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IFRS and US GAAP: similarities and differences

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Preface

PwC is pleased to offer this guide, *IFRS and US GAAP: similarities and differences*. It has been updated as of June 2018.

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

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

Each topical chapter consists of the following:

- A conceptual discussion of the current IFRS and US GAAP similarities and differences

- A detailed analysis of current differences between the frameworks, including an assessment of the impact of the differences

- Commentary and insight with respect to recent/proposed guidance

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

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

References to US GAAP and IFRS

Definitions, full paragraphs, and excerpts from the FASB's *Accounting Standards Codification* and standards issued by the IASB are clearly designated within quotes in the text. In some instances, guidance was cited with minor editorial modification to flow in the context of the PwC Guide. The remaining text is PwC's original content.

References to other chapters and sections in this guide

When relevant, the discussion includes general and specific references to other chapters of the guide that provide additional information. References to another chapter or particular section within a chapter are indicated by the abbreviation "SD" followed by the specific section number (e.g., SD 2.3.2 refers to section 2.3.2 in chapter 2 of this guide).

Guidance date

This guide has been updated and considers guidance under IFRS and US GAAP as of June 30, 2018. Additional updates may be made to keep pace with significant developments. Users should ensure they are using the most recent edition available on CFOdirect (www.cfodirect.com) or Inform (www.pwcinform.com).

Other information

The appendices to this guide include a FASB/IASB project summary exhibit and a summary of significant changes from the previous edition.

* * * * *

This guide has been prepared to support you in reviewing the differences between IFRS and US GAAP that we generally consider to be the most significant or most common. It should be used in combination with a thorough analysis of the relevant facts and circumstances, review of the authoritative accounting literature, and appropriate professional and technical advice.

We hope you find the information and insights in this guide useful.

Paul Kepple
US Chief Accountant

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Chapter 1: Importance of being financially bilingual

1.1 Overview

Most of the world's more significant capital markets now require IFRS, or some form thereof, for financial statements of public-interest entities. For specific country data, see the IASB's jurisdictional profiles (http://www.ifrs.org/Use-around-the-world/Pages/Jurisdiction-profiles.aspx).

The remaining major capital markets without an IFRS mandate are:

- The US, with no current plans to change for domestic registrants (full IFRS allowed for non-US filers);
- Japan, where voluntary adoption is allowed, but no mandatory transition date has been established;
- China, which has continued to amend Chinese Accounting Standards so that its principles are generally consistent with IFRS.

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

From an investor perspective, the need to understand IFRS is arguably even greater. US investors keep looking overseas for investment opportunities. Recent estimates suggest that over $7 trillion of US capital is invested in foreign securities. The US markets also remain open to non-US companies that prepare their financial statements using IFRS. There are currently approximately 500 non-US filers with market capitalization in the multiple of trillions of US dollars that use IFRS without reconciliation to US GAAP.

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

1.2 IFRS and the SEC

Even though a mandatory change to IFRS for US public companies is not expected in the foreseeable future, the discussion about the use of IFRS in the US continues. The Chief Accountant of the SEC's Office of the Chief Accountant, Wes Bricker, indicated that although he does not foresee the use of IFRS for domestic registrants in the foreseeable future, he encouraged the FASB and IASB to work together to eliminate differences when in the best interest of capital markets.

1.3 IFRS affects US businesses in multiple ways

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

1.3.1 Mergers and acquisitions and capital-raising

The volume of global M&A transactions continues to remain at historically high levels. As more companies look outside their borders for potential buyers, targets, and capital, knowledge and understanding of IFRS becomes increasingly important. Significant differences in both bottom-line impact and disclosure requirements exist between IFRS and US GAAP. Understanding these differences and their impact on key deal metrics, as well as on both short- and long-term financial reporting requirements, will lead to a more informed decision-making process and help minimize late surprises that could significantly impact deal value or timing.

1.3.2 Non-US stakeholders

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

1.3.3 Non-US subsidiaries

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

1.4 Our point of view

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

Chapter 2: IFRS first-time adoption

2.1 IFRS first-time adoption

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

2.1.1 *What does IFRS 1 require?*

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

IFRS 1 requires companies to:

- Identify the first IFRS financial statements
- Prepare an opening balance sheet at the date of transition to IFRS
- Select accounting policies that comply with IFRS effective at the end of the first IFRS reporting period and apply those policies retrospectively to all periods presented in the first IFRS financial statements
- Consider whether to apply any of the optional exemptions from retrospective application
- Make extensive disclosures to explain the transition to IFRS

IFRS 1 identifies certain areas in which retrospective application is prohibited. These include the classification and measurement of financial assets, impairments of financial assets, and accounting for embedded derivatives. When IFRS 17 becomes effective in 2021, the accounting for insurance contracts will also be precluded from retrospective application.

IFRS 1 is regularly updated to address first-time adoption issues arising from new standards and amendments as they become effective. There are a number of amendments to IFRS 1 that became effective on or after 1 January 2018 related to new standards and interpretations such as IFRS 9 and IFRS 15.

In addition to the mandatory exemptions, IFRS 1 includes a variety of optional short and long-term exemptions that provide limited relief for first-time adopters, mainly in areas where the information needed to apply IFRS retrospectively might be particularly challenging to obtain. The optional long-term exemptions are available to all first-time adopters, regardless of their date of transition. The standard also provides short-term exemptions, which are temporarily available to users and address transition issues, related to the application of IFRS 7 and IFRS 9 to comparative information.

Although the exemptions can ease the burden of accounting for the initial adoption of new standards, the long-term exemptions do not impact the disclosure requirements of IFRS. As a result, companies may experience challenges in collecting new information and data for retrospective footnote disclosures.

2.1.2 When to apply IFRS 1

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

2.1.3 The opening IFRS balance sheet

The opening IFRS balance sheet is the starting point for all subsequent accounting under IFRS and is prepared at the date of transition, which is the beginning of the earliest period for which full comparative information is presented and disclosed in accordance with IFRS. For example, preparing IFRS financial statements for the three years ending December 31, 2017, would have a transition date of January 1, 2015. 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; and
- Be prepared and presented within an entity’s first IFRS financial statements.

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

2.1.4 Important takeaways

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

Consideration of data gaps—Preparation of the opening IFRS balance sheet and all the related footnote disclosures may require the calculation or collection of information that was not previously required under US GAAP. Companies should plan their transition and identify the differences between IFRS and US GAAP early so that all of the information required can be collected and verified in a timely manner. Likewise, companies should identify differences between local regulatory requirements and IFRS. This could impact the amount of information-gathering necessary. For example, certain information required by the SEC but not by IFRS (e.g., a summary of historical data) can still be presented, in part, under US GAAP but must be clearly labeled as such, and the nature of the main adjustments to comply with IFRS must be discussed. Other incremental information required by a regulator might need to be presented in accordance with IFRS. For example, the SEC in certain instances requires two years of comparative IFRS financial statements, whereas IFRS would require only one.

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

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

Chapter 3:
Revenue recognition

3.1 Revenue recognition

In May 2014, the FASB and IASB issued their long-awaited converged standards on revenue recognition, *Revenue from Contracts with Customers*. The revenue standards, as amended, are effective for calendar year-end companies in 2018 (2019 for non-public entities following US GAAP). The new model impacts revenue recognition under both US GAAP and IFRS, and, with the exception of a few discrete areas as summarized below, eliminates many of the existing differences in accounting for revenue between the two frameworks. Nearly all industries having contracts in the scope of the new standards are affected, and some will see pervasive changes. For further details of the new revenue standards, refer to PwC's accounting and financial reporting guide, *Revenue from contracts with customers*.

While we are aware that ASC 606 is not yet effective for nonpublic entities, the standard will be effective within a very short period of time from the release of this guide. Thus, no comparison between historical US GAAP (ASC 605) and IFRS 15 is provided.

Technical references

US GAAP

ASC 340-40, ASC 606, CON 5

IFRS

IFRS 15

Note

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

3.2 Collectibility threshold

One of the criteria that contracts must meet before an entity applies the revenue standards is that collectibility is probable. While US GAAP and IFRS both use the word "probable," there continues to be a difference in its definition between the two frameworks. Despite different thresholds, as noted in the basis for conclusions, in most situations, an entity will not enter into a contract with a customer if there is significant credit risk without also having protection to ensure it can collect the consideration to which it is entitled. Therefore, we believe there will be limited situations in which a contract would pass the "probable" threshold under IFRS but fail under US GAAP.

US GAAP	IFRS
Probable is defined in US GAAP as "likely to occur," which is generally considered a 75%-80% threshold. ASC 606 contains more guidance on accounting for nonrefundable consideration received if a contract fails the collectibility assessment.	IFRS defines probable as "more likely than not," which is greater than 50%.

3.3 Noncash consideration

Any noncash consideration received from a customer needs to be included in the transaction price. Noncash consideration is measured at fair value.

US GAAP	IFRS
ASC 606 was amended to specify that noncash consideration should be measured at contract inception and addresses how to apply the variable consideration guidance to contracts with noncash consideration. Noncash consideration paid to a customer is recognized as contra-revenue, unless it is payment for a distinct good or service. This is true even if such payments are in the form of share-based payments, which would be valued as noncash consideration following ASC 606.	IFRS 15 has not been amended to address noncash consideration, and as a result, approaches other than that required by ASC 606 may, where appropriate, be applied under IFRS 15. Given the lack of noncash consideration guidance in IFRS 15, these types of share-based payments would be valued following guidance in IFRS 2.

3.4 Licenses of intellectual property

The revenue standards include specific implementation guidance for accounting for the licenses of intellectual property. The overall framework is similar, but there are some differences between US GAAP and IFRS.

US GAAP	IFRS
ASC 606 specifies that an entity should consider the nature of its promise in granting a license (i.e., whether the license is a right to access or right to use intellectual property) when applying the general revenue recognition model to a combined performance obligation that includes a license and other goods or services.	IFRS 15 does not contain the same specific guidance. However, we expect entities to reach similar conclusions under both standards.

