair value. As such, the amendment does not currently have a significant impact on the differences between US GAAP and IFRS. The FASB is currently working on a project regarding the accounting for investment properties, which would require an investment property entity to measure real estate investment properties at fair value. If investment properties are measured at fair value under US GAAP, this amendment to IAS 12 could result in differences in the measurement of deferred taxes on investment properties between the two frameworks. This is likely to be true particularly in jurisdictions where there is no capital gains tax or where the capital gains rate is different from the income tax rate. In such cases, the deferred tax liability measured based on the presumption of recovery through sale as required by the IFRS amendment would generally be less than the deferred tax liability measured based on recovery through use.

**Other (e.g., SEC and/or industry highlights)**

Further differences in deferred taxes exist between US GAAP and IFRS in the treatment of deferred taxes within share-based payment arrangements. Because those differences represent discrete calculations based on the manner of calculation of the deferred tax asset under both frameworks, the relevant differences have been described in the Expense recognition—share-based payments chapter.

## 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.

As it relates to restructuring provisions, the specific communication to employees that is required prior to the recording of a provision under US GAAP is not required by IFRS. This could lead companies to record restructuring provisions in periods earlier than they previously would have under US GAAP. At the same time, 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 previously would have under US GAAP. The IFRS guidance in this area is in a state of transition. Refer to the Recent/proposed guidance section of this chapter for a discussion of certain June 2011 amendments made to the IFRS guidance in relation to termination benefits and the elimination of some (and creation of other) US GAAP differences in this area.

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.

In January 2010, the IASB issued an exposure draft titled *Measurement of Liabilities* in IAS 37. In February 2010, the IASB published a working draft of a proposed new IFRS titled *Liabilities*. The working draft incorporated the measurement changes discussed within the January 2010 exposure draft as well as recognition and disclosure changes from a 2005 exposure draft (and related subsequent deliberations). The proposed new IFRS would introduce significant new recognition and measurement principles and would create new differences between IFRS and US GAAP. Having said that, the timing of any new guidance in this area is unclear. Redeliberations on the project have been postponed until after the joint priority projects. Refer to the Recent/proposed guidance section for further discussion.

The following table provides further details on the foregoing and other selected current differences.

Impact	US GAAP	IFRS
<p><b>Recognition of provisions</b></p> <p>Differences in the definition of “probable” may result in earlier recognition of liabilities under IFRS.</p> <p>The IFRS “present obligation” criteria might result in delayed recognition of liabilities when compared with US GAAP.</p>	<p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p>	<p>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.</p> <p>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.</p> <p>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.</p>
<p><b>Measurement of provisions</b></p> <p>In certain circumstances, the measurement objective of provisions varies under the two frameworks.</p> <p>IFRS results in a higher liability being recorded when there is a range of possible outcomes with equal probability.</p>	<p>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.</p> <p>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.</p> <p>When no amount within a range is a better estimate than any other amount, the low end of the range is accrued.</p>	<p>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).</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Discounting of provisions</b></p> <p>Provisions will be discounted more frequently under IFRS. At the same time, greater charges will be reflected as operating (versus financing) under US GAAP.</p>	<p>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.</p> <p>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.</p> <p>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.</p> <p>There are certain instances outside of ASC 450 (e.g., in the accounting for asset retirement obligations) where discounting is required.</p>	<p>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.</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Restructuring provisions (excluding business combinations)</b></p> <p>Differences exist in the accounting for restructuring or termination benefit provisions (e.g., IFRS does not require specific detailed communication to employees). Reporting under IFRS may alter the timing of expense recognition. Termination benefit costs, for example, may be recognized earlier or later than under US GAAP depending upon the specific facts and circumstances.</p> <p>Upon the adoption of the June 2011 amendments to IAS 19, <i>Employee Benefits</i>, certain differences will be eliminated while others will remain. Refer to the IFRS column as well as the Recent/proposed guidance section for a further discussion.</p>	<p>The guidance prohibits the recognition of a liability based solely on an entity's commitment to an approved plan.</p> <p>Recognition of a provision for one-time termination benefits requires communication of the details of the plan to employees who could be affected. The communication is to contain sufficient details about the types of benefits so that employees have information for determining the types and amounts of benefits they will receive.</p> <p>Further guidance exists for different types of termination benefits (i.e., special termination benefits, contractual termination benefits, severance benefits, and one-time benefit arrangements). For example, one-time termination benefits provided in exchange for an employee's future service are considered a "stay bonus" and are recognized over the employee's future service period.</p> <p>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.</p> <p>Inducements for voluntary terminations are to be recognized when (1) employees accept offers and (2) the amounts can be estimated.</p>	<p>A provision for restructuring costs is recognized when, among other things, an entity has a present obligation.</p> <p>A present obligation exists when, among other conditions, the company is demonstrably committed to the restructuring. An entity is usually demonstrably committed when there is a legal or a constructive obligation. A constructive obligation exists when the entity has a detailed formal plan for the restructuring and it has announced the plan's main features to those affected or is unable to withdraw the plan because it has started to implement the plan. A current provision is unlikely to be justified if there will be a delay before the restructuring begins or if the restructuring will take an unreasonably long time to complete. As long as an entity is "demonstrably committed" to a plan—for example, one that requires future service—a liability would be recognized.</p> <p>Liabilities related to offers for voluntary terminations are recorded when the offer is made to employees and is measured based on the number of employees expected to accept the offer.</p> <p>Upon the adoption of the June 2011 amendments to IAS 19, <i>Employee Benefits</i>, the guidance will change as outlined below:</p>

Impact	US GAAP	IFRS
Restructuring provisions (excluding business combinations) (continued)		<p>Involuntary termination benefits, which have no future service requirement, will be recognized when the termination plan has been communicated to the affected employees and the plan meets specified criteria. This guidance will essentially conform with the current US guidance for one-time termination benefits although under IFRS it will apply to all termination benefits.</p> <p>A benefit paid on involuntary termination that is conditional on the affected employees delivering a period of future service, (i.e., a “stay bonus”) will be viewed as being provided in exchange for future service and will no longer be able to be characterized as termination benefits. Rather, the associated costs would be recognized over the period of service. This change will align IFRS with US GAAP in this area.</p> <p>The treatment of voluntary termination benefits to be paid under a non-binding offer to employees will be recognized only when an employee accepts the offer or the offer becomes binding. This aligns with US GAAP and differs from current IFRS wherein an estimate would be made and recorded upon the offer being made.</p> <p>Voluntary termination benefits to be paid under a binding offer to employees that the entity cannot withdraw will continue to be recognized when the offer is made and measured based on the number of employees expected to accept the offer.</p>

Impact	US GAAP	IFRS
<p><b>Onerous contracts</b></p> <p>Onerous contract provisions may be recognized earlier and in different amounts under IFRS.</p>	<p>Provisions are not recognized for unfavorable contracts unless the entity has ceased using the rights under the contract (i.e., the cease-use date).</p> <p>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.</p> <p>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).</p> <p>US GAAP generally does not allow the recognition of losses on executory contracts prior to such costs being incurred.</p>	<p>Provisions are recognized when a contract becomes onerous regardless of whether the entity has ceased using the rights under the contract.</p> <p>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.</p> <p>In certain limited situations, a lease contract can be split into component contracts. A provision for the onerous part can be recognized if both (1) the onerous and non-onerous portions are clearly identifiable and could have been separated at contract inception, and (2) the future economic benefits can be allocated on a reliable basis to the various elements of the contract.</p> <p>IFRS generally 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.</p>

Impact	US GAAP	IFRS
<p><b>Accounting for government grants</b></p> <p>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.</p>	<p>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.</p>	<p>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. Revenue-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. Capital-based grants are deferred and matched with the depreciation on the asset for which the grant arises.</p> <p>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.</p>



Impact	US GAAP	IFRS
<p><b>Reimbursement and contingent assets</b></p> <p>Guidance varies with respect to when these amounts should be recognized. As such, recognition timing differences could rise.</p>	<p><b>Recovery of recognized losses</b>—An asset relating to the recovery of a recognized loss shall be recognized when realization of the claim for recovery is deemed probable.</p> <p><b>Recoveries representing gain contingencies</b>—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.</p>	<p><b>Reimbursements</b>—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.</p> <p>The virtually certain threshold may, in certain situations, be achieved in advance of the receipt of cash.</p> <p><b>Contingent assets</b>—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.</p>

### Technical references

**IFRS** IAS 19, IAS 20, IAS 37

**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

### Note

The foregoing 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.

## Recent/proposed guidance

### IASB Amendment to IAS 19, *Employee Benefits*

In June 2011, the IASB issued an amendment to the guidance for termination benefits in IAS 19, *Employee Benefits*, to clarify the distinction between termination benefits and post-employment benefits and to align the treatment of some benefits with US GAAP. Under the amendment, termination benefits are defined to include only those benefits that are not offered in exchange for service.

Termination benefits can be either of the following:

- Voluntary, which are benefits offered in exchange for an employee's decision to accept voluntary termination of employment before normal retirement
- Involuntary, which are paid as compensation for terminating an employee before normal retirement date

Voluntary termination benefits to be paid under a binding offer to employees that the entity cannot withdraw are recognized when the offer is made and measured based on the number of employees expected to accept the offer. This is consistent with the accounting required by IAS 19 prior to the amendment. The treatment of voluntary termination benefits to be paid under a non-binding offer to employees is changed such that they are recognized only when the offer becomes binding, typically when an employee accepts the offer. This is a change to the accounting required by IAS 19 prior to the amendment and delays the recognition of voluntary termination benefits for many entities.

Benefits paid to employees who voluntarily terminate their employment under an offer that provides benefits in exchange for service are viewed as enhancements to post-employment benefits, short-term or other long-term benefits based on their nature and not voluntary termination benefits. Examples of such benefits include so-called stay bonuses. The accounting for such benefits was amended because the substance is the benefits are paid in exchange for employee services and the costs of providing this benefit should be recognized as the employee delivers service.

A benefit paid on involuntary termination may be conditional on the affected employees delivering a period of future service, a "stay bonus." These benefits are provided in exchange for a period of future service, and such benefits are not considered termination benefits under the IASB's amendment. The associated costs are recognized over the period of service that represents a delayed recognition of expense for entities that currently treat these as termination benefits.

Involuntary termination benefits that have no future service requirement are recognized when the termination plan has been communicated to the affected employees and the plan meets specified criteria largely the same as under current IAS 19 and IAS 37. The amendment will align accounting for such involuntary termination benefits under IFRS with the "one-time benefits" guidance under US GAAP.

The changes are effective for accounting periods commencing on or after January 1, 2013, with early application permitted. The changes to IAS 19 affect most IFRS preparers that pay termination benefits and more closely align IFRS with US GAAP in some areas.

### FASB Accounting Standards Update (ASU) No. 2010-27, *Fees Paid to the Federal Government by Pharmaceutical Manufacturers*

In March 2010, President Obama signed into law the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act (the Acts). The Acts require certain pharmaceutical manufacturing entities to pay an annual fee in each calendar year beginning on or after January 1, 2011. The annual fee imposed on an individual entity is based on the amount of their branded prescription drug sales for the preceding year as a percentage of the industry's branded prescription drug sales for the same period. The annual fee is payable no later than September 30 of the applicable calendar year and is not tax-deductible.

The annual fee becomes payable to the US Treasury once the pharmaceutical manufacturing entity has a gross receipt from branded prescription drug sales to any specified government program or in accordance with coverage under any government program for each calendar year beginning on or after January 1, 2011.

ASU 2010-27 specifies that the liability for the fee should be estimated and recorded by pharmaceutical manufacturers in full upon the first qualifying sale with a corresponding deferred cost that is amortized to expense using a straight-line method of allocation unless another method better allocates the fee over the calendar year that it is payable. The ASU also addresses income statement classification indicating that the annual fee should be presented as an operating expense.

IFRS does not contain specific guidance on how an entity should recognize and classify the fees mandated on pharmaceutical manufacturers by the Acts. However, the accounting for the fees under IFRS is expected to be consistent with the guidance in ASU 2010-27, except that the fee will generally be presented as a reduction to revenue under IFRS since the fee is linked directly to a particular customer (i.e., the US government).

#### **IASB Exposure Draft, *Measurement of Liabilities in IAS 37*, and Working Draft, *IFRS X, Liabilities***

In January 2010, the IASB issued an exposure draft titled *Measurement of Liabilities in IAS 37*. In February 2010, the IASB published a working draft of a proposed new IFRS titled *Liabilities*. The working draft incorporated the measurement changes discussed within the January 2010 exposure draft as well as recognition and disclosure changes from a 2005 exposure draft (and related subsequent deliberations). The working draft proposals would affect the recognition and/or measurement of most provisions and would be relevant to almost every entity reporting under IFRS.

After receiving more than 200 comment letters on its proposals, the IASB began considering the feedback in September 2010. Soon after beginning redeliberations, the IASB decided in November 2010 to postpone further discussion and analysis on the project until after June 2011. The delay was attributed to the ongoing joint priority projects and the IASB's desire to give proper consideration to the matters raised by respondents. The IASB tentatively decided that if it reaches decisions on all aspects of the proposals, it will re-expose any proposed revised IFRS in its entirety for further comment. Although the IASB indicated it expects to do so in the second half of 2011, the ultimate timing will likely depend on when the IASB and FASB finalize the joint priority projects.

#### **FASB Expected Exposure Draft, *Disclosure of Certain Loss Contingencies***

Nearly two years after issuing its original proposal to enhance disclosures of loss contingencies, the FASB issued an exposure draft of a proposed ASU *Contingencies—Disclosure of Certain Loss Contingencies*, in July 2010. The objective of the board is to require enhanced disclosure of certain loss contingencies under Accounting Standards Codification Topic 450, *Contingencies*, including litigation, environmental remediation, and product warranty liabilities.

The proposed disclosures consist of qualitative and quantitative information about loss contingencies that will enable financial statement users to understand their nature, potential magnitude, and potential timing (if known). The disclosures would include publicly available quantitative information, such as the claim amount for asserted litigation contingencies, other relevant nonprivileged information about the contingency, and, in some cases, information about possible recoveries from insurance and other sources. Public companies would be required to provide a tabular reconciliation (i.e., a rollforward) of recognized loss contingencies from the beginning to the end of the reporting period.

The comment period for the proposal ended in September 2010, and the board received approximately 380 comment letters. In November 2010, the board discussed its plan for redeliberations. At that time, the board acknowledged the concerns of some constituents that insufficient loss contingency disclosures may indicate a compliance issue with the existing guidance rather than a need for a new standard. The board also acknowledged the recent initiatives by the SEC staff to improve compliance with the guidance in this area through emphasis in comment letters, speeches, a "Dear CFO" letter issued in October 2010, and other means. In light of the SEC staff's emphasis, the board decided to evaluate whether there is improved disclosure of loss contingencies during the 2010 year-end financial reporting cycle. At that time, the board will decide whether any future redeliberations are needed or whether additional outreach should be conducted. The board does not expect to take further action on the project before December 2011.