US GAAP	IFRS
ASC 606 defines two categories of intellectual property – functional and symbolic – for purposes of assessing whether a license is a right to access or a right to use intellectual property.	Under IFRS 15, the nature of a license is determined based on whether the entity's activities significantly change the intellectual property to which the customer has rights. We expect that the outcome of applying the two standards will be similar; however, there will be fact patterns for which outcomes could differ.
ASC 606 was amended to use different words to explain that a contract could contain multiple licenses that represent separate performance obligations, and that contractual restrictions of time, geography, or use within a single license are attributes of the license. ASC 606 also includes additional examples to illustrate these concepts.	IFRS 15 was not amended and does not include the same additional examples; however, the IASB included discussion in the basis for conclusions regarding how to account for restrictions within a license.
ASC 606 specifies that an entity cannot recognize revenue from the renewal of a license of intellectual property until the beginning of the renewal period.	IFRS 15 does not contain this specific guidance; therefore, entities applying IFRS might reach a different conclusion regarding when to recognize license renewals.

3.5 Practical expedients at transition and definition of completed contract

ASC 606 and IFRS 15 have some differences in practical expedients available to ease application of and transition to the revenue standards. Additionally, the two standards define a "completed contract" differently.

US GAAP	IFRS
ASC 606 provides a "use of hindsight" practical expedient intended to simplify the transition for contracts modified multiple times prior to the initial application of the standard. An entity applying the expedient will determine the transaction price of a contract at the date of initial application and perform a single, standalone selling price allocation (with the benefit of hindsight) to all of the satisfied and unsatisfied performance obligations in the contract from inception.	IFRS 15 provides a similar "use of hindsight" practical expedient; however, entities can choose to apply the expedient either at the beginning of the earliest period presented or at the date of initial application.

US GAAP	IFRS
ASC 606 permits entities using the modified retrospective transition approach to apply the new standard to either all contracts or only contracts that are not yet complete as of the date of initial application. The US GAAP standard defines a completed contract as a contract for which all (or substantially all) of the revenue was recognized in accordance with legacy revenue guidance before the date of initial application.	IFRS 15 permits entities to apply the new standard either to all contracts or only contracts that are not yet complete as of the date of initial application under the modified retrospective transition approach. The IFRS standard defines a completed contract as a contract for which the entity has transferred all of the goods or services identified in accordance with legacy revenue guidance. IFRS 15 also permits entities using the full retrospective transition approach to not restate contracts that are completed contracts as of the beginning of the earliest period presented.

3.6 Shipping and handling

Entities that sell products often deliver them via third-party shipping service providers. Management needs to consider whether the entity is the principal for the shipping service or is an agent arranging for the shipping service to be provided to the customer when control of the goods transfers at shipping point.

US GAAP	IFRS
ASC 606 allows entities to elect to account for shipping and handling activities that occur after the customer has obtained control of a good as a fulfillment cost rather than an additional promised service.	IFRS 15 does not provide this election. IFRS reporters (and US GAAP reporters that do not make this election) are required to consider whether shipping and handling services give rise to a separate performance obligation.

3.7 Presentation of taxes collected from customers

Entities often collect amounts from customers that must be remitted to a governmental agency. The revenue standards include a general principle that requires management to assess each type of tax, on a jurisdiction-by-jurisdiction basis, to conclude whether to net these amounts against revenue or to recognize them as an operating expense.

US GAAP	IFRS
ASC 606 allows entities to make an accounting policy election to present all taxes collected from customers on a net basis.	IFRS 15 does not provide this election. IFRS reporters (and US GAAP reporters that do not make this election) must evaluate each type of tax on a jurisdiction-by-jurisdiction basis to determine which amounts to exclude from revenue (as amounts collected on behalf of third parties) and which amounts to include.

3.8 Interim disclosure requirements

The general principles in the US GAAP and IFRS interim reporting standards apply to the revenue standard.

US GAAP	IFRS
The FASB amended its interim disclosure standard to require disaggregated revenue information, and added interim disclosure requirements relating to contract balances and remaining performance obligations (for public companies only).	The IASB amended its interim disclosure standard to require interim disaggregated revenue disclosures, but did not add additional disclosures.

3.9 Effective date

There are minor differences in the effective dates between ASC 606 and IFRS 15.

US GAAP	IFRS
ASC 606 is applicable for public business entities for annual reporting periods (including interim periods therein) beginning after December 15, 2017 (nonpublic entities can defer adoption for an extra year).	IFRS 15 is applicable for all entities (public and private) for annual periods beginning on or after January 1, 2018.

3.10 Impairment loss reversal

The revenue standards require entities to recognize an impairment loss on contract costs (that is, capitalized costs to acquire or fulfill a contract) when certain conditions are met.

US GAAP	IFRS
Consistent with other US GAAP impairment guidance, ASC 340-40, *Other Assets and Deferred Costs—Contracts with Customers,* does not permit entities to reverse impairment losses recognized on contract costs.	Consistent with other IFRS impairment guidance, IFRS 15 requires impairment losses to be reversed in certain circumstances similar to the existing standard on impairment of assets.

3.11 Relief for nonpublic entities

The US GAAP standard gives nonpublic entities relief from certain aspects of applying the revenue standard.

US GAAP	IFRS
ASC 606 gives nonpublic entities relief relating to certain disclosures, transition, and the effective date.	IFRS 15 applies to all IFRS reporters, public and nonpublic, except entities that apply IFRS for SMEs.

Chapter 4: Expense recognition—share-based payments

4.1 Expense recognition—share-based payments

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

The share-based payments guidance under IFRS is the same for awards to employees and nonemployees, while US GAAP guidance differs for 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 require faster expense recognition under IFRS than under US GAAP.

The deferred income tax accounting requirements for share-based payments under IFRS vary significantly from US GAAP. Companies can expect to experience greater period-to-period variability in their effective tax rate due to share-based payment awards under IFRS prior to the time of receiving the tax deduction. The extent of variability is linked to the movement of the issuing company's stock price. However, companies reporting under US GAAP could have greater volatility upon receiving the tax deduction as a result of the treatment of the difference between the estimated deferred taxes recognized and the actual tax benefit received.

Recent guidance

On June 20, 2018, the FASB issued Accounting Standards Update 2018-07, *Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting* (ASU 2018-07), which largely aligns the accounting for share-based payment awards issued to employees and nonemployees under US GAAP. Upon adoption, the existing employee guidance will apply to nonemployee share-based transactions, with the exception of specific guidance related to the attribution of compensation cost. The cost of nonemployee awards will continue to be recorded as if the grantor had paid cash for the goods or services rather than the explicit attribution requirements for employee awards. In addition, the contractual term can be used in lieu of an expected term in the valuation of nonemployee awards.

Upon adoption, US GAAP and IFRS for nonemployee awards will be more closely aligned. However, there will continue to be certain differences in the manner of recognition of compensation cost.

The new guidance is effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, including in interim periods, but no earlier than an entity's adoption date of the new revenue standard, ASC 606.

Technical references

US GAAP

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

IFRS

IFRS 2

Note

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

4.2 *Scope*

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

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

Upon adoption of ASU 2018-07, ASC 718, *Compensation—Stock Compensation*, will apply to awards granted to both employees and nonemployees, reducing the degree of differences between US GAAP and IFRS in this area.

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

US GAAP	IFRS
Upon adoption of ASU 2018-07, ASC 718, the existing employee guidance, will apply to nonemployee share-based transactions, with the exception of specific guidance related to the attribution of compensation cost and certain inputs used in the valuation of nonemployee awards.	for goods from vendors or nonemployee-type services are treated differently.

4.3 *Measurement of awards granted to employees by nonpublic companies*

IFRS does not permit alternatives in choosing a measurement method.

US GAAP	IFRS
Equity-classified The guidance allows nonpublic companies to measure stock-based compensation awards by using the fair value method (preferred) or the calculated-value method. **Liability-classified** The guidance allows nonpublic companies to make an accounting policy decision on how to measure stock-based compensation awards that are classified as liabilities. Such companies may use the fair value method, calculated-value method, or intrinsic-value method.	IFRS does not include such alternatives for nonpublic companies and requires the use of the fair-value method in all circumstances.

4.4 *Measurement of awards granted to nonemployees*

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

US GAAP	IFRS
ASC 505-50 states that the fair value of an equity instrument issued to a nonemployee should be measured as of the date at which either (1) a commitment for performance by the counterparty has been reached, or (2) the counterparty's performance is complete.	Transactions with parties other than employees (or those providing employee-type services) should be measured at the date(s) on which the goods are received or the date(s) on which the services are rendered. The guidance does not include a performance commitment concept.

US GAAP	IFRS
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. Upon adoption of ASU 2018-07, nonemployee awards will be measured in the same manner as employee awards under ASC 718, at the fair value of the equity instrument on the grant date.	Nonemployee transactions are generally measured at the fair value of the goods or services received, since it is presumed that it will be possible to reliably measure the fair value of the consideration received. If an entity is not able to reliably measure the fair value of the goods or services received (i.e., if the presumption is overcome), the fair value of the award should be measured indirectly by reference to the fair value of the equity instrument granted as consideration. When the presumption is not overcome, an entity is also required to account for any unidentifiable goods or services received or to be received. This would be the case if the fair value of the equity instruments granted exceeds the fair value of the identifiable goods or services received and to be received.

4.5 *Classification of certain instruments as liabilities or equity*

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

US GAAP	IFRS
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, *Distinguishing Liabilities from Equity*, when assessing classification of an award. In certain situations, puttable shares may be classified as equity awards, as long as the recipient bears the risks and rewards normally associated with equity share ownership for a reasonable period of time (defined as 6 months).	Under IFRS, equity/liability classification for share-based awards is determined wholly on whether the awards are ultimately settled in equity or cash. Puttable shares are always classified as liabilities, even if the put cannot be exercised for an extended period of time. 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.

US GAAP	IFRS
Liability classification is required when an award is based on a fixed monetary amount settled in a variable number of shares.	

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

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

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

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

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

US GAAP	IFRS
A performance target that may be met after the requisite service period is complete is a performance vesting condition. The fair value of the award should not incorporate the probability of a performance condition vesting, but rather should be recognized only if the performance condition is probable of being achieved.	A performance target that may be met after the requisite service period is a nonvesting condition and is reflected in the measurement of the grant date fair value of an award.

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

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

US GAAP	IFRS
The guidance provides specific definitions of service-inception date, grant date, and requisite service, which, when applied, will determine the beginning and end of the period over which compensation cost will be recognized. Additionally, the grant date definition includes a requirement that the employee begins to be affected by the risks and rewards of equity ownership at that date.	IFRS does not include the same detailed definitions. The difference in the grant date definition is that IFRS does not require the employee to begin to be affected by the risks and rewards of equity ownership to have a grant date. Furthermore, the IFRS definition of the start of the service period does not have the same explicit requirements as the US GAAP definition of service inception date, which could result in earlier recognition of compensation cost under IFRS when the grant date is delayed.

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

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

US GAAP	IFRS
Companies are permitted to make an accounting policy election regarding the attribution method for awards with service-only conditions and graded-vesting features. The valuation method that the company uses (single award or multiple tranches of individual awards) is not required to align with the choice in attribution method used (straight-line or accelerated tranche by tranche). For awards with graded vesting and performance or market conditions, the accelerated graded-vesting attribution approach is required.	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, which would accelerate the expense recognition.

4.10 Attribution—awards to nonemployees

Compensation cost for nonemployee awards is recognized over the service period for IFRS, whereas for US GAAP it is recognized in the same period and manner as if cash had been paid in exchange for the goods or services, which may or may not be the same pattern.

US GAAP	IFRS
Under US GAAP, compensation cost for nonemployee awards is recognized as if cash had been paid.	Under IFRS, compensation cost is recognized over the service period for all awards.

4.11 Certain aspects of modification accounting

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

US GAAP	IFRS
An improbable to probable "Type III" modification can result in recognition of compensation cost that is more or less than the fair value of the award on the original grant date. When a modification makes it probable that a vesting condition will be achieved, and the company does not expect the original vesting conditions to be achieved, a new measurement date is established. The grant-date fair value of the award would not be a floor for the amount of compensation cost recognized.	Under IFRS, if the vesting conditions of an award are modified in a manner that is beneficial to the employee, this would be accounted for as a change in only the number of awards that are expected to vest (from zero to a new amount), and the award's full original grant-date fair value would be recognized for the awards over the remainder of the service period. That result is the same as if the modified vesting condition had been in effect on the grant date.

4.12 Accounting for forfeitures

Attribution of compensation costs may differ for entities that elect a policy under US GAAP to account for forfeitures when they occur.

US GAAP	IFRS
Companies make an entity-wide accounting policy election to account for award forfeitures as they occur or by estimating expected forfeitures as compensation cost is recognized.	IFRS does not allow a similar policy election; forfeitures must be estimated.

4.13 Derived service period

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

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

4.14 Tax withholding arrangements—impact to classification

There could be a difference in award classification if the limit for tax withholding is exceeded.

US GAAP	IFRS
An award containing a net settled tax withholding clause could be equity-classified as long as the arrangement limits tax withholding to the maximum individual statutory tax rate in a given jurisdiction. If tax withholding is permitted at some higher rate, then the entire award (not solely the excess) would be classified as a liability.	IFRS has an exception similar to US GAAP. However, there will still be a difference if the withholding limit is exceeded, as only the excess number of equity instruments that can be withheld would be separated and accounted for as a cash-settled share-based payment under IFRS.

4.15 Accounting for income tax effects

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

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

US GAAP	IFRS
The US GAAP model for accounting for income taxes requires companies to record deferred taxes as compensation cost is recognized, as long as a tax deduction is allowed for that particular type of instrument. The measurement of the deferred tax asset is based on the amount of compensation cost recognized for book purposes. Changes in the stock price do not impact the deferred tax asset or result in any adjustments prior to settlement or expiration. Upon settlement or expiration, excess tax benefits and tax deficiencies (the difference between the recorded deferred tax asset and the tax benefit of the actual tax deduction)are recognized within income tax expense.	The measurement of the deferred tax asset in each period is based on an estimate of the future tax deduction, if any, for the award measured at the end of each reporting period (based on the current stock price if the tax deduction is based on the future stock price). When the expected tax benefits from equity awards exceed the recorded cumulative recognized expense multiplied by the tax rate, the tax benefit up to the amount of the tax effect of the cumulative book compensation expense is recorded in the income statement; the excess is recorded in equity. When the expected tax benefit is less than the tax effect of the cumulative amount of recognized expense, the entire tax benefit is recorded in the income statement.

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

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

US GAAP	IFRS
A liability for employee payroll taxes on employee stock-based compensation should be recognized on the date of the event triggering the measurement and payment of the tax (generally the exercise date for a nonqualified option or the vesting date for a restricted stock award).	Social charges, such as payroll taxes levied on the employer in connection with stock-based compensation plans, are expensed in the income statement when the related share-based compensation expense is recognized. The guidance in IFRS for cash-settled share-based payments would be

US GAAP	IFRS
	followed in recognizing an expense for such charges.

4.17 Valuation—Guidance on expected volatility and expected term

Companies that report under US GAAP may place greater reliance on implied short-term volatility to estimate volatility. Companies that report under IFRS do not have the option of using the "simplified method" of calculating expected term provided by SAB Topic 14 and ASC 718. As a result, there could be differences in estimated fair values.

US GAAP	IFRS
SAB Topic 14 includes guidance on expected volatility and expected term, which includes (1) guidelines for reliance on implied volatility and (2) the "simplified method" for calculating the expected term for qualifying awards. Nonpublic entities may use a practical expedient for determining the expected term similar to the simplified method.	IFRS does not include comparable guidance.

4.18 Employee stock purchase plans (ESPP)

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

US GAAP	IFRS
ESPPs are compensatory if terms of the plan: □ Either (1) are more favorable than those available to all shareholders, or (2) include a discount from the market price that exceeds the percentage of stock issuance costs avoided (discount of 5 percent or less is a safe harbor); □ Do not allow all eligible employees to participate on an equitable basis; or □ Include any option features (e.g., look-backs). In practice, most ESPPs are compensatory; however, plans that do not meet any of the above criteria are non-compensatory.	ESPPs are always compensatory and treated like any other equity-settled share-based payment arrangement. IFRS does not allow any safe-harbor discount for ESPPs.

4.19 Group share-based payment transactions

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

US GAAP	IFRS
Generally, push-down accounting of the expense recognized at the parent level would apply to the separate financial statements of the subsidiary. For liability-classified awards settled by the parent company, the mark to market expense impact of these awards should be pushed down to the subsidiary's books each period, generally as a capital contribution from the parent. However, liability accounting at the subsidiary may be appropriate, depending on the facts and circumstances.	For the separate financial statements of the subsidiary, equity or liability classification is determined based on the nature of the obligation each entity has in settling the awards, even if the award is settled in parent equity. The accounting for a group cash-settled share-based payment transaction in the separate financial statements of the entity receiving the related goods or services when that entity has no obligation to settle the transaction would be as an equity-settled share-based payment. The group entity settling the transaction would account for the share-based payment as cash-settled. The accounting for a group equity-settled share-based payment transaction is dependent on which entity has the obligation to settle the award. For the entity that settles the obligation, a requirement to deliver anything other than its own equity instruments (equity instruments of a subsidiary would be "own equity" but equity instruments of a parent would not) would result in cash-settled (liability) treatment. Therefore, a subsidiary that is obligated to issue its parent's equity would treat the arrangement as a liability, even though in the consolidated financial statements the arrangement would be accounted for as an equity-settled share-based payment. Conversely, if the parent is obligated to issue the shares directly to employees of the subsidiary, then the arrangement should be accounted for as equity-settled in both the consolidated financial statements and the separate standalone financial statements of the subsidiary.

Chapter 5: Expense recognition—employee benefits

5.1 Expense recognition—employee benefits

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

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

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

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

Under IFRS, companies have flexibility to present components of net benefit cost within different line items on the income statement. Components recognized in determining net income (i.e., service and finance costs, but not actuarial gains and losses) may be presented as (1) a single net amount or (2) separately displayed. US GAAP prescribes the presentation of the various components of pension cost both prior to and after the adoption of ASU 2017-07.

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

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

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

Recent guidance

In March 2017, the FASB issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. Under current US GAAP, the net benefit cost for retirement plans comprises several different components (e.g., service cost, interest cost, expected return on assets, and the amortization of various deferred items), but is required to be treated and reported as a single aggregate amount of compensation cost.

Under the new guidance, sponsors of benefit plans are required to:

- present service cost in the same line item or items as other current employee compensation costs and present the remaining components of net benefit cost separately in one or more line items and outside of income from operations (if that subtotal is presented), and

- limit the components of net benefit cost eligible to be capitalized (for example, as a cost of inventory or self-constructed assets) to service cost.

The new guidance does not change any other recognition and measurement provisions of current retirement benefits accounting. The amendments are effective for annual and interim reporting periods beginning after December 15, 2017 for public business entities and for annual reporting periods beginning after December 15, 2018 and interim periods within annual periods beginning after December 15, 2019 for other entities. These amendments are to be applied retrospectively for the presentation of service cost and other components of net benefit costs, and prospectively for the capitalization of service cost.