## Financial liabilities and equity

Under current standards, both US GAAP and IFRS define financial liabilities and require that instruments be assessed to determine whether they meet the definition of and require treatment as financial liabilities. In very general terms, financial instruments that do not meet the definition of a financial liability are classified as equity (or mezzanine equity under US GAAP only). The US GAAP definitions of what qualifies as or requires treatment as a financial liability are narrower than the IFRS definitions. The narrower US GAAP definitions of what requires financial liability classification result in more instruments being treated as equity/mezzanine equity under US GAAP and comparatively more instruments being treated as financial liabilities under IFRS.

Under IFRS, contingent settlement provisions and puttable instruments are more likely to result in financial liability classification. When assessing contingent settlement provisions, IFRS focuses on whether the issuer of an instrument has the unconditional right to avoid delivering cash or another financial asset in any or all potential outcomes. The fact that the contingency associated with the settlement provision might not be triggered does not influence the analysis unless the contingency is not genuine or it arises only upon liquidation. With very limited exceptions, puttable instruments are financial liabilities under IFRS.

US GAAP examines whether the instrument in question contains an unconditional redemption requirement. Unconditional redemption requirements result in financial liability classification. Contingent settlement/redemption requirements and/or put options, however, generally would not be unconditional, as they may not occur. As such, under US GAAP, financial liability classification would not be required. SEC-listed entities, however, would need to consider the application of mezzanine equity accounting guidance. When an instrument that qualified for equity treatment under US GAAP is classified as a financial liability under IFRS, there are potential follow-on implications. For example, an entity must consider and address the further potential need to bifurcate and separately account for embedded derivatives within liability-classified host contracts. Also, because the balance sheet classification drives the treatment of disbursements associated with such instruments, classification differences may impact earnings (i.e., interest expense calculated by using the effective interest method, as opposed to dividends) as well as key balance sheet ratios.

Under IFRS, if an instrument has both a financial liability component and an equity component (e.g., redeemable preferred stock with dividends paid solely at the discretion of the issuer), the issuer is required to separately account for each component. 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, and the equity component is measured as the residual amount. US GAAP generally does not have the concept of compound financial instruments outside of instruments with equity conversion features.

For hybrid instruments that contain equity conversion options, IFRS generally requires split accounting of the equity conversion feature and the debt host. While there are circumstances where US GAAP also requires split accounting, there are also circumstances under which a singular accounting model is followed.

Bifurcation/split accounting under IFRS versus singular accounting under US GAAP can create a significantly different balance sheet presentation while also impacting earnings (mainly due to recognition of interest expense at the market rate at inception as opposed to any contractual rate within the compound arrangement).

Whether an instrument (freestanding or embedded) that is settled by delivery or receipt of an issuer's own shares is considered equity may be a source of significant differences between IFRS and US GAAP. For example, net share settlement would cause a warrant or an embedded conversion option to fail equity classification under IFRS; under US GAAP, a similar feature would not automatically taint equity classification, and further analysis would be required to determine whether equity classification is appropriate. Likewise, a contract with settlement alternatives that includes one that does not result in equity classification (e.g., a choice between gross settlement and net cash settlement) would fail equity classification under IFRS even if the settlement choice resides with the issuer.

There are some significant differences in the treatment of written puts that will be settled by gross receipt of an entity's own shares. Under US GAAP, such items are measured initially and subsequently at fair value. Under IFRS, even though the contract in itself may meet the definition of equity if the contract is for the receipt of a fixed number of the entity's own shares for a fixed amount of cash, IFRS requires the entity to set up a financial liability for the discounted value of the amount of cash it may be required to pay.

Additional differences exist relating to financial liabilities that are carried at amortized cost. For these financial liabilities, both IFRS and US GAAP use the effective interest method to calculate amortized cost and allocate interest expense over the relevant period. The effective interest method is based on the effective interest rate calculated at initial recognition of the financial instrument. Under IFRS, the effective interest rate is calculated based on estimated future cash flows through the expected life of the financial instrument. Under US GAAP, the effective interest rate generally is calculated based on the contractual cash flows through the contractual life of the financial liability. Certain exceptions to this rule involve (1) puttable debt (generally amortized over the period from the date of issuance to the first put date) and (2) callable debt (a policy decision to amortize over either the contractual life or the estimated life). Under IFRS, changes in the estimated cash flow due to a closely related embedded derivative that is not bifurcated result in a cumulative catch-up reflected in the current-period income statement. US GAAP does not have the equivalent of a cumulative-catch-up approach.

As discussed in the Recent/proposed guidance section, the FASB and IASB are carrying out a joint project with the objective of comprehensively reconsidering the financial liability and equity accounting guidance under both frameworks.

The following table provides further details on the foregoing and other selected current differences (pre-IFRS 9 and IFRS 13).

Impact	US GAAP	IFRS
<b>Classification</b>		
<p><b>Contingent settlement provisions</b></p> <p>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.</p> <p>Items classified as mezzanine equity under US GAAP generally are classified as financial liabilities under IFRS.</p>	<p>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.</p> <p>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.</p> <p>Mezzanine classification is a US public company concept that is also preferred (but not required) for private companies.</p>	<p>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.</p> <p>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 were 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.</p> <p>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.</p> <p>There is no concept of mezzanine classification under IFRS.</p>



Impact	US GAAP	IFRS
<p><b>Derivative on own shares — fixed-for-fixed versus indexed to issuer's own shares</b></p> <p>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.</p> <p>These differences can impact classification as equity or a derivative asset or liability (with derivative classification more common under IFRS).</p>	<p>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.</p> <p><b>Step 1</b> — 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.</p> <p><b>Step 2</b> — 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.</p> <p>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.</p> <p>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.</p>	<p>Only contracts that provide for gross physical settlement 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.</p> <p>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 fixed-for-fixed 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.</p> <p>However, there is a recent 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.</p>

Impact	US GAAP	IFRS
<p><b>Derivatives on own shares—settlement models</b></p> <p>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.</p>	<p>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.</p> <p>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.</p> <p>Similar to IFRS, derivative contracts that require net cash settlement are assets or liabilities.</p> <p>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.</p>	<p>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.</p> <p>Gross physical settlement is required to achieve equity classification.</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Written put option on the issuer's own shares</b></p> <p>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.</p>	<p>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.</p> <p>ASC 480 requires written put options to be measured at fair value, with changes in fair value recognized in current earnings.</p>	<p>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).</p> <p>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.</p>
<p><b>Compound instruments that are not convertible instruments (that do not contain equity conversion features)</b></p> <p>Bifurcation and split accounting under IFRS may result in significantly different treatment, including increased interest expense.</p>	<p>The guidance does not have the concept of compound financial instruments outside of instruments with equity conversion features. As such, under US GAAP the instrument would be classified wholly within liabilities or equity.</p>	<p>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.</p> <p>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, and the equity component is measured as the residual amount.</p> <p>The accretion calculated in the application of the effective interest rate method on the liability component is classified as interest expense.</p>

Impact	US GAAP	IFRS
<p><b>Convertible instruments (compound instruments that contain equity conversion features)</b></p> <p>Differences in how and when convertible instruments get bifurcated and/or how the bifurcated portions get measured can drive substantially different results.</p>	<p>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).</p> <p>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:</p> <ul style="list-style-type: none"> <li>• For convertible debt instruments that may be settled in cash, 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.</li> <li>• 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.</li> </ul>	<p>For convertible instruments with a conversion feature characterized by 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.</p> <p>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.</p> <p>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.</p> <p>IFRS does not have a concept of BCF, as the compound instruments are already accounted for based on their components.</p>

Impact	US GAAP	IFRS
<p><b>Puttable shares/redeemable upon liquidation</b></p> <p><b>Puttable shares</b></p> <p>Puttable shares are more likely to be classified as financial liabilities under IFRS.</p> <p>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.</p> <p><b>Redeemable upon liquidation</b></p> <p>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.</p>	<p><b>Puttable shares</b></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><b>Redeemable upon liquidation</b></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>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.</p>	<p><b>Puttable shares</b></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>An entity classifies certain puttable instruments as equity when they have particular features and meet certain specific conditions in IAS 32.</p> <p><b>Redeemable upon liquidation</b></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> <p>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.</p>

Impact	US GAAP	IFRS
<b>Measurement</b>		
<p><b>Initial measurement of a liability with a related party</b></p> <p>There are fundamental differences in the approach to related-party liabilities under the two accounting models that may impact the values at which these liabilities initially are recorded. The IFRS model may, in practice, be more challenging to implement.</p>	<p>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.</p> <p>The ASC 850 presumption that related party transactions are not at arm's length and the associated disclosure requirements also should be considered.</p>	<p>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.</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Effective-interest-rate calculation</b></p> <p>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.</p> <p>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.</p>	<p>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.</p>	<p>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.</p> <p>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).</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Modification or exchange of debt instruments and convertible debt instruments</b></p> <p>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.</p>	<p>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.</p> <p>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.</p> <p>If the debt modifications involve changes in noncash embedded features, the following two-step test is required:</p> <p><b>Step 1</b> – 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.</p>	<p>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.</p> <p>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.</p>



Impact	US GAAP	IFRS
<p>Modification or exchange of debt instruments and convertible debt instruments (continued)</p>	<p><b>Step 2</b>—If the test in Step 1 is not met, the following should be assessed:</p> <ul style="list-style-type: none"> <li>• 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.</li> <li>• Whether a substantive conversion option is added or a conversion option that was substantive at the date of modification is eliminated.</li> </ul> <p>If either of these criteria is met, the exchange or modification would be accounted for as an extinguishment.</p>	<p>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.</p>
<p><b>Transaction costs (also known as debt issue costs)</b></p> <p>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.</p>	<p>When the financial liability is not carried at fair value through income, transaction costs are deferred as an asset.</p> <p>Transaction costs are expensed immediately when the financial liability is carried at fair value, with changes recognized in profit and loss.</p>	<p>When the financial liability is not carried at fair value through income, transaction costs 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.</p> <p>Transaction costs are expensed immediately when the financial liability is carried at fair value, with changes recognized in profit and loss.</p>
<p><b>Technical references</b></p> <p><b>IFRS</b> IAS 32, IAS 39, IFRIC 2</p> <p><b>US GAAP</b> 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 825, ASC 850, ASC 860, ASR 268, CON 6</p>		

**Note**

The foregoing 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.

**Recent/proposed guidance****Joint FASB/IASB Financial Instruments with Characteristics of Equity Project**

The FASB and IASB are working jointly to develop a comprehensive standard that will simplify and improve financial reporting requirements for financial instruments with characteristics of equity. In November 2007 and February 2008, the FASB and the IASB, respectively, issued their Preliminary Views, *Financial Instruments with Characteristics of Equity*, as a first major step toward convergence. Although the boards identified early on several approaches to address what should be classified as an equity instrument, more recent deliberations have moved into somewhat uncharted territory, using the current IFRS model as a starting point and then attempting to address the known practice issues with that model to reach a desired classification for certain instruments.

The boards acknowledged that they do not have the capacity currently to devote the time necessary to deliberate the project issues. Consequently, the boards decided to not issue an exposure draft in the near term as originally planned. In July 2011, the IASB issued a request for views seeking input from stakeholders on the strategic direction of the IASB's future work plan, which includes this project. Feedback on the request for views will help the IASB prioritize standard-setting projects and balance its agenda over the next three years.

**IFRS 9, *Financial Instruments***

In October 2010, the requirements for classifying and measuring financial liabilities were added to IFRS 9. Most of the added requirements were carried forward unchanged from IAS 39.

However, the new requirements related to the fair value option for financial liabilities were changed to address the issue of the credit risk of a financial liability, in response to consistent feedback from users of financial statements and others that the effects of changes in a liability's credit risk ought not to affect profit or loss unless the liability is held for trading. IFRS 9 requires for financial liabilities where the fair value option is elected that changes in the credit risk of a financial liability be recognized in other comprehensive income (OCI) and not recycled.

The board recently issued an exposure draft that proposes delaying the effective date of IFRS 9 from January 1, 2013, to January 1, 2015, with early application permitted.

**Differences between the FASB’s proposed changes to the accounting for financial instruments based on current redeliberations up to July 31, 2011, and IFRS 9, *Financial Instruments***

Impact	US GAAP (Based on current redeliberations up to July 31, 2011)	IFRS 9, <i>Financial Instruments</i>
<p>Financial liabilities (own debt)</p> <p>Both proposals permit financial liabilities to be measured at amortized cost. However, differences may exist in the application of the model.</p>	<p>Any debt instrument liability that meets the instrument’s characteristics criterion (i.e., the instrument has to meet the following three criteria: (1) it is not a derivative, (2) the amount transferred at inception will be returned at maturity or settlement, and (3) it cannot be settled such that the investor would not recover substantially all of its initial investment other than due to its own choice) would be classified and measured at amortized cost unless either of the following criteria exists, in which case it would be classified and measured at fair value with changes in fair value recognized in net income:</p> <ul style="list-style-type: none"> <li>• It is held for transfer and the entity has the ability and means to transact at fair value.</li> <li>• It is a short sale.</li> </ul> <p>The current guidance for hybrid financial liabilities to identify any embedded derivative and determine whether it should be accounted for separately from the host contract has been retained.</p>	<p>Financial liabilities that are not held for trading and do not have embedded derivative features that would require bifurcation under IAS 39 would be measured at amortized cost.</p> <p>Financial liabilities held for trading would be measured at fair value, with changes in fair value recognized in net income.</p> <p>The existing bifurcation requirements in IAS 39 would be retained for nontrading financial liabilities that contain embedded derivative features.</p>

Impact	US GAAP (Based on current redeliberations up to July 31, 2011)	IFRS 9, <i>Financial Instruments</i>
<p><b>Convertible debt</b></p> <p>The models are expected to remain largely divergent.</p>	<p>The overall model for classification of financial liabilities would apply; however, the FASB has decided to provide an exception from the classification and measurement approach for issuers of convertible debt where the conversion feature is not required to be separately accounted for as equity under current guidance or separately accounted for as an embedded derivative because it qualifies for the derivative scope exception under ASC 815-10-15-74(a). Under that exception, the entire convertible debt instrument would then be classified and measured at amortized cost.</p> <p>The treatment for other types of convertible debt instruments remains unclear at this point, specifically whether the host contract is eligible for amortized cost after bifurcation of the equity conversion option.</p>	<p>IFRS 9 did not change the accounting for convertible debt. As a result, under IFRS, the debt host is eligible for amortized cost treatment after separation of the equity conversion option. The equity conversion option is either classified as equity if the instrument is convertible at a fixed amount of cash for a fixed number of shares (the fixed-for-fixed requirement) or recognized separately as an embedded derivative if the fixed-for-fixed requirement is not met.</p>
<p><b>Fair value option</b></p> <p>The fair value option would not be applicable to non-hybrid financial liabilities within the scope of the proposed FASB guidance. IFRS 9, on the other hand, continues to permit entities to irrevocably elect the fair value option for financial liabilities.</p>	<p>The fair value option would not be applicable to instruments within the scope of the proposed guidance on the basis that it undermines the business strategy approach to classification and measurement. A fair value option would be provided only for hybrid financial liabilities that would otherwise have required bifurcation into a host contract and embedded derivative.</p>	<p>An irrevocable fair value election is allowed at initial recognition if (1) measuring at fair value eliminates/significantly reduces an accounting mismatch, (2) the instrument contains an embedded derivative, or (3) the group of instruments is managed on a fair value basis. Changes in fair value related to the entity's own credit would be reclassified to OCI with no subsequent recycling.</p>



## 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, 2013, 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, 2011, 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.

Moreover, the FASB and the IASB are jointly reconsidering accounting for financial instruments, including hedge accounting. Once finalized, the new guidance will replace the FASB's and IASB's respective financial instruments guidance. Despite starting as a joint initiative, the FASB and IASB so far have reached different conclusions. Refer to the Recent/proposed guidance section for further discussion.

The following table provides further details on the foregoing and other selected current differences (pre-IFRS 9 and IFRS 13).

Impact	US GAAP	IFRS
<b>Derivative definition and scope</b>		
<p><b>Net settlement provisions</b></p> <p>More instruments will qualify as derivatives under IFRS.</p> <p>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.</p>	<p>To meet the definition of a derivative, a financial instrument or other contract must require or permit net settlement.</p> <p>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.</p> <p>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).</p>	<p>IFRS does not include a requirement for net settlement within the definition of a derivative. It only requires settlement at a future date.</p> <p>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.</p> <p>Effective January 1, 2010, 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 would be considered a derivative under IAS 39 for the acquirer; however, the option may be classified as equity from the seller's perspective.</p>
<p><b>Own use versus normal purchase normal sale (NPNS)</b></p> <p>The "own use" exception is mandatory under IFRS but the "normal purchase normal sale" exception is elective under US GAAP.</p>	<p>There are many factors to consider in determining whether a contract related to nonfinancial items can qualify for the NPNS exception.</p> <p>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.</p>	<p>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.</p> <p>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.</p>



Impact	US GAAP	IFRS
<b>Embedded derivatives</b>		
<p><b>Reassessment of embedded derivatives</b></p> <p>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.</p>	<p>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.</p> <p>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.</p> <p>An embedded derivative that is clearly and closely related is not reassessed subsequent to inception for the “clearly and closely related” feature. 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.</p>	<p>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.</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Calls and puts in debt instruments</b></p> <p>IFRS and US GAAP have fundamentally different approaches to assessing whether puts and calls embedded in debt host instruments require bifurcation.</p>	<p>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.</p> <p><b>Test 1</b>—If a debt instrument is issued at a substantial premium or discount and a contingent call or put can accelerate repayment of principal, then the call or put is not clearly and closely related.</p> <p><b>Test 2</b>—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.</p>	<p>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.</p>

Impact	US GAAP	IFRS
<p><b>Nonfinancial host contracts—currencies commonly used</b></p> <p>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.</p>	<p>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.</p>	<p>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.</p> <p>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.</p>

**Measurement of derivatives**

<p><b>Day one gains and losses</b></p> <p>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.</p> <p>The ability to recognize day one gains and losses is different under both frameworks, with gain/loss recognition more common under US GAAP.</p>	<p>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.</p> <p>In these cases, entities must recognize day one gains and losses even if some inputs to the measurement model are not observable.</p>	<p>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.</p>
--	--	---

Impact	US GAAP	IFRS
<b>Hedge qualifying criteria</b>		
<p><b>When to assess effectiveness</b></p> <p>Non-SEC-listed entities may see greater flexibility in the frequency of required effectiveness testing under IFRS.</p> <p>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.</p>	<p>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).</p>	<p>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.</p> <p>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.</p>
<b>Hedge accounting practices allowed under US GAAP that are not acceptable under IFRS</b>		
<p><b>Effectiveness testing and measurement of hedge ineffectiveness</b></p> <p>IFRS requires an increased level of hedge effectiveness testing and/or detailed measurement compared to US GAAP.</p> <p>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 matched-terms method.</p>	<p>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.</p>	<p>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.</p>

Impact	US GAAP	IFRS
<p>Effectiveness testing and measurement of hedge ineffectiveness (continued)</p>	<p><b>Shortcut method</b></p> <p>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).</p> <p><b>Critical terms match</b></p> <p>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.</p> <p>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.</p>	<p><b>Shortcut method</b></p> <p>IFRS does not allow a shortcut method by which an entity may assume no ineffectiveness.</p> <p>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.</p> <p><b>Critical terms match</b></p> <p>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.</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Credit risk and hypothetical derivatives</b></p> <p>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.</p>	<p>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.</p> <p>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.</p>	<p>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.</p> <p>The extent of ineffectiveness depends on whether the hedging derivative instrument is in an asset or a liability position and the method used for measuring derivative liabilities. This is because counterparty credit risk always affects the valuation of a derivative asset. If the derivative instrument is in a liability position, the ineffectiveness will depend on the method used to measure the liability.</p> <p>However, once an entity applies IFRS 13, the non-performance risk (i.e., the credit risk of a financial liability) will be reflected in the fair value of that financial liability. Therefore, this difference between IFRS and US GAAP will no longer exist going forward. Please refer to the Assets—financial assets chapter for further details.</p>

Impact	US GAAP	IFRS
<p><b>Servicing rights</b></p> <p>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.</p>	<p>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.</p> <p>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.</p>	<p>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).</p> <p>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.</p>
<p><b>Cash flow hedges with purchased options</b></p> <p>For cash flow hedges, US GAAP provides more flexibility than IFRS with respect to designating a purchased option as a hedging instrument.</p> <p>As a result of the difference, there may be more income statement volatility for IFRS entities using purchased options in their hedging strategies.</p>	<p>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.</p> <p>Alternatively, the hedge relationship can exclude time value from the hedging instrument such that effectiveness is assessed based on intrinsic value.</p>	<p>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.</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Foreign currency risk and internal derivatives</b></p> <p>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.</p>	<p>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.</p>	<p>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.</p> <p>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.</p>



Impact	US GAAP	IFRS
<b>Hedge accounting practices not allowed under US GAAP that are acceptable under IFRS</b>		
<p><b>Hedges of a portion of the time period to maturity</b></p> <p>IFRS is more permissive than US GAAP with respect to a partial-term fair value hedge.</p>	<p>US GAAP does not permit the hedged risk to be defined as a portion of the time period to maturity of a hedged item.</p>	<p>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.</p>
<p><b>Designated risks for financial assets or liabilities</b></p> <p>IFRS provides opportunities with respect to achieving hedge accounting for a portion of a specified risk.</p> <p>Those opportunities may reduce the amount of ineffectiveness that needs to be recorded in the income statement under IFRS (when compared with US GAAP).</p>	<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"> <li>• Overall fair value or cash flows</li> <li>• Benchmark interest rates</li> <li>• Foreign currency exchange rates</li> <li>• Creditworthiness and credit risk</li> </ul> <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>

Impact	US GAAP	IFRS
<p><b>Fair value hedge of interest rate risk in a portfolio of dissimilar items</b></p> <p>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.</p> <p>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.</p>	<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>
<p><b>Firm commitment to acquire a business</b></p> <p>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.</p>	<p>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).</p>	<p>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.</p>

Impact	US GAAP	IFRS
<p><b>Foreign currency risk and location of hedging instruments</b></p> <p>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.</p>	<p>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.</p>	<p>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.</p> <p>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.</p> <p>The same flexibility regarding location of the hedging instrument applies to net investment hedges.</p>
<p><b>Hedging more than one risk</b></p> <p>IFRS provides greater flexibility with respect to utilizing a single hedging instrument to hedge more than one risk in two or more hedged items.</p> <p>That difference may allow entities to adopt new and sometimes more complex strategies to achieve hedge accounting while managing certain risks.</p>	<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>

Impact	US GAAP	IFRS
<p><b>Cash flow hedges and basis adjustments on acquisition of nonfinancial items</b></p> <p>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).</p> <p>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.</p>	<p>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.</p> <p>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.</p>	<p>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.</p> <p>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.</p>

### Technical references

**IFRS** IAS 39, IFRS 7, IFRIC 9, IFRIC 16

**US GAAP** ASC 815, ASC 815-20-25-3, ASC 815-15-25-4 through 25-5, ASC 815-20-25-94 through 25-97, ASC 830-30-40-2 through 40-4

### Note

The foregoing 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.

## Recent/proposed guidance

### **FASB Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities***

The FASB and IASB are jointly reconsidering the accounting for financial instruments, including hedge accounting. Among other things, the boards expect 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. Comments were due by September 30, 2010. The FASB proposes to carry forward many of its ideas contained in the 2008 exposure draft on hedge accounting. However, in contrast with the 2008 exposure draft, the FASB proposes to continue with the bifurcation-by-risk approach as contained in Topic 815 for financial instruments classified at fair value with changes in fair value recognized in other comprehensive income (OCI).

The 2010 exposure draft:

- Lowers the threshold to qualify for hedge accounting. The hedging relationship must be “reasonably effective” instead of “highly effective.” A company would need to demonstrate and document at inception that (1) an economic relationship exists between the derivative and the hedged item, and (2) the changes in fair value of the hedging instrument would be reasonably effective in offsetting changes in the hedged item’s fair value or variability in cash flows of the hedged transaction. While this assessment would need to be performed only qualitatively, the proposal notes that a quantitative assessment might be necessary in certain situations.
- Replaces the current requirement to quantitatively assess hedge effectiveness each quarter with a qualitative assessment at inception and limited reassessments in subsequent periods. The proposal also would eliminate the shortcut and critical-terms match method. Under the proposal, a subsequent hedge effectiveness assessment would be required only if circumstances suggest that the hedging relationship may no longer be effective. Companies would need to remain alert for circumstances that indicate that their hedging relationships are no longer effective. Under current guidance, it is not unusual for companies to determine that a hedging relationship is highly effective in one period but not highly effective in the next period. In those circumstances, companies are unable to consistently apply hedge accounting from period to period. The board believes that by lowering the effectiveness threshold to reasonably effective, the frequency of these occurrences should diminish.
- Prohibits the discretionary de-designation of hedging relationships. The proposed model no longer would allow an entity to discontinue fair value or cash flow hedge accounting by simply revoking the designation. A company would only be able to discontinue hedge accounting by entering into an offsetting derivative instrument or by selling, exercising, or terminating the derivative instrument. As a result, once a company elects to apply hedge accounting, it would be required to keep the hedge relationship in place throughout its term, unless the required criteria for hedge accounting no longer are met (e.g., the hedge is no longer reasonably effective) or the hedging instrument expires, is sold, terminated, or exercised.
- Requires recognition of the ineffectiveness associated with both over- and under-hedges for all cash flow hedging relationships (i.e., the accumulated OCI balance should represent a “perfect” hedge). This represents a significant change since under current US GAAP, only the effect of over-hedging is recorded as ineffectiveness during the term of the hedge.
- The FASB’s proposal will simplify certain key aspects of hedge accounting that many companies have found challenging. However, it also will limit or eliminate other aspects of the current model that some companies found beneficial. The proposed hedge accounting has the potential to create significant differences when compared with that proposed by IFRS. Despite the overall difference in approach to the project, the FASB and IASB have been jointly discussing hedge accounting.

### IASB Exposure Draft, *Hedge Accounting*

In December 2010, the IASB released for public comment an exposure draft of proposed changes to the accounting for hedging activities, resulting from the third phase of the IASB's project to revise financial instruments accounting. Comments were due by March 9, 2011.

The proposed 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 IASB's exposure draft proposes changes to the general hedge accounting model only. The IASB is working toward finalizing its general hedge accounting model in the fourth quarter of 2011. The macro hedge accounting principles will be addressed in a separate exposure draft, which is expected to be released in the first quarter of 2012.

The following key changes are proposed by the IASB based on current redeliberations:

- 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. An entity should not designate a hedging relationship such that it reflects an imbalance between the weightings of the hedged item and hedging instrument that would create hedge ineffectiveness (irrespective of whether recognized or not) in order to achieve an accounting outcome that is inconsistent with the purpose of hedge accounting. 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 proposal would permit entities to hedge risk components for non-financial items, provided such components are separately identifiable and reliably measurable.
- More flexibility in hedging groups of dissimilar items (including net exposure). The IASB's proposal 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 proposal 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 1 and then released to net income based on the type of item the option hedges. During their re-deliberations, the IASB decided that the same accounting should apply for forward points in a forward contract.
- Prohibition of voluntary de-designation of the hedging relationship unless the risk management objective for such relationship changes. The IASB's proposal 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.

### 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.



## 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 is required under IFRS when an entity has the ability to govern the financial and operating policies of another entity to obtain benefits.

US GAAP has a two-tiered 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 evaluated to determine whether they are variable-interest entities (VIEs). Consolidation of all non-VIEs is assessed on the basis of voting and other decision-making rights. 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 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 that transactions in the gap period be recognized in the consolidated financial statements.

In May 2011 the IASB issued IFRS 10, *Consolidated Financial Statements*, which replaces all of the guidance on control and consolidation in IAS 27, *Consolidated and Separate Financial Statements*, and SIC-12, *Consolidation—Special Purpose Entities*. IFRS 10 changes the definition of control such that the same consolidation criteria are applied to all entities. This definition is supported by application guidance that addresses the different ways in which a reporting entity (investor) might control another entity (investee). The changed definition and application guidance is not expected to result in changes in the consolidation conclusions for many entities, although for affected entities, such as for certain structured entities, the changes could be significant.

For jointly controlled entities, current IFRS provides an option for proportional consolidation; the proportional method is allowed under US GAAP only for unincorporated entities in certain industries. In May 2011 the IASB issued IFRS 11, *Joint arrangements*. Changes in the definitions have reduced the types of joint arrangements to two: joint operations and joint ventures. At the same time, the current IFRS policy choice of proportionate consolidation for jointly controlled entities has been eliminated. Equity accounting will be mandatory for participants in joint ventures once IFRS 11 is adopted. Entities that participate in joint operations will follow accounting similar to that for joint assets or joint operations under IAS 31.

The IASB also recently issued IFRS 12, *Disclosure of Interests in Other Entities*, setting out the required disclosures for entities reporting under the two new standards, IFRS 10 and IFRS 11. IFRS 12 replaces the disclosure requirements currently found in IAS 28, *Investments in Associates*, and requires entities to disclose information that helps financial statement readers evaluate the nature, risks, and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements, and unconsolidated structured entities.

Reference should be made to the Recent/proposed guidance section for further discussion of IFRS 10, IFRS 11, and IFRS 12 as well as other recent/proposed standard-setting activity.

The following table provides further details on the foregoing and other selected current differences.