Technical references

US GAAP

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

IFRS

IAS 19, IAS 37, IFRS 13, IFRIC 14

Note

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

5.2 Expense recognition—gains/losses

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

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

US GAAP	IFRS
The guidance permits companies to either (1) record 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).	Remeasurements are recognized immediately in OCI. There is no option to recognize gains/losses in profit or loss. In addition, the "corridor and spreading" option—which allows delayed recognition of gains and losses—is prohibited.
Whether gains/losses are recognized immediately or amortized in a systematic fashion, they are ultimately recorded within the statement of operations as components of net periodic benefit cost.	Once recognized in OCI, gains/losses are not subsequently recorded within profit or loss. The standard does not require that the amounts recognized in OCI be immediately taken to retained earnings; they may remain in a specific reserve or 'other' reserves within equity.

5.3 Expense recognition—prior service costs and credits

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

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

US GAAP	IFRS
Prior service cost (whether for vested or unvested benefits) should be recognized in other comprehensive income at the date of the adoption of the plan amendment and then amortized into income over one of the following: □ The participants' remaining years of service (for pension plans, except where all or almost all plan participants are inactive) □ The participants' remaining years of service to full eligibility date (for other postretirement benefit plans, except where all or almost all plan participants are inactive) □ The participants' life expectancy (for plans that have all or almost all inactive participants) Negative prior service cost should be recognized as a prior service credit in other comprehensive income and used first to reduce any remaining positive prior service cost included in accumulated other comprehensive income. Any remaining prior service credits should then be amortized over the same periods as described above.	Recognition of all past service costs is required at the earlier of when a plan amendment occurs or when the entity recognizes related restructuring costs (in the event of a curtailment). Unvested past service cost may not be spread over a future service period. Curtailments that reduce benefits are not disclosed separately, but are considered as part of the past service costs.

5.4 Expense recognition—expected return on plan assets

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

US GAAP	IFRS
Expected return is based on an expected rate of return on plan assets. Plan assets should be measured at fair value for balance sheet recognition and for disclosure purposes. However, for purposes of determining the expected return on plan assets and the related accounting for gains and losses, plan assets can be measured by using either fair value or a calculated value that recognizes changes in fair value over a period of not more than five years.	Net interest cost or income is calculated by applying the discount rate (as described below) to the defined benefit liability or asset of the plan. The defined benefit asset or liability is the surplus or deficit (i.e., the net amount of the defined benefit obligation less plan assets) which is recognized on the balance sheet after considering the asset ceiling test. Plan assets should always be measured at fair value.

5.5 Income statement classification

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

US GAAP	IFRS
Prior to adoption of ASU 2017-07, all components of net benefit cost must be aggregated and presented as a net amount in the income statement. Although it is appropriate to allocate a portion of net benefit cost to different line items (such as cost of goods sold or general and administrative expenses, based on which line items other employee costs are included), disaggregating the components of net benefit cost is not permitted. Upon adoption of ASU 2017-07, service cost will be presented in the same line item or items as other current employee compensation costs (and included within income from operations, if that subtotal is presented). The remaining components of net benefit cost must be presented separately in one or more line items and outside of income from operations (if that subtotal is presented).	Employers have flexibility to either (1) present all components recognized in determining net income (i.e., service and net interest cost but not gains and losses) as a single net amount (similar to US GAAP) or (2) present those components separately within the income statement.

5.6 Capitalization of employee benefit costs

IFRS does not specify which components of net benefit costs are eligible for capitalization. Both before and after adoption of ASU 2017-07, US GAAP specifies which components of net benefit cost are eligible to be capitalized (for example, as a cost of inventory or self-constructed assets).

US GAAP	IFRS
Prior to adoption of ASU 2017-07, the net benefit cost is considered one aggregate amount. When it is appropriate to capitalize costs (for example, as a cost of inventory or a self-constructed asset), the entire net benefit cost applicable to the pertinent employees for the period is capitalized. Upon adoption of ASU 2017-07, only service cost will be eligible to be capitalized.	IFRS does not specify which components of net benefit costs are eligible for capitalization. Therefore, there could be a difference in the components of costs capitalized.

5.7 Measurement date and frequency

IFRS requires interim remeasurements in more circumstances than US GAAP and does not provide for a practical expedient to use a measurement date other than the end of the fiscal year or interim period.

US GAAP	IFRS
The measurement of plan assets and benefit obligations is required as of the employer's fiscal year-end balance sheet date, unless the plan is sponsored by a consolidated subsidiary or equity method investee with a different fiscal period. Interim remeasurements generally occur only if there is a significant event, such as a plan amendment, curtailment, or settlement. US GAAP permits a company to elect an accounting policy to use the calendar month-end closest to the fiscal year-end for measuring plan assets and obligations. The funded status would be adjusted for contributions and other significant events that occur between the alternative measurement date and the fiscal year-end. A similar practical expedient can also be used for interim remeasurements for significant events that occur on dates other than calendar month-end dates.	Employers typically remeasure the benefit obligation and plan assets at each interim period to determine the balance sheet and OCI component, but that will not lead to a change in service cost or interest cost (unless there was a plan amendment, curtailment, or settlement). IFRS does not provide for a practical expedient to use a measurement date other than the end of the fiscal year or interim period.

5.8 Substantive commitment to provide pension or other postretirement benefits

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

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

5.9 Defined benefit versus defined contribution plan classification

Certain plans currently accounted for as defined benefit plans under US GAAP may be accounted for as defined contribution plans under IFRS and vice versa. Classification differences would result in differences to expense recognition as well as to balance sheet presentation.

US GAAP	IFRS
A defined contribution plan is any arrangement that provides benefits in return for services rendered, establishes an individual account for each participant, and is based on contributions by the employer or employee to the individual's account and the related investment experience. Multiemployer plans are treated similar to defined contribution plans. A pension plan to which two or more unrelated employers contribute is generally considered to be a multiemployer plan.	An arrangement qualifies as a defined contribution plan if an employer's legal or constructive obligation is limited to the amount it contributes to a separate entity (generally, a fund or an insurance company). There is no requirement for individual participant accounts. 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

US GAAP	IFRS
A common characteristic of a multiemployer plan is that there is commingling of assets contributed by the participating employers. Subsidiaries whose employees participate in a plan sponsored by a parent company also follow multiemployer plan accounting in their separate stand-alone financial statements.	should record its proportionate share of all relevant amounts in the plan. However, defined benefit accounting may not be required if the company cannot obtain sufficient information. Subsidiaries that participate in parent-sponsored plans are not multiemployer plans. The accounting by the subsidiary will depend on the specific facts and circumstances.

5.10 Curtailments

A number of differences exist in relation to how curtailments are defined and how both curtailment gains and losses are calculated (in light of the differences in the underlying accounting for gains/losses and prior service cost).

Additionally, when a curtailment is caused by employee terminations, the timing of recognizing a loss differs.

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

US GAAP	IFRS
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. Curtailments resulting from employee terminations are recognized when the curtailment is probable and reasonably estimable for losses, but when the termination occurs for gains. Curtailments resulting from plan terminations or amendments are recognized when realized (i.e., once the plan amendment is adopted). The guidance requires certain offsets of unamortized gains/losses in a curtailment but does not permit pro rata recognition of the remaining unamortized gains/losses.	The definition of a curtailment is limited to "a significant reduction by the entity in the number of employees covered by a plan." Curtailment gains and losses should be recorded when the curtailment occurs. IFRS requires the gain or loss related to plan amendments, curtailments, and termination benefits that occur in connection with a restructuring to be recognized when the related restructuring cost is recognized, if that is earlier than the normal IAS 19 recognition date.

5.11 Settlements

Because of differences in the definition of a settlement and an accounting policy choice that is available under US GAAP but not IFRS, the frequency of accounting for transactions as a settlement may differ between US GAAP and IFRS.

US GAAP	IFRS
A settlement gain or loss normally is recognized in earnings when the settlement occurs. Lump sum payments are considered a form of settlement. However, an employer may elect an accounting policy whereby settlement gain or loss recognition is not required if the cost of all settlements within a plan year does not exceed the sum of the service and interest cost components of net benefit cost for that period.	A settlement gain or loss is recognized when the settlement occurs. If the settlements are due to lump sum elections by employees as part of the normal operating procedures of the plan, settlement accounting does not apply.

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

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

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

US GAAP	IFRS
Under US GAAP, a settlement gain/loss reflects the pro-rata recognition of previously unamortized gains or losses on the entire plan.	Under IFRS, a settlement gain or loss generally reflects the difference between the settlement price and the actuarial valuation of the obligation that has been settled.

5.12 Asset ceiling

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

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

5.13 Measurement of defined benefit obligation when both employers and employees contribute

The accounting for plans where an employer's exposure may be limited by employee contributions may differ.

US GAAP	IFRS
The measurement of plan obligations generally does not reflect a reduction when the employer's exposure is limited or when the employer can increase contributions from employees from current levels to help meet a deficit. Under US GAAP, employee contributions typically reduce service cost in the period of contribution.	The measurement of plan obligations where risks associated with the benefit are shared between employers and employees should reflect the substance of the arrangements where the employer's exposure is limited or where the employer can increase contributions from employees to help meet a deficit. IFRS allows contributions that are linked to service, and do not vary with the length of employee service, to be deducted from the cost of benefits earned in the period that the service is provided rather than spreading them over the employees' working lives.

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

5.14 Plan asset valuation

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

US GAAP	IFRS
Plan assets should be measured at fair value less cost to sell.	Plan assets should be measured at fair value, which is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
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.	Under IFRS, the fair value of insurance policies should be estimated using, for example, a discounted cash flow model with a discount rate that reflects the associated risk and the expected maturity date or expected disposal date of the assets. Qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan are measured at the present value of the related obligations. Under IFRS, the use of the cash surrender value is generally inappropriate.