Impact	US GAAP	IFRS
<b>General requirements</b>		
<p><b>Requirements to prepare consolidated financial statements</b></p> <p>IFRS does not provide industry-specific exceptions (e.g., investment companies and broker/dealers) to the requirement for consolidation of controlled entities.</p> <p>However, IFRS is, in limited circumstances, more flexible with respect to the right to issue nonconsolidated financial statements.</p>	<p>The guidance applies to legal structures.</p> <p>Industry-specific guidance precludes consolidation of controlled entities by certain types of organizations, such as registered investment companies or broker/dealers.</p> <p>Consolidated financial statements are presumed to be more meaningful and are required for SEC registrants.</p> <p>There are no exemptions for consolidating subsidiaries in general-purpose financial statements.</p>	<p>Parent entities prepare consolidated financial statements that include all subsidiaries. An exemption applies to a parent entity when all of the following conditions apply:</p> <ul style="list-style-type: none"> <li>• It is wholly owned or the owners of the minority interests have been informed about and do not object to the parent's not presenting consolidated financial statements</li> <li>• The parent's debt or equity securities are not publicly traded and the parent is not in the process of issuing securities in public securities markets</li> <li>• The immediate or ultimate parent publishes consolidated financial statements that comply with IFRS</li> </ul> <p>A subsidiary is not excluded from consolidation simply because the investor is a venture capital organization, mutual fund, unit trust, or similar entity. However, note that under a separate joint FASB and IASB proposal due for issuance in the third quarter of 2011, an entity that is controlled by an investment entity as defined in the proposal would be carried at fair value, rather than consolidated.</p> <p>The guidance applies to activities regardless of whether they are conducted by a legal entity.</p>

Impact	US GAAP	IFRS
<p><b>Consolidation model</b></p> <p>Differences in consolidation can arise due to:</p> <ul style="list-style-type: none"> <li>• Differences in how economic benefits are evaluated when the consolidation assessment considers more than just voting rights (i.e., differences in methodology)</li> <li>• Specific differences or exceptions such as: <ul style="list-style-type: none"> <li>- The consideration of variable interests</li> <li>- De facto control</li> <li>- How potential voting rights are evaluated</li> <li>- Guidance related to de facto agents and related parties</li> <li>- Reconsideration events</li> </ul> </li> </ul> <p>In May 2011, the IASB issued new consolidation guidance. The differences noted above still exist although the approach for entities considered to be VIEs will be more aligned. This is because the new IFRS definition of control is similar to that applied to VIEs under US GAAP. Refer to the Recent/proposed guidance section for a further discussion of the new IFRS consolidation guidance.</p>	<p>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.</p> <p>In applying the qualitative model, an entity is deemed to have a controlling financial interest if it meets both of the following criteria:</p> <ul style="list-style-type: none"> <li>• Power to direct activities of the VIE that most significantly impact the VIE’s economic performance (power criterion)</li> <li>• Obligation to absorb losses from or right to receive benefits of the VIE that could potentially be significant to the VIE (losses/benefits criterion)</li> </ul> <p>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.</p> <p>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 impacts the entity’s economic performance.</p>	<p>IFRS focuses on the concept of control in determining whether a parent-subsidiary relationship exists. Control is the parent’s ability to govern the financial and operating policies of a subsidiary to obtain benefits. 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 special-purpose entity’s (SPE) equity. The application of the control concept requires, in each case, judgment in the context of all relevant factors.</p> <p>When control of an SPE is not apparent, IFRS requires evaluation of the entity—based on the entity’s characteristics as a whole—to determine the controlling party. The concept of having rights to the majority of the economic benefits and residual risks is just one part of the analysis. Other factors considered in the evaluation are whether the activities of the SPE are being conducted on behalf of the entity, if the entity has decision-making powers to obtain the majority of the SPE’s benefits or has delegated its decision-making. The substance of the arrangement would be considered in order to decide the controlling party for IFRS purposes.</p>

Impact	US GAAP	IFRS
<p>Consolidation model (continued)</p>	<p>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 a 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.</p> <p>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.</p> <p><b>De facto control concept</b></p> <p>No de facto control concept exists. Effective control as described above is limited to contractual arrangements.</p>	<p>In May 2011, the IASB issued new consolidation guidance (IFRS 10). IFRS 10 introduces a new definition of control that would apply to all entities. The new control definition states that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Power is the current ability to direct the activities that significantly influence returns. Returns must vary and can be positive, negative, or both.</p> <p><b>De facto control concept</b></p> <p>A parent could have control over an entity in some circumstances where it holds less than 50 percent of the voting rights of an 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.</p> <p>IFRS 10 codifies the de facto control concept and clarifies that in assessing control over the investee, an investor should consider economic dependency, the size of its shareholding in comparison to other holdings, and voting patterns at shareholder meetings.</p>

Impact	US GAAP	IFRS
Consolidation model (continued)	<p><b>Potential voting rights</b></p> <p>No specific guidance exists requiring the consideration of potential voting rights.</p> <p><b>Shared power</b></p> <p>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 requires the consent of each parties sharing the power.</p>	<p><b>Potential voting rights</b></p> <p>IFRS specifically requires potential voting rights to be assessed. Instruments that are currently exercisable or convertible are included in the assessment, with no requirement to assess whether exercise is economically reasonable (provided such rights have economic substance).</p> <p>However, in contrast with the current guidance, IFRS 10 does not require that potential voting rights are currently exercisable. Rather, all relevant facts and circumstances would need to be considered.</p> <p><b>Shared power</b></p> <p>The concept of joint control currently exists only within the joint venture literature, and requires the unanimous consent of all parties sharing control.</p> <p>However, IFRS 10 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.</p>

Impact	US GAAP	IFRS
Consolidation model (continued)	<p><b>Agent versus principal analysis</b></p> <p>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.</p> <p>The FASB is expected to incorporate an agent versus principal analysis in US GAAP for VIEs and limited partnership entities that would be broadly consistent with IFRS 10.</p> <p><b>Related parties and de facto agents</b></p> <p>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, etc.) whose actions are likely to be influenced or controlled by the reporting entity.</p> <p>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.</p>	<p><b>Agent versus principal analysis</b></p> <p>IFRS currently does not have any guidance for determining if a decision maker is acting as an agent or a principal.</p> <p>IFRS 10 includes new guidance on agent/principal relationships. An investor (an agent) may be engaged to act on behalf of a single party or a group of parties (principals). Certain power is delegated by the principals to the agent. An agent does not consolidate the entity. IFRS 10 includes four key factors to consider when determining whether the investor is acting as an agent, namely: (1) the scope of its decision making, (2) the rights held by other parties, (3) the remuneration it receives, and (4) other interests that it holds in the entity.</p> <p><b>Related parties and de facto agents</b></p> <p>IFRS does not currently address the impact of related parties and de facto agents.</p> <p>IFRS 10 requires that related parties and de facto agents be considered. How those interests are considered in the consolidation analysis, however, is not prescribed. In addition, 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 standalone basis but the related party group as a whole controls the entity.</p>

Impact	US GAAP	IFRS
Consolidation model (continued)	<p><b>Reconsideration events</b></p> <p>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.</p> <p>However, the determination of a VIE's primary beneficiary is an ongoing assessment.</p> <p><b>Silos</b></p> <p>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.</p>	<p><b>Reconsideration events</b></p> <p>There is no concept of a trigger event in the current literature. IFRS 10 also requires the consolidation analysis to be based on a continuous assessment.</p> <p><b>Silos</b></p> <p>IFRS does not provide explicit guidance on silos. However, it does create an obligation to consider whether a corporation, trust, partnership, or other unincorporated entity has been created to accomplish a narrow and well-defined objective. The governing document of such entities may impose strict and sometimes permanent limits on the decision-making ability of the board, trustees, etc. IFRS requires the consideration of substance over form and discrete activities within a much larger operating entity to fall within its scope. When a SPE is identified within a larger entity (including a non-SPE), the SPE's economic risks, rewards, and design are assessed in the same manner as with any legal entity.</p> <p>IFRS 10 incorporates guidance for silos that is similar to US GAAP; however, the silo guidance under IFRS 10 applies whether or not the larger entity is a VIE.</p>

Impact	US GAAP	IFRS
<p><b>Special-purpose entities</b></p> <p>Differences in consolidation can arise due to differences in the definition of VIE versus SPE, including scope exceptions (i.e., scope differences).</p>	<p>Consolidation requirements focus on whether an entity is a VIE regardless of whether it would be considered an SPE.</p> <p>Often, an SPE would be considered a VIE because they are typically narrow in scope, thus often highly structured and thinly capitalized, but this is not always the case. For example, clear SPEs benefit from exceptions to the variable interest model such as pension, postretirement, or postemployment plans.</p> <p>The guidance above applies only to legal entities.</p>	<p>Decision-making rights are not always indicative of control, particularly in the case of an SPE where decision-making rights may be either severely limited (on autopilot) or structured for a narrow, well-defined purpose (such as a lease or securitization). As a result, IFRS requires other indicators of control to be considered. Those indicators are as follows:</p> <ul style="list-style-type: none"> <li>• Whether the SPE conducts its activities on behalf of the evaluating entity</li> <li>• Whether the evaluating entity has the decision-making power to obtain the majority of the benefits of the SPE</li> <li>• Whether the evaluating entity has the right to obtain the majority of the benefits of the SPE</li> <li>• Whether the evaluating entity has the majority of the residual or ownership risks of the SPE or its assets</li> </ul> <p>This guidance is applied to all SPEs with the exception of postemployment benefit plans or other long-term employee benefit plans.</p> <p>The guidance above applies to activities regardless of whether they are conducted by a legal entity.</p> <p>IFRS 10 introduces a new definition of control which states that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The new definition of control under IFRS 10 would apply to all entities, including structured entities.</p>

Impact	US GAAP	IFRS
<p>Special-purpose entities (continued)</p>		<p>IFRS 10 could change previous consolidation conclusions for structured entities. An investor with power over the investee and some of the variable returns that concluded it did not consolidate because it had less than the majority of the risks and rewards may now have to consolidate. Similarly, an investor that concluded it needed to consolidate on the basis that the SPE's activities are being conducted on behalf of the entity for its specific business needs may now have to deconsolidate if it does not have control as defined under the new guidance.</p>
<p><b>Accounting policies and reporting periods</b></p> <p>In relation to certain specialized industries, US GAAP allows more flexibility for utilization of different accounting policies within a single set of consolidated financial statements.</p> <p>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.</p>	<p>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.</p> <p>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.</p>	<p>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.</p> <p>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.</p>



Impact	US GAAP	IFRS
<p><b>Disclosures</b></p> <p>US GAAP requires greater disclosure about an entity's involvement in VIEs.</p> <p>In May 2011, the IASB issued new disclosure guidance. Many of the new disclosures for interests in consolidated and unconsolidated structured entities are similar to those already contained in US GAAP for VIEs. Many of the current IFRS disclosures for consolidated entities will still be required. Some new disclosures for interests in entities that are not structured entities will also be required, such as the significant judgment and assumption made under a principal versus agent analysis.</p>	<p>Applies to both nonpublic and public enterprises.</p> <p>The principal objectives of VIE disclosures are to provide financial statement users with an understanding of the following:</p> <ul style="list-style-type: none"> <li>• 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</li> <li>• 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</li> <li>• The nature of, and changes in, the risks associated with an enterprise's involvement with the VIE</li> <li>• How an enterprise's involvement with the VIE affects the enterprise's financial position, financial performance, and cash flows</li> </ul> <p>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.</p> <p>US GAAP provides additional detailed disclosure guidance in order to meet the objectives described above.</p>	<p>Current IFRS does not have SPE-specific disclosure requirements.</p> <p>IFRS has several consolidation disclosure requirements, which include the following:</p> <ul style="list-style-type: none"> <li>• The nature of the relationship between the parent and a subsidiary when the parent does not own, directly or indirectly through subsidiaries, more than half of voting power</li> <li>• The reasons why ownership, directly or indirectly through subsidiaries, of more than half of voting or potential voting power of an investee does not constitute control</li> <li>• The date of a subsidiary's financial statements when such financial statements are used to prepare consolidated financial statements and are as of a date or for a period that is different from that of the parent's financial statements, and the reason for using a different date or period</li> <li>• The nature and extent of any significant restrictions (e.g., resulting from borrowing arrangements or regulatory requirements) on the ability of the subsidiaries to transfer funds to parent in the form of cash dividends or to repay loans or advances</li> <li>• Schedule that shows effects of changes in a parent's ownership interest in a subsidiary that do not result in a loss of control on equity attributable to owners of parent</li> </ul>

Impact	US GAAP	IFRS
Disclosures (continued)	<p>Guidance also calls for certain specific disclosures to be made by (1) a primary beneficiary of a VIE and (2) an enterprise that holds a variable interest in a VIE (but is not the primary beneficiary).</p>	<ul style="list-style-type: none"> <li>• If control of a subsidiary is lost, the parent shall disclose the gain or loss, if any, and:               <ol style="list-style-type: none"> <li>1. 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</li> <li>2. Line item(s) in the statement of comprehensive income in which gain or loss is recognized (if not presented separately in the statement of comprehensive income)</li> </ol> </li> </ul> <p>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.</p> <p>In May 2011, the IASB issued IFRS 12, which would replace the existing disclosure requirements. IFRS 12 requires disclosures for both consolidated and unconsolidated structured entities.</p>

Impact	US GAAP	IFRS
<p>Disclosures (continued)</p>		<p>IFRS 12 requires entities to disclose information that helps financial statement readers to evaluate the nature, risks, and financial effects associated with the entity's interests in subsidiaries, associates, joint ventures, and unconsolidated structured entities. To achieve this, IFRS 12 requires specific disclosures about significant judgments and assumptions, interests in subsidiaries, interests in joint arrangements and associates, and interests in unconsolidated structured entities. Many of the current IFRS disclosures for consolidated entities will still be required. Some new disclosures for interests in entities that are not structured entities will also be required, such as information about subsidiaries with material noncontrolling interests and the significant judgments and assumptions made under a principal versus agent analysis.</p>
<p><b>Equity investments/investments in associates and joint ventures</b></p>		
<p><b>Potential voting rights</b></p> <p>The consideration of potential voting rights might lead to differences in whether an investor has significant influence.</p>	<p>Potential voting rights are generally not considered in the assessment of whether an investor has significant influence.</p>	<p>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.</p>

Impact	US GAAP	IFRS
<p><b>Definition and types of joint ventures</b></p> <p>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.</p>	<p>The term joint venture refers only to jointly controlled entities, where the arrangement is carried on through a separate entity.</p> <p>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.</p> <p>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.</p>	<p>A joint venture is defined as 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 of the parties sharing control, but not necessarily all parties in the venture, is required.</p> <p>Current IFRS distinguishes between three types of joint ventures:</p> <ul style="list-style-type: none"> <li>• Jointly controlled entities, in which the arrangement is carried on through a separate entity (company or partnership)</li> <li>• Jointly controlled operations, in which each venturer uses its own assets for a specific project</li> <li>• Jointly controlled assets, which is a project carried on with assets that are jointly owned</li> </ul> <p>IFRS 11 classifies joint arrangements into two types:</p> <ul style="list-style-type: none"> <li>• Joint operations, which gives parties to the arrangement direct rights to the assets and obligations for the liabilities</li> <li>• Joint venture, which gives the parties rights to the net assets or outcome of the arrangement</li> </ul>