5.15 Discount rates

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

US GAAP	IFRS
The discount rate is based on the rate at which the benefit obligation could be effectively settled. Companies may look to the rate of return on high-quality, fixed-income investments with similar durations to those of the benefit obligation to establish the discount rate. The SEC has stated that the term "high quality" means that a bond has received one of the two highest ratings given by a recognized ratings agency (e.g., Aa or higher by Moody's).	The 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.
The guidance does not specifically address circumstances in which a deep market in high-quality corporate bonds does not exist (such as in certain foreign jurisdictions). However, in practice, a hypothetical high-quality corporate bond yield is determined based on a spread added to representative government bond yields.	Where a deep market of high-quality corporate bonds does not exist, companies are required to look to the yield on government bonds when selecting the discount rate. A synthetically constructed bond yield designed to mimic a high-quality corporate bond may not be used to determine the discount rate.

5.16 Accounting for termination indemnities

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

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

5.17 Deferred compensation arrangements—employment benefits

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

US GAAP	IFRS
Individual deferred compensation arrangements that are not considered, in the aggregate, to be a "plan" do not follow the pension accounting standard. Deferred compensation liabilities are measured at the present value of the benefits expected to be provided in exchange for an employee's service to date. If expected benefits are attributed to more than one individual year of service, the costs should be accrued in a systematic and rational manner over the relevant years of service in which the employee earns the right to the benefit (to the full eligibility date). When a deferred compensation award includes a performance condition, it should be recognized when achievement is probable. A number of acceptable attribution models are used in practice, including the sinking-fund model and the straight-line model. Gains and losses are recognized immediately in the income statement.	IFRS does not distinguish between individual senior executive employment arrangements and a "plan" in the way that US GAAP does. Whether a postemployment benefit is provided for one employee or all employees, the accounting is the same under IFRS. Deferred compensation accounting relates to benefits that are normally paid while in service but more than 12 months after the end of the accounting period in which they are earned. The liability associated with deferred compensation contracts classified as other long-term benefits under IAS 19 is measured by the projected-unit-credit method (equivalent to postemployment-defined benefits). All prior service costs and gains and losses are recognized immediately in profit or loss. When a deferred compensation award includes a performance condition, the probability of achieving the condition is incorporated into the measurement of the award.

5.18 Accounting for taxes

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

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

5.19 Recent/proposed guidance

5.19.1 IASB amendment - Remeasurements upon a significant event

On February 7, 2018, the IASB issued amendments related to the remeasurement of the net defined benefit liability (asset) in the event of plan amendments, curtailments, and settlements. The amendments require an entity to:

- use updated assumptions to determine current service cost and net interest for the remainder of the period after a plan amendment, curtailment, or settlement; and

- recognize in profit or loss as part of past service cost, or as a gain or loss on settlement, any reduction in a surplus, even if that surplus was not previously recognized because it would have exceeded the asset ceiling. In other words, the gain or loss should be determined without considering the effect of the asset ceiling.

The amendments are to be applied prospectively to plan amendments, settlements, or curtailments that occur after the beginning of the first annual reporting period beginning on or after January 1, 2019. Early application is permitted. Upon adoption, we believe US GAAP and IFRS accounting will be consistent regarding the determination of benefit cost for the remainder of the period, but the current US GAAP and IFRS difference with regard to the asset ceiling described in SD 5.12 will remain.

5.19.2 IASB exposure draft - Availability of refunds from a defined benefit plan managed by an independent trustee

The IASB issued a proposed amendment to clarify whether a trustee's power can affect a company's unconditional right to a refund and restrict the recognition of an asset. The proposal was intended to clarify that a surplus that a company recognizes as an asset on the basis of a future refund should not include amounts that another party can unilaterally use for other purposes, such as to enhance benefits for participants without the company's consent. Additionally, it would also clarify that a company cannot recognize an asset on the basis of gradual settlement of plan liabilities if other parties can wind up the plan without the company's consent. It also distinguishes between the power to make investment decisions and the power to wind up a plan or the power to use a surplus to enhance benefits. Also, when determining the availability of a refund or reduction in future contributions, a company should consider statutory requirements, contractual agreements, and any constructive obligation.

Based on the significant concerns raised during the comment period on the proposal, the IASB plans to perform further work on the possible effects of the amendments before issuing a final standard. If the proposed amendment is adopted, the current US GAAP and IFRS difference with regard to the asset ceiling described in SD 5.12 will remain.

Chapter 6: Assets—nonfinancial assets

6.1 Assets—nonfinancial assets

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

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

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

As further discussed in SD 6.24, Recent/proposed guidance, the FASB and IASB issued their new lease standards in early 2016. The changes are expected to impact almost all entities and significantly changes lease accounting for lessees.

Technical references

US GAAP

ASC 205, ASC 250, ASC 330, ASC 360-10, ASC 360-20, ASC 410-20, ASC 410-20-25, ASC 835-20, ASC 840, ASC 840-40, ASC 845, ASC 853, ASC 908-30, ASC 976

IFRS

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

Note

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

Long-lived assets

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

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

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

US GAAP	IFRS
US GAAP requires a two-step impairment test and measurement model as follows: **Step 1**—The carrying amount is first compared with the undiscounted cash flows. If the carrying amount is lower than the undiscounted cash flows, no impairment loss is recognized, although it might be necessary to review depreciation (or amortization) estimates and methods for the related asset. **Step 2**—If the carrying amount is higher than the undiscounted cash flows, an impairment loss is measured as the difference between the carrying amount and fair value. Fair value is defined as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date (an exit price). Fair value should consider the impact of the related current and deferred tax balances and should be based on the assumptions of market participants and not those of the reporting entity.	IFRS uses a one-step impairment test. The carrying amount of an asset is compared with the recoverable amount. The recoverable amount is the higher of (1) the asset's fair value less costs of disposal or (2) the asset's value in use. 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. Fair value less costs of disposal represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date less costs of disposal. Current and deferred tax balances, with the exception of unused tax losses, and their associated cash flows, are taken into account when calculating fair value less costs of disposal, if a market participant would also include them. Value in use represents entity-specific or CGU-specific future pretax cash flows discounted to present value by using a pretax, market-determined rate that reflects the current assessment of the time value of money and the risks specific to the asset or CGU for which the cash flow estimates have not been adjusted.
Changes in market interest rates are not considered impairment indicators.	Changes in market interest rates can potentially trigger impairment and, hence, are impairment indicators.

US GAAP	IFRS
The reversal of impairments is prohibited.	If certain criteria are met, the reversal of impairments, other than those of goodwill, is permitted. For noncurrent, nonfinancial assets (excluding investment properties and biological assets) carried at fair value instead of depreciated cost, impairment losses related to the revaluation are recorded in other comprehensive income to the extent of prior upward revaluations, with any further losses being reflected in the income statement.

6.2.1 *Impairment of long-lived assets—cash flow estimates*

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

US GAAP	IFRS
Future cash flow estimates used in an impairment analysis should include: □ All cash inflows expected from the use of the long-lived asset (asset group) over its remaining useful life, based on its existing service potential □ Any cash outflows necessary to obtain those cash inflows, including future expenditures to maintain (but not improve) the long-lived asset (asset group) □ Cash flows associated with the eventual disposition, including selling costs, of the long-lived asset (asset group) US GAAP specifies that the remaining useful life of a group of assets over which cash flows may be considered should be based on the remaining useful life of the "primary" asset of the group.	Cash flow estimates used to calculate value in use under IFRS should include: □ Cash inflows from the continuing use of the asset or the activities of the CGU □ Cash outflows necessarily incurred to generate the cash inflows from continuing use of the asset or CGU (including cash outflows to prepare the asset for use) and that are directly attributable to the asset or CGU □ Cash outflows that are indirectly attributable (such as those relating to central overheads) but that can be allocated on a reasonable and consistent basis to the asset or CGU □ Cash flows expected to be received (or paid) for the

US GAAP	IFRS
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.	disposal of assets or CGUs at the end of their useful lives □ Cash outflows to maintain the operating capacity of existing assets, including, for example, cash flows for day-to-day servicing Cash flow projections used to measure value in use should be based on reasonable and supportable assumptions of economic conditions that will exist over the asset's remaining useful life. Cash flows expected to arise from future restructurings or from improving or enhancing the asset's performance should be excluded. Cash flows are from the perspective of the entity itself. Projections based on management's budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified. Estimates of cash flow projections beyond the period covered by the most recent budgets/forecasts should extrapolate the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate shall not exceed the long-term average growth rate for the products, industries, or country in which the entity operates, or for the market in which the asset is used unless a higher rate can be justified.

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

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

US GAAP	IFRS
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.	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. If an active market (as defined by IFRS 13) exists for the output produced by an asset or group of assets, that asset or group should be identified as a CGU, even if some or all of the output is used internally.
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.	Unlike US GAAP, liabilities are generally excluded from the carrying amount of the CGU. However, there may be circumstances when it is not possible to determine the recoverable amount without considering a recognized liability. In such cases, the liability should be included in the CGU.

6.3 *Impairment of long-lived assets held for sale—general*

US GAAP and IFRS criteria are similar in determining when long-lived assets qualify for held-for-sale classification. Under both US GAAP and IFRS, long-lived assets held for sale should be measured at the lower of their carrying amount or fair value less cost to sell. However, differences could exist in what is included in the disposal group between US GAAP and IFRS.

US GAAP	IFRS
US GAAP requires a disposal group to include items associated with accumulated other comprehensive income. This includes any cumulative translation adjustment, which is considered part of the carrying amount of the disposal group [ASC 830-30-45-13].	Under IFRS 5, a disposal group generally should not include amounts that have been recognized in other comprehensive income and accumulated in equity for the purpose of calculating impairment. Other comprehensive balances that recycle should only be recognized in the income statement when the disposal group is sold.

6.4 Carrying basis

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

US GAAP	IFRS
US GAAP generally utilizes historical cost and prohibits revaluations except for certain categories of financial instruments, which are carried at fair value.	Historical cost is the primary basis of accounting. However, IFRS permits the revaluation to fair value of some intangible assets; property, plant, and equipment; and investment property and inventories in certain industries (e.g., commodity broker/dealer). IFRS also requires that biological assets (except bearer plants) be reported at fair value.

Intangible assets[1]

6.5 Internally developed intangibles

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

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

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

[1] Excluding goodwill, which is addressed in SD 13, *Business Combinations*.

US GAAP	IFRS
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, including fees paid in a cloud computing arrangement. 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.	□ The technical feasibility of completing the intangible asset □ The intention to complete the intangible asset □ The ability to use or sell the intangible asset □ How the intangible asset will generate probable future economic benefits (the entity should demonstrate the existence of a market or, if for internal use, the usefulness of the intangible asset) □ The availability of adequate resources to complete the development and to use or sell it □ The ability to measure reliably the expenditure attributable to the intangible asset during its development Expenditures on internally generated brands, mastheads, publishing titles, customer lists, and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognized as intangible assets. Development costs initially recognized as expenses cannot be capitalized in a subsequent period.

6.6 Acquired research and development assets

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

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

US GAAP	IFRS
Research and development intangible assets acquired in an asset acquisition are capitalized only if they have an alternative future use. For an asset to have alternative future use, it must be reasonably expected (greater than a 50% chance) that an entity will achieve economic benefit from such alternative	The price paid reflects expectations about the probability that the future economic benefits of the asset will flow to the entity. The probability recognition criterion is always assumed to be met for separately acquired intangible assets.

use and further development is not needed at the acquisition date to use the asset.	

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

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

US GAAP	IFRS
Separately recorded indefinite-lived intangible assets, whether acquired or internally developed, shall be combined into a single unit of accounting for purposes of testing impairment if they are operated as a single asset and, as such, are essentially inseparable from one another. Indefinite-lived intangible assets may be combined only with other indefinite-lived intangible assets; they may not be tested in combination with goodwill or with a finite-lived asset. US GAAP literature provides a number of indicators that an entity should consider in making a determination of whether to combine intangible assets.	As most indefinite-lived intangible assets (e.g., brand name) do not generate cash flows independently of other assets, it might not be possible to calculate the value in use for such an asset on a standalone basis. Therefore, it is necessary to determine the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets, (known as a CGU), in order to perform the test.

6.7.1 Indefinite-lived intangible assets—impairment testing

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

US GAAP	IFRS
ASC 350, *Intangibles-Goodwill and Other*, requires an indefinite-lived intangible asset to be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. An entity may first assess qualitative factors to determine if a quantitative	IAS 36, *Impairment of Assets*, requires an entity to test an indefinite-lived intangible asset for impairment annually. It also requires an impairment test in between annual tests whenever there is an indication of impairment. IAS 36 allows an entity to carry forward the most recent detailed calculation of an asset's recoverable amount when

US GAAP	IFRS
impairment test is necessary. Further testing is only required if the entity determines, based on the qualitative assessment, that it is more likely than not that an indefinite-lived intangible asset's fair value is less than its carrying amount. Otherwise, no further impairment testing is required. An entity can choose to perform the qualitative assessment on none, some, or all of its indefinite lived intangible assets. An entity can bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to the quantitative impairment test and then choose to perform the qualitative assessment in any subsequent period.	performing its current period impairment test, provided the following criteria are met: (i) the asset is assessed for impairment as a single asset (that is it generates cash flows independently of other assets and is not reviewed for impairment as part of a CGU); (ii) the most recent impairment test resulted in an amount that exceeded the asset's carrying amount by a substantial margin; and (iii) an analysis of events that have occurred and changes in circumstances since the last review indicate that the likelihood that the asset's current recoverable amount would be less than its carrying amount is remote.

6.7.2 *Indefinite-lived intangible assets—impairment charge measurement*

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

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

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

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

US GAAP	IFRS
When assessing potential impairment, at least at each balance sheet date, the unamortized capitalized costs for each product must be compared with the net	Under IFRS, intangible assets not yet available for use are tested annually for impairment because they are not being amortized.

US GAAP	IFRS
realizable value of the software product. The amount by which the unamortized capitalized costs of a software product exceed the net realizable value of that asset shall be written off. The net realizable value is the estimated future gross revenue from that product reduced by the estimated future costs of completing and disposing of that product. The net realizable value calculation does not utilize discounted cash flows.	Once such assets are brought into use, amortization commences and the assets are tested for impairment when there is an impairment indicator. The impairment is calculated by comparing the recoverable amount (the higher of either (1) fair value less costs of disposal or (2) value in use) to the carrying amount. The value in use calculation uses the present value of future cash flows.

6.9 Advertising costs

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

US GAAP	IFRS
The costs of other than direct response advertising should be either expensed as incurred or deferred and then expensed the first time the advertising takes place. This is an accounting policy decision and should be applied consistently to similar types of advertising activities. Certain direct response advertising costs are eligible for capitalization if, among other requirements, probable future economic benefits exist. Direct response advertising costs that have been capitalized are then amortized over the period of future benefits (subject to impairment considerations).	Costs of advertising are expensed as incurred. The guidance does not provide for deferrals until the first time the advertising takes place, nor is there an exception related to the capitalization of direct response advertising costs or programs. Prepayment for advertising may be recorded as an asset only when payment for the goods or services is made in advance of the entity's having the right to access the goods or receive the services.
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.	The cost of materials, such as sales brochures and catalogues, is recognized as an expense when the entity has the right to access those goods.

Property, plant and equipment

6.10 Depreciation

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

US GAAP	IFRS
US GAAP generally does not require the component approach for depreciation. 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. While US GAAP has an explicit requirement to evaluate the remaining useful life of intangible assets each reporting period, this requirement is not explicit for tangible assets.	IFRS requires that separate significant components of property, plant, and equipment with different economic lives be recorded and depreciated separately. The guidance includes a requirement to review residual values and useful lives at each balance sheet date.

6.11 Overhaul costs

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

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

6.12 Asset retirement obligations

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

US GAAP	IFRS
Asset retirement obligations (AROs) are recorded at fair value and are based upon the legal obligation that arises as a result of the acquisition, construction, or development of a long-lived asset. The use of a credit-adjusted, risk-free rate is required for discounting purposes when an expected present-value technique is used for estimating the fair value of the liability. A fair value measurement should include a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows. The guidance also requires an entity to measure changes in the liability for an ARO due to passage of time by applying an interest method of allocation to the amount of the liability at the beginning of the period. The interest rate used for measuring that change would be the credit-adjusted, risk-free rate that existed when the liability, or portion thereof, was initially measured. In addition, changes to the undiscounted cash flows are recognized as an increase or a decrease in both the liability for an ARO and the related asset retirement cost. Upward revisions are discounted by using the current credit-adjusted, risk-free rate. Downward revisions are discounted by using the credit-adjusted, risk-free rate that existed when the original liability was recognized. If an entity cannot identify the prior period to which the downward revision relates, it may use a weighted-average, credit-adjusted, risk-free rate to discount the downward revision to estimated future cash flows.	IFRS requires that management's best estimate of the costs of dismantling and removing the item or restoring the site on which it is located be recorded when an obligation exists. The estimate is to be based on a present obligation (legal or constructive) that arises as a result of the acquisition, construction, or development of a fixed asset. If it is not clear whether a present obligation exists, the entity may evaluate the evidence under a more-likely-than-not threshold. This threshold is evaluated in relation to the likelihood of settling the obligation. The guidance uses a pretax discount rate that reflects current market assessments of the time value of money and the risks specific to the liability. IFRS 9 does not explicitly state whether an entity's own credit risk should be taken into accounting in determining the amount of the provision. Changes in the measurement of an existing decommissioning, restoration, or similar liability that result from changes in the estimated timing or amount of the cash outflows or other resources, or a change in the discount rate, adjust the carrying value of the related asset under the cost model. Adjustments may result in an increase of the carrying amount of an asset beyond its recoverable amount. An impairment loss would result in such circumstances. Adjustments may not reduce the carrying amount of an asset to a negative value. Once the carrying value reaches zero, further reductions are recorded in profit and loss. The periodic unwinding of the discount is recognized in profit or loss as a finance cost as it occurs.

6.13 Borrowing costs

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

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

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

US GAAP	IFRS
Capitalization of interest costs is required while a qualifying asset is being prepared for its intended use. The guidance does not require that all borrowings be included in the determination of a weighted-average capitalization rate. Instead, the requirement is to capitalize a reasonable measure of cost for financing the asset's acquisition in terms of the interest cost incurred that otherwise could have been avoided. Eligible borrowing costs do not include exchange rate differences from foreign currency borrowings. Also, generally, interest earned on invested borrowed funds cannot offset interest costs incurred during the period. An investment accounted for by using the equity method meets the criteria for a qualifying asset while the investee has activities in progress necessary to commence its planned principal operations, provided that the investee's activities include the use of funds to acquire qualifying assets for its operations.	Borrowing costs directly attributable to the acquisition, construction, or production of a qualifying asset are required to be capitalized as part of the cost of that asset. The guidance acknowledges that determining the amount of borrowing costs directly attributable to an otherwise qualifying asset might require professional judgment. Having said that, the guidance first requires the consideration of any specific borrowings and then requires consideration of all general borrowings outstanding during the period. In broad terms, a qualifying asset is one that necessarily takes a substantial period of time to get ready for its intended use or sale. Investments accounted for under the equity method would not meet the criteria for a qualifying asset. Eligible borrowing costs include exchange rate differences from foreign currency borrowings.

Leases

6.14 Lease scope

As further discussed in SD 6.24, the FASB and IASB issued their new lease standards in early 2016. The guidance in this section describes the similarities and differences between the currently applicable US GAAP guidance (ASC 840, *Leases*) and IFRS guidance (IAS 17, *Leases*).