Impact	US GAAP	IFRS
<p data-bbox="155 464 537 533"><b>Accounting for joint venture arrangements</b></p> <p data-bbox="155 554 570 705">Current IFRS provides an option for proportional consolidation of jointly controlled entities. Under US GAAP, the proportional method is allowed only for entities in certain industries.</p> <p data-bbox="155 726 565 821">The proportional consolidation option under IFRS will be eliminated upon the adoption of IFRS 11.</p>	<p data-bbox="615 554 1052 1121">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.</p> <p data-bbox="615 1142 1052 1453">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.</p>	<p data-bbox="1078 554 1507 1026">Under current IFRS, either the proportionate consolidation method or the equity method is allowed to account for a jointly controlled entity (a policy decision that must be applied consistently). Proportionate consolidation requires the venturer's share of the assets, liabilities, income, and expenses to be either combined on a line-by-line basis with similar items in the venturer's financial statements or reported as separate line items in the venturer's financial statements. A full understanding of the rights and responsibilities conveyed in management agreements is necessary.</p> <p data-bbox="1078 1047 1513 1268">Upon adoption of IFRS 11, the existing policy choice of proportionate consolidation for jointly controlled entities will be eliminated. A joint venturer will be able to account for its interest in a joint venture using only the equity method in accordance with IAS 28.</p> <p data-bbox="1078 1289 1513 1383">A joint operator will recognize its share of assets, liabilities, revenue, and expenses based on its direct rights and obligations.</p>

Impact	US GAAP	IFRS
<p><b>Accounting for contributions to a jointly controlled entity</b></p> <p>Gain recognition upon contribution to a jointly controlled entity is more likely under IFRS.</p>	<p>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).</p> <p>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.</p>	<p>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 recognizes in its consolidated income statement the portion of the gain or loss attributable to the equity interests of the other venturers, except when:</p> <ul style="list-style-type: none"> <li>• The significant risks and rewards of the contributed assets have not been transferred to the jointly controlled entity</li> <li>• The gain or loss on the assets contributed cannot be measured reliably, or</li> <li>• The contribution transaction lacks commercial substance</li> </ul> <p>IAS 28 (Amended 2011) provides an exception to the recognition of gains or losses only when the transaction lacks commercial substance.</p>
<p><b>Equity method of accounting—exemption from applying the equity method</b></p> <p>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.</p>	<p>Equity method investments are considered financial assets and therefore are eligible for the fair value accounting option. An entity can measure investment in associates or joint ventures at fair value through profit or loss, regardless of whether it is a venture capital or similar organization.</p>	<p>An entity can elect fair value through profit or loss accounting when equity method investments are held by, or are held indirectly through, venture capital organizations, mutual funds, unit trusts, or similar entities.</p>

Impact	US GAAP	IFRS
<p><b>Equity method of accounting—classification as held for sale</b></p> <p>Application of the equity method of accounting may cease before significant influence is lost under IFRS (but not under US GAAP).</p>	<p>Under US GAAP, equity method investments are not classified as held for sale. An investor applies equity method accounting until significant influence is lost.</p>	<p>If equity method investments meet the held for sale criteria in accordance with IFRS 5, an investor records the investments at the lower of its (1) fair value less costs to sell or (2) carrying amount as of the date the investments are classified as held for sale.</p>
<p><b>Equity method of accounting—acquisition date excess of investor’s share of fair value over cost</b></p> <p>IFRS may allow for day one gain recognition (whereas US GAAP would not).</p>	<p>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.</p>	<p>Any acquisition date excess of the investor’s share of fair value over cost is recognized as income in the period in which the investment is acquired.</p>
<p><b>Equity method of accounting—conforming accounting policies</b></p> <p>A greater degree of conformity is required under IFRS.</p>	<p>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.</p>	<p>An investor’s financial statements are prepared using uniform accounting policies for similar transactions and events. The uniformity of accounting policies extends to equity method investees.</p>
<p><b>Equity method of accounting—impairment</b></p> <p>Impairment losses may be recognized earlier under IFRS.</p>	<p>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.</p>	<p>An investor should assess whether impairment indicators exist, in accordance with IAS 39. If impairment is likely, the investment is tested for impairment in accordance with IAS 36. The concept of a temporary decline does not exist under IFRS.</p>

Impact	US GAAP	IFRS
<p><b>Equity method of accounting—losses in excess of an investor’s interest</b></p> <p>Losses may be recognized earlier under US GAAP.</p>	<p>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.</p>	<p>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.</p>
<p><b>Equity method of accounting—loss of significant influence or joint control</b></p> <p>The potential for greater earnings volatility exists under IFRS.</p>	<p>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.</p>	<p>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 change in value is considered in calculating the gain or loss on the transaction.</p>
<p><b>Technical references</b></p> <p><b>IFRS</b> IAS 1, IAS 27, IAS 27 (Revised 2008), IAS 28, IAS 28 (Amended 2011), IAS 31, IAS 36, IAS 39, IFRS 5, IFRS 10, IFRS 11, IFRS 12, SIC 12, SIC 13</p> <p><b>US GAAP</b> ASC 205, ASC 323, ASC 323–10–15–8 through 15–11, ASC 325–20, ASC 360, ASC 810, ASC 810–10–25–1 through 25–14, ASC 810–10–60–4, SAB Topic 5H, SAB Topic 5–H (2)–(6)</p>		

#### Note

The foregoing 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.



## Recent/proposed guidance

In May 2011, the IASB issued IFRS 10, *Consolidated Financial Statements*, IFRS 11, *Joint Arrangements*, IFRS 12, *Disclosure of Interests in Other Entities*, IAS 27 (Amended), *Separate Financial Statements* and IAS 28 (Amended), *Investments in Associates and Joint Ventures*. These standards are effective for annual periods beginning on or after January 1, 2013, with earlier application permitted.

### IFRS 10, *Consolidated Financial Statements*

IFRS 10 changes the definition of control, such that the same consolidation criteria will apply to all entities. The revised definition of control and associated guidance in IFRS 10 replaces not only the definition and guidance in IAS 27, *Consolidated and Separate Financial Statements*, but also the four indicators of control in SIC 12, *Consolidation—Special Purpose Entities*. IAS 27 (Amended) is renamed *Separate Financial Statements* and guidance on consolidation is now removed from this standard. The existing guidance for separate financial statements in IAS 27 remains unchanged.

The new definition of control states that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The new definition of control within IFRS 10 is supported by application guidance that addresses the different ways in which a reporting entity (investor) might control another entity (investee).

IFRS 10 could change previous consolidation conclusions for structured entities. An investor with the power over the investee and some of the variable returns that concluded it did not consolidate because it had less than the majority of the risks and rewards may now have to consolidate. Similarly, an investor that concluded it needed to consolidate on the basis that the SPE's activities are being conducted on behalf of the entity for its specific business needs may now have to deconsolidate if it does not have control as defined under the new guidance. IFRS 10 does not specifically exclude investment companies, as the IASB continues to work on a project on accounting by investment companies for controlled entities.

Similar to the current US GAAP model for VIEs, the revised definition of control focuses on the need to have both power and variable returns before control is present. Power is the current ability to direct the activities that significantly influence returns. Returns must vary and can be positive, negative, or both.

The determination of power is based on facts and circumstances (including substantive potential voting rights) and is continuously assessed. The fact that control is intended to be temporary does not obviate the requirement to consolidate any investee under the control of the investor. Voting rights or contractual rights may be evidence of power, or a combination of the two may give an investor power. Power does not have to be exercised in order to exist. An investor with more than half the voting rights would meet the power criteria in the absence of restrictions or other circumstances.

The application guidance includes examples illustrating when an investor may have control with less than half of the voting rights. When assessing if it controls the investee, an investor should consider potential voting rights, rights from other contractual arrangements, and the size of its shareholding in comparison to other holdings, together with other facts and circumstances such as voting patterns at shareholder meetings. This last consideration will bring the notion of “de facto” control firmly within the consolidation standard.

IFRS 10 also includes guidance on participating and protective rights. Participating rights give an investor the ability to direct the activities of an investee that significantly affect the returns. Protective rights (often known as veto rights) may restrict an investor's ability to control if the rights apply to decisions in the ordinary course of business.

The new standard includes guidance on agent/principal relationships. An investor (the agent) may be engaged to act on behalf of a single party or a group of parties (the “principals”). Certain power is delegated to the agent—for example, to manage investments.

The investor may or may not have control over the pooled investment funds. IFRS 10 includes a number of factors to consider when determining whether the investor has control or is acting as an agent. If an investor acts as an agent it would not consolidate.

In 2009, the FASB completed its own project to improve the consolidation guidance and disclosures related to variable interest entities. Those changes together with IFRS 10 are intended to move the FASB and IASB's respective guidance relating to the consolidation of structured vehicles and other special purpose entities closer together. However, while the boards' respective guidance is based on generally consistent definitions of control, some differences will exist in how those principles are required to be applied. In limited circumstances this would result in different consolidation conclusions under each accounting framework.

### **IFRS 11, *Joint Arrangements***

The IASB issued IFRS 11, which supersedes IAS 31, *Interests in Joint Ventures*. IFRS 11 defines a joint arrangement as an arrangement where two or more parties contractually agree to share control. Joint control exists only when the decisions about activities that significantly affect the returns of an arrangement require the unanimous consent of the parties sharing control. All parties to a joint arrangement must recognize their rights and obligations arising from the arrangement. The focus is no longer on the legal structure of joint arrangements, but rather on how the rights and obligations are shared by the parties to the joint arrangement.

IFRS 11 eliminates the existing policy choice of proportionate consolidation for jointly controlled entities. In addition, the standard categorizes joint arrangements as one of the following:

- Joint operations—Parties to the arrangement have direct rights to the assets and obligations for the liabilities. A joint operator will recognize its interest based on its involvement in the joint operation (i.e., based on its direct rights and obligations) rather than on the participation interest it has in the joint arrangement. A joint operator in a joint operation will therefore recognize in its own financial statements its:
  - Assets, including its share of any assets held jointly
  - Liabilities, including its share of any liabilities incurred jointly
  - Revenue from the sale or use of its share of the output and its share of revenues earned jointly
  - Expenses, including its share of any expenses incurred jointly
- Joint ventures—Parties to the arrangement have rights to the net assets or outcome of the arrangement. A joint venturer does not have rights to individual assets or obligations for individual liabilities of the joint venture. Instead, joint venturers share in the net assets and, in turn, the outcome (profit or loss) of the activity undertaken by the joint venture. Equity accounting is required for joint venturers.

This is not a joint project with the FASB, and the impact of IFRS 11 will differ depending on whether an arrangement is a joint operation or a joint venture.

### **IFRS 12, *Disclosure of Interests in Other Entities***

IFRS 12 sets out the required disclosures for entities reporting under IFRS 10 and IFRS 11. It replaces the disclosure requirements currently found in IAS 28, *Investments in Associates*. The new standard requires entities to disclose information that helps financial statement readers to evaluate the nature, risks, and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements, and unconsolidated structured entities.

To meet this objective, disclosures are required for significant judgments and assumptions as well as interests in subsidiaries, joint arrangements and associates, and unconsolidated structured entities. Many of the disclosures for unconsolidated structured entities and interests in subsidiaries that are structured entities are already also required for VIEs under US GAAP.

**IAS 28 (Amended), *Investments in Associates and Joint Ventures***

The fundamental approach to the equity method of accounting has not been changed, but IAS 28(Amended) incorporates joint ventures and provides more specific provisions. It clarifies, for example, that when a portion of an investment in an associate or a joint venture meets the held for sale criteria in accordance with IFRS 5, any retained portion of the investment is not classified as held for sale. Under US GAAP no portion of an equity method investment would qualify for the held for sale designation. IAS 28(Amended) also clarifies that if an investment in an associate becomes an investment in a joint venture, or vice versa, the equity method continues to be applied and the retained interest is not remeasured. This treatment is consistent with US GAAP. As discussed in the chart above, IAS 28 (Amended) provides an exception to the recognition of gains or losses on contribution of a non-monetary asset only when the transaction lacks commercial substance. The guidance under US GAAP in this area is depends upon the specific facts and circumstances.

**FASB Proposed Accounting Standards Update, *Consolidation (Topic 810)—Agent/Principal Analysis***

The application of the FASB's 2009 changes to its VIE model were deferred for certain investment companies such as mutual funds, hedge funds, private equity funds, venture capital funds, and certain mortgage REITs. If an entity meets the conditions for the deferral, the reporting enterprise should continue to apply the previous VIE model that was based on a quantitative analysis of the risks and rewards of the entity or other applicable consolidation guidance when evaluating the entity for consolidation.

The boards worked together to develop a principal versus agent analysis that would eliminate the deferral for certain investment companies. The FASB is expected to issue this proposal in the third quarter of 2011 for public comment, whereas the IASB has issued this concept in final form and it is included in IFRS 10. The FASB's proposal is expected to broadly align the principal versus agent analysis with that included in IFRS 10 for VIEs and all limited partnerships.

**Joint FASB/IASB Investment Entities Project**

The FASB and IASB also have a joint project to address the consolidation of investment entities and intend to issue their respective proposals by the third quarter of 2011. The boards have tentatively agreed to define investment entities similarly and require that investment entities not consolidate investments in entities that they control but instead measure those investments at fair value with changes in fair value recognized in profit or loss. The IASB tentatively decided that the parent of an investment entity (if the parent is not an investment entity itself) would not retain the fair value accounting that is applied by the investment entity to its controlled investments on consolidation. However, the FASB tentatively decided to retain the investment entity accounting on consolidation.





---

## ***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, with two major exceptions: (1) full goodwill and (2) the requirements regarding recognition of contingent assets and contingent liabilities. Significant differences also continue to exist in subsequent accounting. Different requirements for impairment testing and accounting for deferred taxes are among the most significant.

Further details on the foregoing and other selected current differences are described in the following table.

Impact	US GAAP	IFRS
<b>Costs of acquisitions</b>		
<p data-bbox="159 512 505 548"><b>Contingent consideration</b></p> <p data-bbox="159 569 591 816">The accounting for contingent consideration is recorded at fair value. Other guidance within each framework may result in different initial classification (i.e., equity versus liability classification) of contingent consideration. Varying initial classification also results in different subsequent accounting.</p> <p data-bbox="159 837 545 989">In addition, asset or liability classified contingent consideration that does not qualify as a financial instrument under IFRS may not be subject to remeasurement at fair value.</p>	<p data-bbox="618 569 1036 688">Contingent consideration is recognized initially at fair value as an asset, liability, or equity according to the applicable US GAAP guidance.</p> <p data-bbox="618 709 1052 1056">Contingent consideration classified as an asset or liability is remeasured to fair value at each reporting date until the contingency is resolved. The changes in fair value are recognized in earnings unless the arrangement is a hedging instrument. If so, ASC 815, as amended by the new business combination guidance (included in ASC 805), requires the changes to be initially recognized in other comprehensive income.</p> <p data-bbox="618 1077 1052 1197">Contingent consideration classified as equity is not remeasured at each reporting date. Settlement is accounted for within equity.</p>	<p data-bbox="1081 569 1498 688">Contingent consideration is recognized initially at fair value as an asset, liability, or equity according to the applicable IFRS guidance.</p> <p data-bbox="1081 709 1515 1056">Contingent consideration classified as an asset or liability will generally be a financial instrument measured at fair value, with any gains or losses recognized in profit or loss (or other comprehensive income, as appropriate). Contingent consideration classified as an asset or liability that is not a financial instrument is subsequently accounted for in accordance with the provisions standard or other IFRS as appropriate.</p> <p data-bbox="1081 1077 1484 1167">Contingent consideration classified as equity is not remeasured. Settlement is accounted for within equity.</p>
<b>Acquired assets and liabilities</b>		
<p data-bbox="159 1287 480 1323"><b>Acquired contingencies</b></p> <p data-bbox="159 1344 586 1434">There are significant differences related to the recognition of contingent liabilities and contingent assets.</p>	<p data-bbox="618 1344 1052 1717">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. An acquirer shall develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature.</p>	<p data-bbox="1081 1344 1498 1690">The acquiree's contingent liabilities are recognized separately 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 cumulative amortization recognized under the revenue guidance, if appropriate, or the best estimate of the amount required to settle (under the provisions guidance).</p> <p data-bbox="1081 1711 1468 1738">Contingent assets are not recognized.</p>

Impact	US GAAP	IFRS
<p data-bbox="110 464 472 533"><b>Assignment/allocation and impairment of goodwill</b></p> <p data-bbox="110 554 537 674">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.</p> <p data-bbox="110 695 548 821">Additional differences in the impairment testing methodologies could create further variability in the timing and extent of recognized impairment losses.</p>	<p data-bbox="570 554 922 646">Goodwill is assigned to an entity's reporting units, as defined within the guidance.</p> <p data-bbox="570 667 1003 724">Goodwill impairment testing is performed under a two-step approach(*):</p> <ol data-bbox="570 737 1003 1318" style="list-style-type: none"> <li data-bbox="570 737 1003 961">1. 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.</li> <li data-bbox="570 974 1003 1318">2. 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.</li> </ol> <p data-bbox="570 1339 992 1459">Any loss recognized is not permitted to exceed the carrying amount of goodwill. The impairment charge is included in operating income.</p> <p data-bbox="570 1480 1003 1885">(*) In 2010, the FASB issued Accounting Standards Update (ASU) 2010-28, which amended the guidance on goodwill impairment testing. The new guidance modified Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that goodwill impairment exists. See the Recent/proposed guidance section for further discussion.</p>	<p data-bbox="1036 554 1463 646">Goodwill is allocated to a cash-generating unit (CGU) or group of CGUs, as defined within the guidance.</p> <p data-bbox="1036 667 1463 724">Goodwill impairment testing is performed under a one-step approach:</p> <p data-bbox="1036 745 1463 865">The recoverable amount of the CGU or group of CGUs (i.e., the higher of its fair value less costs to sell and its value in use) is compared with its carrying amount.</p> <p data-bbox="1036 886 1382 1010">Any impairment loss is recognized in operating results as the excess of the carrying amount over the recoverable amount.</p> <p data-bbox="1036 1031 1442 1186">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 book value of goodwill.</p>



Impact	US GAAP	IFRS
<p><b>Contingent consideration — seller accounting</b></p> <p>Entities that sell a business that includes contingent consideration might encounter significant differences in the manner in which such contingencies are recorded.</p>	<p>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.</p>	<p>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.</p>
<b>Other</b>		
<p><b>Noncontrolling interests</b></p> <p>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.</p>	<p>Noncontrolling interests are measured at fair value.</p>	<p>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.</p>

Impact	US GAAP	IFRS
<p><b>Combinations involving entities under common control</b></p> <p>Under US GAAP, there are specific rules for common-control transactions. IFRS provides more variability in the accounting treatment for such transactions.</p>	<p>Combinations of entities under common control are generally recorded at predecessor cost, reflecting the transferor's carrying amount of the assets and liabilities transferred.</p>	<p>IFRS does not specifically address such transactions. Entities develop and consistently apply an accounting policy; management can elect to apply purchase 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 (i.e., it provides more-reliable and more-relevant information).</p>
<p><b>Identifying the acquirer</b></p> <p>Potentially different entities might be determined to be the acquirer when applying purchase accounting.</p> <p>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.</p>	<p>The acquirer is determined by reference to ASC 810-10, under which generally the party that holds directly or indirectly 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.</p>	<p>The acquirer is determined by reference to the consolidation guidance, under which generally the party that holds greater than 50 percent of the voting power has control. In addition, in several instances, control might exist if less than 50 percent of the voting power is held by an entity.</p>

Impact	US GAAP	IFRS
<p><b>Fair value</b></p> <p>When measuring the fair value of assets acquired and liabilities assumed, there are differences in the definitions of fair value between current US GAAP and current IFRS, which could result in different fair values of assets acquired and liabilities assumed, including goodwill.</p> <p>In May 2011, the FASB and IASB issued new guidance on fair value measurement. Once effective, the new guidance results in a consistent definition of fair value and, for the most part, common requirements for the measurement of and disclosure about fair value between US GAAP and IFRS. Refer to the Assets—financial assets chapter for a further discussion of the new fair value guidance.</p>	<p>Fair value 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. The exchange price represents an exit price.</p> <p>A fair value measurement assumes that the transaction occurs in the principal market for the asset or liability, or, in the absence of a principal market, the most advantageous market.</p> <p>Fair value measurements include the concept of “highest and best use,” which refers to how market participants would use an asset to maximize the value of the asset or group of assets. The highest and best use is determined based on the use of the asset by market participants, even if the intended use of the asset by the reporting entity is different.</p> <p>The fair value definition of a liability is based on a transfer concept and includes nonperformance risk, which generally considers the reporting entity’s own credit risk.</p> <p>New fair value measurement guidance was issued in May 2011. Once effective, the principles for the measurement of fair value will, for the most part, be the same under US GAAP and IFRS. Refer to the Assets—financial assets chapter for a further discussion of the new fair value guidance.</p>	<p>Fair value is currently defined as the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm’s-length transaction. IFRS does not specifically refer to either an entry or exit price.</p> <p>IFRS currently does not contain guidance about which market should be used as a basis for measuring fair value when more than one market exists; however, under both IFRS and US GAAP, observable markets typically do not exist for many assets acquired in a business combination. As a result, for many nonfinancial assets, the principal or most advantageous market will be represented by a hypothetical market, which likely will be the same under both frameworks.</p> <p>IFRS currently does not include an equivalent valuation premise of “highest and best use” similar to US GAAP.</p> <p>The current fair value definition of a liability uses a settlement concept.</p> <p>The fair value of financial instruments should reflect the credit quality of the instrument, and generally the entity’s own credit risk. However, the fair value of nonfinancial liabilities might not necessarily consider the entity’s own credit risk.</p> <p>New fair value measurement guidance was issued in May 2011. The new guidance defines fair value 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. The revised definition aligns with current and future US GAAP.</p>

Impact	US GAAP	IFRS
Fair value (continued)		Once effective, the principles for the measurement of fair value will, for the most part, be the same under US GAAP and IFRS. Refer to the Assets—financial assets chapter for a further discussion of the new fair value guidance.
<p><b>Push-down accounting</b></p> <p>The lack of push-down accounting under IFRS can lead to significant differences in instances where push down accounting was utilized under US GAAP.</p>	The SEC's push-down accounting guidance is applicable to public companies applying US GAAP. If a company becomes substantially wholly owned, it is required to reflect the new basis of accounting recorded by the parent arising from acquisition of the company in the company's standalone financial statements. Nonpublic entities can also elect to apply push-down accounting.	IFRS 3 is silent on whether push-down accounting is allowed or required. It may be appropriate under IFRS when the regulator requires it and the country law permits it.

### 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.

### Technical references

**IFRS** IAS 12, IAS 27 (Revised 2008), IAS 38, IAS 39, IFRS 2, IFRS 3 (Revised 2008), IFRS 13

**US GAAP** ASC 205–20, ASC 350–10, ASC 350–20, ASC 350–30, ASC 360–10, ASC 805, ASC 810

**PwC Guide** *A Global Guide to Accounting for Business Combinations and Noncontrolling Interests*

### Note

The foregoing 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.

## Recent/proposed guidance

### **FASB Accounting Standards Update No. 2010-28, *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts***

In December 2010, the FASB amended Accounting Standards Codification Subtopic 350-20, *Intangibles—Goodwill and Other—Goodwill* with Accounting Standards Update (ASU) No. 2010-28. This ASU amends Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. An entity is required to perform Step 2 of the goodwill impairment test for reporting units with zero or negative carrying amounts if it is more likely than not that goodwill impairment exists. An entity should consider whether there are any adverse qualitative factors indicating that it is more likely than not that impairment may exist. The qualitative factors are consistent with the existing guidance, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. For nonpublic entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Nonpublic entities may early adopt the amendments using the effective date for public entities.

### **FASB Proposed Accounting Standards Update, *Testing Goodwill for Impairment***

In April 2011, the FASB issued a proposed ASU, *Testing Goodwill for Impairment*, which would change the goodwill impairment test with the objective of simplifying the testing requirements. The proposal would allow an entity to first assess qualitatively whether it is necessary to perform the current two-step goodwill impairment test. An entity would be required to perform Step 1 if it determines qualitatively that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount. Otherwise, no further testing would be required.

The new qualitative indicators would replace those currently used to determine whether to test goodwill for impairment between annual tests. The indicators also would be used when determining whether to perform Step 2 for reporting units with zero or negative carrying amounts.

### **FASB Accounting Standards Update No. 2011-04, *Fair Value Measurement (topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRSs*, and IASB IFRS 13, *Fair Value Measurement***

In May 2011, the FASB issued ASU 2011-04, an amendment to ASC 820, and the IASB issued IFRS 13, *Fair Value Measurement*. The new guidance results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between US GAAP and IFRS. Refer to the Assets—financial assets chapter for further details.



---

## Other accounting and reporting topics

## 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, several joint projects in progress may eliminate some of them.

There are currently differences in the calculation of diluted earnings per share, which could result in differences in the amounts reported. Some of the differences (such as the inclusion under US GAAP of contingently convertible debt securities if they have a dilutive impact; that is, the contingency feature is ignored) would result in lower potential common shares under IFRS, while others (such as the presumption that contracts that can be settled by the issuer in either cash or common shares will always settle in shares) generally would result in a higher number of potential common shares under IFRS. Further, differences in guidance relating to other topics (for example, deferred tax accounting requirements for share-based payments) could result in different diluted earnings per share amounts.

IFRS currently contains a different definition of a discontinued operation than does US GAAP. The IFRS definition of a component—for purposes of determining whether a disposition would qualify for discontinued operations treatment—requires the unit to represent a separate major line of business or geographic area of operations or to be a subsidiary acquired exclusively with a view toward resale. More disposals qualify as discontinued operations under the US GAAP definition. However, there is a joint project under way with the objective of a converged definition.

Differences in the guidance surrounding the offsetting of financial 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, which could impact an entity's key metrics or ratios. The IASB and FASB agreed in June 2010 to work together to try to achieve greater convergence in their criteria for balance sheet offsetting under IFRS and US GAAP. The boards tentatively decided that the focus of offsetting should be on financial instruments. Based on the June 2011 deliberations, the FASB supported (by a narrow margin) an exception that would permit netting of derivatives under an enforceable master netting agreement under US GAAP. The IASB, however, unanimously decided not to permit a similar exception under IFRS. As a result, the requirements are not expected to be converged except for disclosures. Please refer to the Assets—financial assets chapter for further details.

The following table provides further details on the foregoing and other selected current differences.



Impact	US GAAP	IFRS
<p><b>Financial statements</b></p>		
<p><b>Balance sheet – offsetting assets and liabilities</b></p> <p>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.</p>	<p>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:</p> <ul style="list-style-type: none"> <li>• Each of two parties owes the other determinable amounts</li> <li>• The reporting party has the right to set off the amount owed with the amount owed by the other party</li> <li>• The reporting party intends to set off</li> <li>• The right of setoff is enforceable by law</li> </ul> <p>Repurchase agreements and reverse-repurchase agreements that meet certain conditions are permitted, but not required, to be offset in the balance sheet.</p>	<p>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:</p> <ul style="list-style-type: none"> <li>• Currently have a legally enforceable right to set off the recognized amounts</li> <li>• Intend either to settle on a net basis or to realize the asset and settle the liability simultaneously</li> </ul> <p>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.</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Balance sheet—offsetting assets and liabilities (continued)</b></p>	<p>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.</p>	
<p><b>Balance sheet: classification—post-balance sheet refinancing agreements</b></p> <p>Under IFRS, the classification of debt does not consider post-balance sheet refinancing agreements. As such, more debt is classified as current under IFRS.</p>	<p>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.</p> <p>The presentation of a classified balance sheet is required, with the exception of certain industries.</p>	<p>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.</p> <p>The presentation of a classified balance sheet is required, except when a liquidity presentation is more relevant.</p>

Impact	US GAAP	IFRS
<p><b>Balance sheet: classification—refinancing counterparty</b></p> <p>Differences in the guidance for accounting for certain refinancing arrangements may result in more debt classified as current under IFRS.</p>	<p>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.</p>	<p>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.</p>
<p><b>Income statement</b></p> <p>The most significant differences between the frameworks are, under IFRS, the ability to present expenses based on their nature, rather than their function, and the option to present all items of income and expense in either a single statement of comprehensive income or two statements (an income statement and a statement of comprehensive income). IFRS does not permit display of comprehensive income and its components in a statement of changes in equity, which is acceptable under US GAAP.</p> <p>Upon adoption of the converged standards, US GAAP will no longer permit display of other comprehensive income and its components in a statement of changes in equity, thereby eliminating this difference. Refer to the section on Recent/proposed guidance for further details.</p>	<p>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.</p> <p>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.</p>	<p>Entities may present all items of income and expense in either a single statement of comprehensive income or two statements (an income statement and a statement of comprehensive income). Expenses may be presented either by function or by nature. Additional disclosure of expenses by nature is required if functional presentation is used.</p> <p>While certain minimum line items are required, no prescribed statement of comprehensive income format exists.</p>

Impact	US GAAP	IFRS
<p data-bbox="110 464 428 489">Income statement (continued)</p>	<p data-bbox="570 464 1003 678">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 statement of operations or in the notes to the financial statements.</p> <p data-bbox="570 701 1003 789">“Extraordinary items” are defined as being both infrequent and unusual and are rare in practice.</p> <p data-bbox="570 812 1003 900">Entities may utilize one of three formats in their presentation of comprehensive income:</p> <ul data-bbox="570 913 1003 1182" style="list-style-type: none"> <li data-bbox="570 913 1003 972">• A single primary statement of income and comprehensive income</li> <li data-bbox="570 982 1003 1071">• A two-statement approach (a statement of income and a statement of comprehensive income)</li> <li data-bbox="570 1081 1003 1182">• A separate category highlighted within the primary statement of changes in shareholders’ equity</li> </ul> <p data-bbox="570 1205 1003 1545">In June 2011 the FASB issued ASU No. 2011-05, <i>Presentation of Comprehensive Income</i>. Upon adoption of the new standard, entities will present items of net income and other comprehensive income either in one single statement of comprehensive income or in two separate, but consecutive, statements. The option to present other comprehensive income and its components in the statement of changes in equity will be eliminated.</p> <p data-bbox="570 1568 1003 1627">Refer to the section on Recent/proposed guidance for further details.</p>	<p data-bbox="1036 464 1469 615">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.</p> <p data-bbox="1036 638 1469 758">Entities should not mix functional and nature classifications of expenses by excluding certain expenses from the functional classifications to which they relate.</p> <p data-bbox="1036 781 1469 1058">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.</p> <p data-bbox="1036 1081 1419 1106">“Extraordinary items” are prohibited.</p> <p data-bbox="1036 1129 1469 1566">In June 2011 the IASB issued amendments to IAS 1, <i>Presentation of Financial Statements</i>. Upon adoption of the amendments, entities will still be 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. The amendment will, however, require items included in other comprehensive income that may be recycled into profit or loss in future periods to be presented separately from those that will not be recycled.</p> <p data-bbox="1036 1589 1469 1648">Refer to the section on Recent/proposed guidance for further details.</p>
<p data-bbox="110 1675 391 1701">Statements of equity</p> <p data-bbox="110 1724 496 1812">IFRS requires a statement of changes in equity to be presented as a primary statement for all entities.</p>	<p data-bbox="570 1724 1003 1843">Permits the statement of changes in shareholders’ equity to be presented either as a primary statement or within the notes to the financial statements.</p>	<p data-bbox="1036 1724 1414 1812">A statement of changes in equity is presented as a primary statement for all entities.</p>