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

US GAAP	IFRS
The guidance in ASC 840 applies only to property, plant, and equipment.	The scope of IAS 17 is not restricted to property, plant, and equipment. Accordingly, it may be applied more broadly (for example, to some intangible assets and inventory). However, the standard cannot be applied to licensing agreements, or leases to explore for or use minerals, oil, natural gas, and similar non-regenerative resources. It can also not be used as a basis of measurement for investment property subject to IAS 40, or to measure biological assets subject to IAS 41.

6.15 *Lease classification—general*

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

US GAAP	IFRS
The guidance under ASC 840 contains four specific criteria for determining whether a lease should be classified as an operating lease or a capital lease by a lessee. The criteria for capital lease classification broadly address the following matters: □ Ownership transfer of the property to the lessee □ Bargain purchase option □ Lease term in relation to economic life of the asset □ Present value of minimum lease payments in relation to fair value of the leased asset The criteria contain certain specific quantified thresholds such as whether the lease term equals or exceeds 75% of the economic life of the leases asset (“75% test”) or the present value of the minimum lease payments equals or exceeds 90% of the fair value of the leased property (“90% test”). Events of default must be evaluated pursuant to ASC 840-10-25-14 to assess	The guidance under IAS 17 focuses on the overall substance of the transaction. Lease classification as an operating lease or a finance lease (i.e., the equivalent of a capital lease under US GAAP) depends on whether the lease transfers substantially all of the risks and rewards of ownership to the lessee. Although similar lease classification criteria identified in US GAAP are considered in the classification of a lease under IFRS, there are no quantitative breakpoints or bright lines to apply (e.g., 90%). IFRS also lacks guidance similar to ASC 840-10-25-14 with respect to default remedies. Under IFRS there are additional indicators that may, individually or in combination, result in a lease being classified as a finance lease. For example, a lease of special-purpose assets that only the lessee can use without major modification generally would be classified as a finance lease.

US GAAP	IFRS
whether remedies payable upon default are minimum lease payments for purposes of applying the 90% test. The guidance indicates that the maximum amount of potential payments under all non-performance events of default must be included in the lease classification 90% test unless each of the following 4 criteria are met: (i) the covenant is customary; (ii) predefined criteria relating solely to the lessee and its operations have been established for the determination of the event of default; (iii) the occurrence of the event of default is objectively determinable; and (iv) it is reasonable to assume at lease inception that an event of default will not occur. For a lessor to classify a lease as a direct financing or sales-type lease under the guidance, two additional criteria must be met: collectibility of the minimum lease payments must be reasonably predictable; and there cannot be any important uncertainty as to the amount of the unreimbursable costs yet to be incurred by the lessor during the lease term.	This would also be the case for any lease that does not subject the lessor to significant risk with respect to the residual value of the leased property. There are no incremental criteria for a lessor to consider in classifying a lease under IFRS.

6.16 Sale-leaseback arrangements

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

US GAAP	IFRS
The gain on a sale-leaseback transaction generally is deferred and amortized over the lease term. Immediate recognition of the full gain is normally appropriate only when the leaseback is considered minor, as defined. If the leaseback is more than minor but less than substantially all of the asset life, a gain is only recognized immediately to the extent that the gain exceeds	When a sale-leaseback transaction results in a lease classified as an operating lease, the full gain on the sale normally would be recognized immediately if the sale was executed at the fair value of the asset. It is not necessary for the leaseback to be minor. If the sale price is below fair value, any profit or loss should be recognized immediately, except that if there is a loss compensated

US GAAP	IFRS
(a) the present value of the minimum lease payments if the leaseback is classified as an operating leases; (b) the recorded amount of the leased asset if the leaseback is classified as a capital lease. If the lessee provides a residual value guarantee, the gain corresponding to the gross amount of the guarantee is deferred until the end of the lease; such amount is not amortized during the lease term. When a sale-leaseback transaction involves the leaseback of the entire property sold and the leaseback is a capital lease, then under ASC 840-40-25-4, the substance of the transaction is a financing and the profit should be deferred until the sale is recognized. There are onerous rules for determining when sale-leaseback accounting is appropriate for transactions involving real estate (including integral equipment). If the rules are not met, the sale leaseback will be accounted for as a financing. As such, the real estate will remain on the seller-lessee's balance sheet, and the sales proceeds will be reflected as debt. Thereafter, the property will continue to depreciate, and the rent payments will be re-characterized as debt service.	by below-market rentals during the lease term the loss should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortized over the period for which the asset is expected to be used. When a sale-leaseback transaction results in a finance lease, the gain is amortized over the lease term. There are no real estate-specific rules equivalent to the US guidance. Accordingly, almost all sale-leaseback transactions result in sale-leaseback accounting. If the leaseback is classified as an operating lease, the property sold would be removed from the seller-lessee's balance sheet.

6.17 Leases involving land and buildings

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

US GAAP	IFRS
Under ASC 840, land and building elements generally are accounted for as a single unit of account, unless the land represents 25% or more of the total fair value of the leased property. When considering the classification of land that is considered	Under IAS 17, land and building elements must be considered separately, unless the land element is not material. This means that nearly all leases involving land and buildings should be bifurcated into two components, with separate classification considerations and accounting for each component.

US GAAP	IFRS
its own unit of account, ASC 840 would require the lease to be classified as an operating lease unless either the transfer-of-ownership criterion or the bargain-purchase-option criterion is met. In those cases the lessee should account for the land lease as a capital lease.	The lease of the land element should be classified based on a consideration of all of the risks and rewards indicators that apply to leases of other assets. Accordingly, a land lease would be classified as a finance lease if the lease term were long enough to cause the present value of the minimum lease payments to be at least substantially all of the fair value of the land, even if legal ownership is not transferred. 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. Accordingly, in a single lease transaction, the lease of the building and the underlying land may be classified differently.

6.18 Lease—other

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

US GAAP	IFRS
The renewal or extension of a lease beyond the original lease term, including those based on existing provisions of the lease arrangement, normally triggers accounting for the arrangement as a new lease.	If the period covered by the renewal option was not considered to be part of the initial lease term but the option is ultimately exercised based on the contractually stated terms of the lease, the original lease classification under the guidance continues into the extended term of the lease; it is not revisited.

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

US GAAP	IFRS
The lessor can classify leases that would otherwise be classified as direct-financing leases as leveraged leases if certain additional criteria are met. Financial lessors sometimes prefer leveraged lease accounting	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.

US GAAP	IFRS
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.	Any nonrecourse debt would be reflected gross on the balance sheet.

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

US GAAP	IFRS
Under the guidance, income recognition for an outright sale of real estate is appropriate only if certain requirements are met. By extension, such requirements also apply to a lease of real estate. Accordingly, a lessor is not permitted to classify a lease of real estate as a sales-type lease unless ownership of the underlying property automatically transfers to the lessee at the end of the lease term, in which case the lessor must apply the guidance appropriate for an outright sale.	IFRS does not have specific requirements similar to US GAAP with respect to the classification of a lease of real estate. Accordingly, a lessor of real estate (e.g., a dealer) will recognize income immediately if a lease is classified as a finance lease (i.e., if it transfers substantially all the risks and rewards of ownership to the lessee).

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

US GAAP	IFRS
Lessee involvement in the construction of an asset to be leased upon construction completion is subject to specific detailed guidance to determine whether the lessee should be considered the owner of the asset during construction. If the lessee has substantially all of the construction period risks, as determined by specific criterion included in ASC 840-40-55, the lessee must account for construction in progress as if it were the legal owner and recognize landlord financed construction costs as debt. Once construction is complete, the arrangement is evaluated as a sale-leaseback.	No specific guidance relating to lessee involvement in the construction of an asset exists under IFRS.

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

Other

6.19 Distributions of nonmonetary assets to owners

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

US GAAP	IFRS
Accounting for the pro-rata distribution of assets that constitute a business to owners of an enterprise (a spin-off) 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.	Unless part of a common control transaction, 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, the distributing 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. The recognition of the distribution at fair value by the entity distributing nonmonetary assets does not affect the accounting by the spinee after the distribution.

6.20 Inventory costing

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

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

US GAAP	IFRS
A variety of inventory costing methodologies such as LIFO, FIFO, and/or weighted-average cost are permitted. For companies using LIFO for US income tax purposes, the book/tax conformity rules also require the use of LIFO for book accounting/reporting purposes. Reversals of write-downs are prohibited.	A number of costing methodologies such as FIFO or weighted-average costing are permitted. The use of LIFO, however, is precluded. Reversals of inventory write-downs (limited to the amount of the original write-down) are required for subsequent recoveries.

6.21 Inventory measurement

In the past there was a difference between US GAAP and IFRS in that US GAAP referred to the lower of cost or market whereas IFRS referred to the lower of cost and net realizable value. The FASB released Accounting Standards Update 2015-11 on July 22, 2015, which eliminated this difference. Now under both US GAAP and IFRS, inventory is measured at the lower of cost and net realizable value. Net realizable value is defined as the estimated selling price less the costs of completion and sale.

The ASU was effective for annual periods beginning after December 15, 2016. Private companies need to apply the ASU to interim periods beginning after December 15, 2017.

6.22 Biological assets—fair value versus historical cost

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

US GAAP	IFRS
Biological assets can be measured at historical cost or fair value less costs to sell, as a policy election. If historical cost is elected, these assets are tested for impairment in the same manner as other long-lived assets. If fair value is elected, all changes in fair value in subsequent periods are recognized in the income statement in the period in which they arise.	Under IAS 41, biological assets are measured at fair value less costs to sell for initial recognition and at each subsequent reporting date, except when the measurement of fair value is unreliable. All changes in fair value are recognized in the income statement in the period in which they arise.

US GAAP	IFRS
	Bearer plants are accounted for in the same way in IAS 16, *Property, Plant and Equipment*. Whereas the produce growing on bearer plants is within the scope of IAS 41 and measured at fair value.