Impact	US GAAP	IFRS
<p><b>Statement of cash flows</b></p> <p>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.</p>	<p>Bank overdrafts are not included in cash and cash equivalents; changes in the balances of overdrafts are classified as financing cash flows, rather than being included within cash and cash equivalents.</p> <p>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.</p> <p>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.</p> <p>Additional disclosure rules exist regarding the supplemental disclosure of interest and taxes paid during the period.</p>	<p>Cash may also include bank overdrafts repayable on demand. Short-term bank borrowings are not included in cash or cash equivalents and are considered to be financing cash flows.</p> <p>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. Interest capitalized under IAS 23 should generally be classified in a manner consistent with the classification of the underlying asset on which the asset was capitalized. For example, interest payments that are capitalized as part of the cost of property, plant, and equipment should generally be classified as part of an entity's investing activities. Interest payments that are capitalized as part of the cost of inventories should be classified as part of an entity's operating activities. The total amount of interest paid during a period, whether expensed or capitalized, is disclosed in the statement of cash flows.</p> <p>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.</p>

Impact	US GAAP	IFRS
<p><b>Disclosure of critical accounting policies and significant estimates</b></p> <p>An increased prominence exists in the disclosure of an entity's critical accounting policies and disclosures of significant accounting estimates under IFRS in relation to the requirements of US GAAP.</p>	<p>For SEC registrants, disclosure of the application of critical accounting policies and significant estimates is normally made in the <i>Management's Discussion and Analysis</i> section of Form 10-K.</p> <p>Financial statements prepared under US GAAP include a summary of significant accounting policies used within the notes to the financial statements.</p>	<p>Within the notes to the financial statements, entities are required to disclose both:</p> <ul style="list-style-type: none"> <li>• 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</li> <li>• 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.</li> </ul>
<p><b>Comparative financial information</b></p> <p>IFRS specifies the periods for which comparative financial information is required, which differs from both US GAAP and SEC requirements.</p>	<p>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.</p>	<p>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.</p> <p>A third balance sheet also is required for first-time adopters of IFRS and in situations where a restatement or reclassification has occurred. Restatements or reclassifications in this context are in relation to a change in accounting policies or accounting estimates, errors, or changes in presentation of previously issued financial statements.</p>

Impact	US GAAP	IFRS
<b>Earnings per share</b>		
<p><b>Diluted earnings-per-share calculation — year-to-date period calculation</b></p> <p>Differences in the calculation methodology could result in different denominators being utilized in the diluted earnings-per-share (EPS) year-to-date period calculation.</p>	<p>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.</p>	<p>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.</p>
<p><b>Diluted earnings-per-share calculation — contracts that may be settled in stock or cash (at the issuer’s election)</b></p> <p>Differences in the treatment of convertible debt securities may result in lower diluted EPS under IFRS.</p>	<p>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.</p>	<p>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; that presumption may not be rebutted.</p>

Impact	US GAAP	IFRS
<p><b>Diluted earnings-per-share calculation</b></p> <p>The treatment of contingency features in the dilutive EPS calculation may result in higher diluted EPS under IFRS.</p>	<p>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.</p>	<p>The potential common shares arising from contingently convertible debt securities would be included in the dilutive EPS computation only if the contingency price was met as of the reporting date.</p>
<p><b>Diluted EPS calculation—application of treasury stock method to share-based payments—windfall tax benefits</b></p> <p>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.</p> <p>Refer to the Expenses recognition—share-based payments section for a broader discussion of income tax effects associated with share-based payments.</p>	<p>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.</p> <p>The treatment is the same as for vested options (i.e., windfall tax benefits included in the theoretical proceeds).</p>	<p>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.</p> <p>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.</p>



Impact	US GAAP	IFRS
<b>Foreign currency translation</b>		
<p><b>Trigger to release amounts recorded in a currency translation account</b></p> <p>Different recognition triggers for amounts captured in a currency translation account (CTA) could result in more instances where amounts included in a CTA are recycled through the income statement under IFRS compared with US GAAP.</p>	<p>Some or all of the CTA balance is released into the income statement in the following situations where a parent sells its interest or its interest is diluted via the foreign operation’s share issuance:</p> <ul style="list-style-type: none"> <li>• When control of a foreign subsidiary is lost, the entire CTA balance is released</li> <li>• Complete or substantially complete liquidation of a foreign operation triggers full release of CTA</li> <li>• When an interest is sold but significant influence is retained, a proportion of CTA is released</li> <li>• When significant influence is lost, a proportion of CTA is released into the income statement and the remaining CTA balance affects the cost basis of the investment retained</li> </ul> <p>Amounts in the CTA generally should not be released into earnings when a first-tier foreign subsidiary sells or liquidates a second-tier subsidiary because the first-tier subsidiary still contains investments in foreign assets. This principle may be overcome in certain cases.</p>	<p>The triggers for sale and dilution noted in the US GAAP column apply for IFRS, except when significant influence is lost, the entire CTA balance is released into the income statement.</p> <p>Also, the sale of a second-tier subsidiary may trigger the release of CTA associated with that second-tier subsidiary even though ownership in the first-tier subsidiary has not been affected.</p>
<p><b>Translation in consolidated financial statements</b></p> <p>IFRS does not require equity accounts to be translated at historical rates.</p>	<p>Equity is required to be translated at historical rates.</p>	<p>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.</p>

Impact	US GAAP	IFRS
<p><b>Determination of functional currency</b></p> <p>Under US GAAP there is no hierarchy of indicators to determine the functional currency of an entity, whereas a hierarchy exists under IFRS.</p>	<p>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.</p>	<p>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).</p>
<b>Other</b>		
<p><b>Interim financial reporting—allocation of costs in interim periods</b></p> <p>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.</p> <p>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.</p>	<p>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.</p>	<p>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.</p>

Impact	US GAAP	IFRS
<p><b>Definition of discontinued operations</b></p> <p>The definitions of discontinued operations are different under IFRS compared with US GAAP. Therefore, disposal transactions may be accounted for differently. Refer to the section on Recent/proposed guidance for potential changes in this area.</p>	<p>The results of operations of a component of an entity that either has been disposed of or is classified as held for sale are reported as discontinued operations if both:</p> <ul style="list-style-type: none"> <li>• The operations and cash flows have been or will be eliminated from the ongoing operations of the entity</li> <li>• There will be no significant continuing involvement in the operations of the component after the disposal transaction</li> </ul> <p>A component presented as a discontinued operation under US GAAP may be a reportable segment, operating segment, reporting unit, subsidiary, or asset group.</p> <p>Generally, partial disposals characterized by movement from a controlling to a noncontrolling interest would not qualify as discontinued operations due to continuing involvement.</p>	<p>A discontinued operation is a component of an entity (operations and cash flows that can be clearly distinguished, operationally and for financial reporting, from the rest of the entity) that either has been disposed of or is classified as held for sale and represents a separate major line of business or geographic area of operations, or is a subsidiary acquired exclusively with a view to resale.</p> <p>Partial disposals characterized by movement from a controlling to a noncontrolling interest could qualify as discontinued operations.</p>
<p><b>Related parties—disclosure of management compensation</b></p> <p>Under IFRS, a financial statement requirement exists to disclose the compensation of key management personnel.</p>	<p>Disclosure of the compensation of key management personnel is not required within the financial statements.</p> <p>SEC regulations require key management compensation to be disclosed outside the primary financial statements.</p>	<p>The compensation of key management personnel is disclosed within the financial statements in total and by category of compensation. Other transactions with key management also must be disclosed.</p>

Impact	US GAAP	IFRS
<p><b>Related parties—disclosure of transactions with the government and government-related entities</b></p> <p>There are exemptions from certain related party disclosure requirements under IFRS that do not exist under US GAAP.</p>	<p>There are no exemptions available to reporting entities from the disclosure requirements for related party transactions with governments and/or government-related entities.</p>	<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"> <li>• A government that has control, joint control, or significant influence over the reporting entity</li> <li>• 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</li> </ul>
<p><b>Operating segments—segment reporting</b></p> <p>A principles-based approach to the determination of operating segments in a matrix-style organizational structure could result in entities disclosing different operating segments.</p>	<p>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.</p>	<p>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).</p>

### Technical references

**IFRS** IAS 1, IAS 8, IAS 21, IAS 24, IAS 33, IFRS 5, IFRS 8

**US GAAP** ASC 205, ASC 205-20, ASC 230, ASC 260, ASC 280, ASC 360-10, ASC 830, ASC 830-30-40-2 to 40-4, ASC 850

### Note

The foregoing 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.

## Recent/proposed guidance

### **FASB Accounting Standards Update No. 2011-05, *Presentation of Comprehensive Income*, and IASB Amendment to IAS 1, *Presentation of Financial Statements***

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income*, and at the same time, the IASB issued an amendment to IAS 1, *Presentation of Financial Statements*, which requires the presentation of net income and other comprehensive income either in a single continuous statement or in two separate, but consecutive, statements. Presentation of other comprehensive income within the statement of equity will no longer be permitted under US GAAP. The option to present other comprehensive income within the statement of changes in equity had been eliminated under IFRS in 2007. As such, the current changes to IFRS are more limited.

Although the boards worked on the guidance jointly, certain differences remain, including:

- IFRS will require that items included in other comprehensive income that may be recycled into profit or loss in future periods (for example, cash flow hedges and the cumulative translation adjustment) be presented separately from those that will not be recycled (for example, revaluations of property, plant and equipment, and actuarial gains and losses). This distinction does not exist under US GAAP, where all items included in other comprehensive income are subject to recycling.
- The IASB amendment requires an entity that elects to show items in other comprehensive income before tax 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. This distinction does not exist under US GAAP, where all items included in OCI are subject to recycling.
- The IASB did not eliminate the option to present the components of accumulated OCI on the face of the statement of financial position. The FASB, on the other hand, has eliminated the option to present the components of accumulated OCI on the face of the statement of financial position, requiring this to be in the footnotes.
- In addition, the IASB retained the option to disclose reclassification adjustments in the notes of the financial statements. The FASB has eliminated this option.

Despite these differences, the proposals are intended to enhance comparability of entities' reporting between US GAAP and IFRS and to provide a more consistent method of presenting non-owner transactions that affect an entity's equity. For public entities applying US GAAP, the guidance is effective for fiscal years (and interim periods within those years) beginning after December 15, 2011. For non-public entities applying US GAAP, the guidance is effective for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. For IFRS, the amendment is applicable for fiscal years that begin on or after July 1, 2012. Full retrospective application is required, and early adoption is permitted under both frameworks.

### **IASB Amendment to IAS 24, *Related Party Disclosures***

In November 2009, the IASB issued an amendment that both:

- Removes the requirement for government-related entities to disclose details of all transactions with the government and other government-related entities
- Clarifies and simplifies the definition of a related party

Government-related entities are now defined as entities that are controlled, jointly controlled, or significantly influenced by the government. The amendment significantly relaxes the disclosure requirements and should be of substantial benefit to government-related entities. New disclosures are required that will provide more meaningful information about the nature of an entity's relationship with the government and material transactions.

The amendment also simplifies the definition of a related party, removing inconsistencies and complexities associated with the original definition. The amendment will make the definition of a related party easier to apply but will require some entities to make additional disclosures.

The revised standard is effective for annual periods beginning on or after January 1, 2011. Early adoption is permitted. US GAAP does not have any special related party exemptions for government or government-controlled entities.

#### **Joint FASB/IASB Staff Draft, *Preliminary Views on Financial Statement Presentation***

In October 2008, a joint discussion paper was issued with the goal of converging financial statement presentation, and in July 2010, the boards published a staff draft of an exposure draft. The purpose of this joint project is to establish a standard that will guide the organization and presentation of information in the financial statements. The result of this project would directly affect how management of an entity communicates with users of financial statements. The proposal seeks to improve the usefulness of the information provided in an entity's financial statements to help users make decisions in their capacity as capital providers. The proposed model would have a significant impact on financial statement presentation and would eliminate existing differences between US GAAP and IFRS in this area. In October 2010, in light of other priorities and limited resources, the project was postponed and will be revisited by the boards no earlier than December 2011.

#### **Joint FASB/IASB Exposure Draft, *Discontinued Operations***

In September 2008, the boards issued a joint exposure draft to develop a converged definition of a discontinued operation along with converged disclosure requirements for all components of an entity that have been (or will be) disposed. A subset of the financial statement presentation project, this project is intended to converge discontinued-operations guidance in US GAAP and IFRS. The FASB plans to adopt a definition that is similar to the current IFRS definition. That guidance focuses on whether the operation is a separate major line of business or geographical area of operation. The FASB, however, will also go a step further on disclosure by requiring information for disposals of components that do not qualify as discontinued operations. This project was reassessed as a lower priority project and further action is not expected before December 2011.

#### **Joint FASB/IASB Project, *Conceptual Framework***

In October 2004, the boards added to their agendas a joint project to develop an improved, common conceptual framework that builds on their existing frameworks and provides a sound foundation for developing future accounting standards. Such a framework is essential to fulfilling the boards' goal of developing standards that are principles-based, internally consistent, and internationally converged, and that lead to financial reporting that provides the information capital providers need to make decisions in their capacity as capital providers. This project is being conducted in eight phases, with exposure drafts on Phase D, The Reporting Entity, and Phase A, Objectives and Qualitative Characteristics, issued in March 2010 and May 2008, respectively. In October 2010, in light of other priorities and limited resources, the project was postponed and will be revisited by the boards no earlier than December 2011.

#### **Joint FASB/IASB Exposure Draft, *Simplifying Earnings per Share***

In August 2008, a joint exposure draft was issued to reduce differences between US GAAP and IFRS. The objectives of the Earnings per Share project were to simplify and converge the calculation of EPS according to IAS 33, *Earnings per Share*, and ASC 260, *Earnings per Share*. The project would help eliminate differences in the denominator of the earnings-per-share calculation. In April 2009, the boards considered comments received in relation to the exposure draft. In light of other priorities, the project was removed from the FASB and IASB's agenda and is currently inactive.

#### **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.

---

## IFRS for small and medium-sized entities

## ***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 set of standards 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.

### ***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) if 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 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 the two accounting frameworks are not completely compatible for consolidation.

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 are considering proposals to replace their local GAAP with IFRS for SMEs or standards similar to 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.

### ***What are some of the differences between full IFRS and IFRS for SMEs?***

IFRS for SMEs retains many of the principles of full IFRS but simplifies a number of areas that are generally less complicated or not 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 areas 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 be more relevant and less cumbersome for private entities to apply. 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.

**Uncertain tax positions (UTPs)**—There is no specific guidance on UTPs within the existing full IFRS income tax standard, though the topic is being considered as part of the IASB's current project on income taxes. However, under the general principles, the UTP liability is recorded if the likelihood of payment is greater than 50 percent 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.

### ***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, the lowest point on 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, the midpoint should be recorded.

**Borrowing costs**—US GAAP requires capitalization of borrowing costs directly attributable to the acquisition, construction, or production of qualifying assets. Under IFRS for SMEs, all borrowing costs must be expensed.

**Equity instruments**—Under US GAAP, complex equity instruments such as puttable stock and mandatorily redeemable preferred shares may qualify as equity (or mezzanine equity), particularly for private companies. 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 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.

## Recent/proposed guidance

### IFRS

The IASB intends to update IFRS for SMEs periodically (i.e., every three years or so) to minimize the impact of changing accounting standards on private company resources and users. Therefore, to date, the IASB has issued no significant changes to IFRS for SMEs since its original release date.

Although there have been no amendments to 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). If approved by the IASB, the Q&As are issued as non-mandatory guidance intended to help those who use IFRS for SMEs to think about specific accounting questions.

In June 2011, the SMEIG issued Q&A 2011/01, *Use of the IFRS for SMEs in a Parent's Separate Financial Statements*, to address whether a parent entity is permitted to use IFRS for SMEs in its separate financial statements. Q&A 2011/01 concludes that if a parent entity itself does not have public accountability, it may present its separate financial statements in accordance with IFRS for SMEs even if it presents its consolidated financial statements in accordance with full IFRSs.

### US GAAP

During 2010, a blue ribbon panel was formed to advise the Financial Accounting Foundation (FAF), the parent organization of the FASB, on how US GAAP can best meet the needs of US users of private company financial statements. In January 2011, the blue ribbon panel recommended changes to the current accounting standard-setting structure, including the creation of a new standard-setting board under the oversight of the FAF. This board would propose exceptions and modifications to US GAAP for private companies. The new board would work closely with the FASB with the goal of having a coordinated and efficient standard-setting process, with final authority vested with the new board. The FAF will consider the blue ribbon panel's recommendations as it continues to deliberate on improvements to the standard-setting process and will likely seek input from constituents through an exposure process in late 2011.

The proposed standard-setting model is different than that used by the IASB, which retains authority for standard setting for both public and private entities.

## How can I learn more?

For an in-depth comparison of IFRS for SMEs and full IFRS, please refer to the PwC publication *Similarities and differences—a comparison of IFRS for SMEs and “full IFRS.”*



## FASB/IASB project summary exhibit

The following table presents a summary of all joint projects on the agenda of the IASB and FASB, and the related discussion papers, exposure drafts, and final standards expected to be issued in 2011 and 2012. In addition, each board separately has a number of research and standards projects in various stages of completion. 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 IASB, visit [www.ifrs.org](http://www.ifrs.org). For the FASB, visit [www.fasb.org](http://www.fasb.org).

	Responsible Board	2011	2012
		Issuance anticipated	Issuance anticipated
<b>Standards and amendment to standards</b>			
Balance sheet—offsetting	Joint	F	
Consolidation—Policy and procedures	FASB	ED	F
Consolidation—Investment companies	Joint	ED	F
Discontinued operations <sup>1</sup>	Joint		
Emissions trading schemes <sup>1</sup>	Joint		
Financial Instruments—classification and measurement	FASB	ED	F
Impairment	Joint	ED	F
Hedge accounting	Joint	F <sup>2</sup>	ED <sup>2</sup>
Financial instruments with characteristics of equity <sup>1</sup>	Joint		
Financial statement presentation <sup>1</sup>	Joint		
Insurance contracts	Joint		ED
Leases	Joint	ED	F
Revenue recognition	Joint	ED	F
<b>Conceptual framework</b>			
Phase B: Elements and recognition	Joint		
Phase C: Measurement <sup>1</sup>	Joint		
Phase D: Reporting entity <sup>1</sup>	Joint		

<sup>1</sup> This is a lower priority joint project. Further consideration is not expected before December 2011.

<sup>2</sup> The IASB expects to finalize its general hedge accounting model in 2011. The macro hedge accounting principles will be addressed in a separate exposure draft that is expected to be released in 2012. The FASB's timing is expected to be later (2013).

	Responsible Board	2011	2012
		Issuance anticipated	Issuance anticipated

### Other IASB projects

Annual improvements—2011 cycle	IASB	ED	F
Extractive activities <sup>3</sup>	IASB		
Liabilities (IAS 37 amendments) <sup>4</sup>	IASB		
Rate-regulated activities <sup>3</sup>	IASB		
Common control <sup>3</sup>	IASB		

### FASB research and other FASB projects

#### FASB research projects

Differential Standard-Setting Framework for Private Companies	FASB	DP	
---	------	----	--

#### Other FASB projects

Codification technical corrections	FASB	ED	F
Disclosure of certain loss contingencies <sup>5</sup>	FASB		
Disclosure framework	FASB	DP	
Disclosures about an employer's participation in a multi-employer plan	FASB	F	
Disclosure about risks and uncertainties and the liquidation basis of accounting (formerly going concern)	FASB	ED	F
Goodwill impairment assessment	FASB	F	
Investment properties	FASB	ED	F

### Explanation of symbols:

DP = Discussion Paper

ED = Exposure Draft

F = Final

<sup>3</sup> In light of other priorities, the board has paused the project and will consider whether to include the project on its active agenda in the future.

<sup>4</sup> The board has postponed further discussion and analysis on the project until at least the second half of 2011.

<sup>5</sup> The board decided to evaluate whether there is improved disclosure of loss contingencies during the 2010 year-end financial reporting cycle. Further action is not expected before December 2011.





## Index

### Business combinations

Acquired contingencies . . . . .	197
Assignment/allocation and impairment of goodwill . . . . .	198
Combinations involving entities under common control. . . . .	200
Contingent consideration . . . . .	197
Contingent consideration— seller accounting . . . . .	199
Fair value. . . . .	201–202
Identifying the acquirer. . . . .	200
Noncontrolling interests . . . . .	199
Push-down accounting . . . . .	202

### Consolidation

Accounting for contributions to a jointly controlled entity . . . . .	188
Accounting for joint venture arrangements . . . . .	187
Accounting policies and reporting periods . . . . .	182
Consolidation model . . . . .	176–180
Definition and types of joint ventures . . . . .	186
Disclosures . . . . .	183–185
Equity method of accounting—acquisition date excess of investor’s share of fair value over cost . . . . .	189
Equity method of accounting—classification as held for sale . . . . .	189
Equity method of accounting— conforming accounting policies . . . . .	189
Equity method of accounting— exemption from applying the equity method. . . . .	188
Equity method of accounting—impairment . . . . .	189
Equity method of accounting—losses in excess of an investor’s interest . . . . .	190
Equity method of accounting—loss of significant influence or joint control . . . . .	190
Potential voting rights . . . . .	185
Requirements to prepare consolidated financial statements. . . . .	175
Special-purpose entities . . . . .	181–182

### Derivatives and hedging

Calls and puts in debt instruments. . . . .	160
Cash flow hedges and basis adjustments on acquisition of nonfinancial items . . . . .	170
Cash flow hedges with purchased options. . . . .	165
Credit risk and hypothetical derivatives . . . . .	164
Day one gains and losses . . . . .	161
Designated risks for financial assets or liabilities . . . . .	167
Effectiveness testing and measurement of hedge ineffectiveness. . . . .	162–163
Fair value hedge of interest rate risk in a portfolio of dissimilar items. . . . .	168
Firm commitment to acquire a business . . . . .	168
Foreign currency risk and internal derivatives . . . . .	166
Foreign currency risk and location of hedging instruments . . . . .	169
Hedges of a portion of the time period to maturity . . . . .	167
Hedging more than one risk . . . . .	169
Net settlement provisions . . . . .	158
Nonfinancial host contracts—currencies commonly used. . . . .	161
Own use versus normal purchase normal sale (NPNS) . . . . .	158
Reassessment of embedded derivatives. . . . .	159
Servicing rights . . . . .	165
When to assess effectiveness. . . . .	162

### Employee benefits

Accounting for costs. . . . .	68
Accounting for termination indemnities . . . . .	67
Asset ceiling . . . . .	63
Balance sheet recognition . . . . .	59
Curtailments. . . . .	61
Deferred compensation arrangements—employment benefits . . . . .	65
Defined benefit versus defined contribution plan classification . . . . .	60





**IFRS first-time adoption**

Important takeaways . . . . .	21
The opening IFRS balance sheet . . . . .	20
What does IFRS 1 require? . . . . .	19
When to apply IFRS 1 . . . . .	20

**IFRS for small and medium-sized entities**

What are some of the differences between full IFRS and IFRS for SMEs? . . . . .	222
What are some of the differences between US GAAP and IFRS for SMEs? . . . . .	223
What companies can use IFRS for SMEs? . . . . .	222

**Liabilities—other**

Accounting for government grants . . . . .	134
Discounting of provisions . . . . .	130
Measurement of provisions . . . . .	129
Onerous contracts . . . . .	133
Recognition of provisions . . . . .	129
Reimbursement and contingent assets . . . . .	135
Restructuring provisions (excluding business combinations) . . . . .	131–132

**Nonfinancial assets**

Advertising costs . . . . .	82
Asset groupings . . . . .	79
Asset retirement obligations . . . . .	84
Biological assets—fair value versus historical cost . . . . .	91
Borrowing costs . . . . .	85
Carrying basis . . . . .	79
Cash flow estimates . . . . .	77–78
Depreciation . . . . .	83
Distributions of nonmonetary assets to owners . . . . .	90
Impairment of long-lived assets held for use . . . . .	75–76

Impairments of software costs to be sold, leased, or otherwise marketed . . . . .	82
Indefinite-lived intangible assets— impairment charge measurement . . . . .	81
Indefinite-lived intangible assets— level of assessment for impairment testing . . . . .	81
Internally developed intangibles . . . . .	80
Inventory costing . . . . .	90
Inventory measurement . . . . .	90
Investment property . . . . .	91
Lease classification	
General . . . . .	86
Other . . . . .	88–89
Lease scope . . . . .	85
Leases involving land and buildings . . . . .	88
Overhaul costs . . . . .	83
Sale-leaseback arrangements . . . . .	87

**Other accounting and reporting topics**

Balance sheet: classification	
Post-balance sheet refinancing agreements . . . . .	208
Refinancing counterparty . . . . .	209
Balance sheet—offsetting assets and liabilities . . . . .	207–208
Comparative financial information . . . . .	212
Definition of discontinued operations . . . . .	217
Determination of functional currency . . . . .	216
Diluted earnings-per-share calculation . . . . .	214
Diluted earnings-per-share calculation—contracts that may be settled in stock or cash (at the issuer's election) . . . . .	213
Diluted earnings-per-share calculation— year-to-date period calculation . . . . .	213
Diluted EPS calculation—application of treasury stock method to share-based payments—windfall tax benefits . . . . .	214
Disclosure of critical accounting policies and significant estimates . . . . .	212
Income statement . . . . .	209–210

Interim financial reporting—allocation of costs in interim periods . . . . .	216	Awards with conditions other than service, performance, or market conditions . . . . .	45
Operating segments—segment reporting . . . . .	218	Cash-settled awards with a performance condition . . . . .	47
Related parties—disclosure of management compensation . . . . .	217	Certain aspects of modification accounting . . . . .	46
Related parties—disclosure of transactions with the government and government-related entities . . . . .	218	Classification of certain instruments as liabilities or equity . . . . .	45
Statement of cash flows . . . . .	211	Derived service period . . . . .	47
Statements of equity . . . . .	210	Employee stock purchase plan (ESPP) . . . . .	50
Translation in consolidated financial statements . . . . .	215	Group share-based payment transactions . . . . .	50
Trigger to release amounts recorded in a currency translation account . . . . .	215	Measurement of awards granted to employees by nonpublic companies . . . . .	43
<b>Revenue recognition</b>		Measurement of awards granted to nonemployees . . . . .	44
Barter transactions . . . . .	35	Recognition of social charges (e.g., payroll taxes) . . . . .	49
Construction contracts . . . . .	33–34	Scope . . . . .	43
Contingent consideration—general . . . . .	27	Service-inception date, grant date, and requisite service . . . . .	45
Discounting of revenues . . . . .	36	Tax withholding arrangements—impact to classification . . . . .	48
Extended warranties . . . . .	36	Valuation—SAB Topic 14 guidance on expected volatility and expected term . . . . .	49
Multiple-element arrangements		<b>Taxes</b>	
Contingencies . . . . .	29	Deferred taxes on investments in subsidiaries, joint ventures, and equity investees . . . . .	122–123
Customer loyalty programs . . . . .	30	Exemptions from accounting for temporary differences . . . . .	124
General . . . . .	28	Interim reporting . . . . .	126
Loss on delivered element only . . . . .	31	Intraperiod allocations . . . . .	122
Revenue recognition—general . . . . .	26	Measurement of foreign nonmonetary assets and liabilities where the local currency is not the functional currency . . . . .	124
Sale of goods—continuous transfer . . . . .	34	Presentation . . . . .	125
Sale of services		Recognition of deferred tax assets . . . . .	123
General . . . . .	32	Tax basis . . . . .	125
Right of refund . . . . .	32	Tax rate applied to current and deferred taxes . . . . .	123
<b>Share-based payments</b>		Uncertain tax positions . . . . .	121
Accounting for income tax effects . . . . .	48–49	Unrealized intragroup profits . . . . .	122
Alternative vesting triggers . . . . .	46		
Attribution—awards with service conditions and graded-vesting features . . . . .	46		



---

## ***Looking for more on IFRS?***

### **US IFRS resources**

[www.pwc.com/usifrs](http://www.pwc.com/usifrs)

Our US IFRS site contains a wealth of information and tools on where we currently stand and what companies should be doing in the US. Resources include our “IFRS First” newsletter, extensive publications, in-depth webcast series, Video Learning Center, interactive IFRS adoption by country map, and more. Designed primarily with first-time adopters of IFRS in mind.

### **Global IFRS resources**

[www.pwc.com/ifrs](http://www.pwc.com/ifrs)

Visitors can use the global site as a portal to their country-specific PwC IFRS pages or take advantage of our global IFRS resources including publications, learning tools, newsletters, illustrative financial statements and more.

***To have a deeper conversation  
about how this subject may affect  
your business, please contact:***

James G. Kaiser  
US Convergence & IFRS Leader  
PricewaterhouseCoopers LLP  
267 330 2045  
E-mail: [james.g.kaiser@us.pwc.com](mailto:james.g.kaiser@us.pwc.com)

***For additional contacts, visit  
this publication's web page via  
[www.pwc.com/usifrs/simsdiffs](http://www.pwc.com/usifrs/simsdiffs)***

This publication is printed on Mohawk Options PC.  
It is a Forest Stewardship Council (FSC) certified stock  
using 100% post-consumer waste (PCW) fiber and  
manufactured with renewable, non-polluting, wind-  
generated electricity.