6.23 *Investment property*

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

US GAAP	IFRS
There is no specific definition of investment property. The historical-cost model is used for most real estate companies and operating companies holding investment-type property. Investor entities—such as many investment companies, insurance companies' separate accounts, bank-sponsored real estate trusts, and employee benefit plans that invest in real estate—carry their investments at fair value. The fair value alternative for leased property does not exist.	Investment property is separately defined as property (land and/or buildings) held in order to earn rentals and/or for capital appreciation. The definition does not include owner-occupied property, property held for sale in the ordinary course of business, or property being constructed or developed for such sale. Properties under construction or development for future use as investment properties are within the scope of investment properties. Investment property is initially measured at cost (transaction costs are included). Thereafter, it may be accounted for on a historical-cost basis or on a fair value basis as an accounting policy choice.[2] When fair value is applied, the gain or loss arising from a change in the fair value is recognized in the income statement. The carrying amount is not depreciated. The election to account for investment property at fair value may also be applied to leased property.

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

6.24 Recent/proposed guidance

6.24.1 Leases—Joint Project of the FASB and IASB

The FASB and IASB issued their respective standards in the first quarter of 2016. The FASB issued ASC 842 in February 2016 and the IASB issued IFRS 16 in January 2016. The issuance of the standards are the culmination of multiple years of deliberating a leasing model with the primary objective of bringing almost all leases onto the balance sheet for lessees. It was initially intended to be a converged standard, however, the Boards ultimately diverged and there are some differences. The FASB has discussed numerous lease-related questions since issuing ASC 842, and has issued three Accounting Standards Updates during 2018 relating to the accounting for easements, certain technical corrections and targeted improvements to the transition provisions, and a lessor's separation of lease and nonlease components. The FASB also exposed additional practical expedients in August 2018 related to how lessors should report certain taxes and lessor costs paid directly by the lessee.

Summarized below is an overview of the model highlighting the key differences between the standards.

6.24.1.1 Scope

The lease standards provide for certain scope exceptions from the entirety of the guidance. The exceptions to the scope of the lease standards that apply to both US GAAP and IFRS include:

- Leases to explore for or use minerals, oil, natural gas, and similar non-regenerative resources
- Leases of biological assets
- Service concession arrangements
- Certain types of intangible assets

There are additional exceptions from the scope of ASC 842 that do not exist in IFRS 16. ASC 842 has a scope exception that excludes all types of intangible assets, leases of inventory, and leases of assets under construction from its scope. Under IFRS 16, a lessee may, but is not required to, apply lease accounting to leases of intangible assets other than rights held under licensing agreements within the scope of IAS 38, *Intangible Assets,* for such items as motion picture films, video recordings, manuscripts, patents, and copyrights. Under IFRS 16, a lessor is required to apply lease accounting to leases of intangible assets other than licenses of intellectual property within the scope of IFRS 15.

Under both ASC 842 and IFRS 16, even if not a lease in its entirety, an arrangement would include an embedded lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. A customer has the right to control the use of an identified asset if it has both (a) the right to obtain substantially all of the economic benefits from use of the identified asset and (b) the right to direct the use of the identified asset. This analysis is performed at the inception of the arrangement and is only reassessed if there is a contract modification.

The IFRS 16 and ASC 842 guidance on identifying whether arrangements are or contain leases is nearly identical. Notwithstanding this, application of the guidance may require significant judgment, and, as a result, the practical application of the principles to similar transactions may differ.

IFRS 16 and ASC 842 allow lessees to make a policy election by class of underlying asset for leases that are short-term in nature (i.e., a lease term of 12 months or less at lease commencement) under which lessees would not be required to recognize a right-of-use asset and lease liability. Lease expense would be recognized on a straight-line basis in the income statement, and any variable payments would be recognized as they occur.

IFRS 16 provides an additional policy election for lessees on a lease-by-lease basis to exclude leases of low-value assets from the initial recognition requirements and account for the lease similar to short-term leases as discussed above. IFRS 16 does not define the term "low value," but the Basis for Conclusions explains that the Board had in mind assets of a value of USD 5,000 or less when new. The term "low value" is not based on entity-specific materiality. In ASC 842, the FASB observed in the Basis of Conclusions that similar to accounting policies in other areas of US GAAP, entities may be able to establish reasonable capitalization thresholds below which assets and liabilities related to a lease are not recognized.

Unless otherwise noted, the guidance below assumes that a lessee is not applying either the short-term or low-value exemptions.

6.24.1.2 Separating components of a contract and contract combinations

Contracts often contain multiple obligations of the supplier, which might include a combination of lease and non-lease components. For example, the lease of an industrial space might contain provisions related to the lease of land as well as the existing buildings and equipment, or a contract for a car lease may include maintenance.

When such multi-element arrangements exist, the standards require each separate lease and nonlease component to be accounted for separately unless an entity elects to not separate components (see below). A separate non-lease component exists if a separate good or service (e.g., maintenance) is transferred to the lessee. A separate lease component exists if (a) the lessee can benefit from the underlying asset separate from other lease components and (b) the component is neither highly dependent nor highly interrelated with other lease components in the arrangement.

For a lease of land and building under IFRS, a lessor is required to assess the land separate from the building unless the land element is immaterial to the lease. If lease payments cannot be allocated reliably between land and building, the lease is classified as a finance lease unless it is clear that both elements are operating leases. Under ASC 842, a lessee or lessor accounts for the right to use land as a separate lease component from the right to use a building unless the accounting effect of doing so would be insignificant.

Once the separate lease and non-lease components have been identified, the consideration in the contract should be allocated to the separate components. The contract consideration is allocated based on relative stand-alone prices for lessees, and for lessors is based on ASC 606 and IFRS 15 allocation methodologies.

The standards provide an accounting policy election under which a lessee is not required to separate non-lease components from the lease components and can account for each lease component and any associated non-lease components as a single lease component. This policy election can be made by class of underlying asset.

The FASB issued an update to ASC 842 in July 2018 allowing lessors to elect, by class of asset, to not separate nonlease components from associated lease components under qualifying circumstances. If elected, the lessor would account for the combined component as either an operating lease under ASC 842, or under the guidance for the nonlease component (e.g., as revenue under ASC 606) depending on which is the predominant component. This election is not available for lessors under IFRS 16.

6.24.1.3 Lessee accounting

Classification

The most significant difference between the standards is that under ASC 842, a lessee can have either a finance or operating lease, determined using classification criteria similar to that used for capital leases in existing lease guidance. In contrast, under IFRS 16, lessees account for all leases like finance leases in ASC 842.

The classification criteria for lessees under ASC 842 is as follows. If any of the following criteria are met, the lease is a finance lease.

- The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
- The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.
- The lease term is for the major part of the remaining economic life of the underlying asset. However, if the commencement date falls at or near the end of the economic life of the underlying asset, this criterion will not be used for lease classification purposes.
- The present value of the sum of lease payments and any residual value guaranteed by the lessee that is not already reflected in lease payments equals or exceeds substantially all of the fair value of the underlying asset.
- The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term.

Balance sheet

Under both standards, lessees will record all leases within the scope of the standards, regardless of classification, on the balance sheet as a right-of-use asset and lease liability at lease commencement. The initial right-of-use asset and lease liability will be measured based on the present value of the lease payments (as defined in the standards) using the interest rate implicit in the lease (unless the rate cannot be readily determined, in which case the incremental borrowing rate of the lessee will be used). The definition of incremental borrowing rate is different under IFRS than under US GAAP as IFRS requires use of a borrowing rate for a similar security with a similar value to the right-of-use asset whereas US GAAP is more general in that it simply requires use of a collateralized rate for an amount equal to the lease payments. Both IFRS and US GAAP require entities to consider a similar term and economic environment as the lease.

Under IFRS, if an entity has elected to apply the fair value model under IAS 40, the lessee shall also apply that model to subsequently measure the right-of-use assets that meet the definition of investment property. Additionally, if the right-of-use assets relate to a class of property, plant, and equipment measured using the revaluation model under IAS 16, that class of right-of-use asset may also be measured using the revaluation model, if elected.

Income statement

With regard to the impact on the income statement, the significant difference between the standards is driven by the fact that lessees applying ASC 842 will still classify certain leases as operating leases. Under ASC 842, there will be a different pattern of recognition for leases classified as operating leases in which the amortization of the right-of-use asset and interest expense related to the lease liability will be recorded together as lease expense to produce a straight-line recognition effect in the income statement.

The income statement will look similar between the standards for leases classified as finance leases. The income statement recognition for finance leases of lessees will consist of an amortization of the right-of-use asset and interest expense related to the lease liability.

Under IFRS, if an entity has elected to apply the fair value model under IAS 40, the lessee shall also apply that model to subsequently measure the right-of-use assets that meet the definition of investment property. The change in fair value will be recognized in the income statement.

6.24.1.4 Lessor accounting

Classification

The criteria used for lessor classification of leases are substantially the same between the standards, although under ASC 842, a lease is classified as a finance lease if it meets one of the criteria, whereas IFRS 16 refers to them as “examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease." However, similar to the existing standards, IFRS 16 does not require the collection of the lease payments to be probable for a lease to be classified as a finance lease. The classification of the lease is performed at inception under IFRS 16 and at commencement under ASC 842. The criteria that are applied are the same as those discussed in SD 6.15 for the application of IFRS (IAS 17) today.

In 2017, the FASB confirmed that lessors should apply the sales-type lease classification guidance, even for transactions that contain relatively little fixed consideration. Because a lessor cannot include many variable payments in the measurement of its net investment in a lease, such sales-type leases may result in a lessor recognizing a "Day 1" loss (because lessors would derecognize the entire "sold" asset, but would not recognize a receivable for most variable payments). IFRS 16, however, says that variable lease payments could mean that the lessor does not transfer the risks and rewards, and so requires that such leases be treated as operating leases (thus lessors would not derecognize the asset).

Under US GAAP, the specialized accounting for leveraged leases in ASC 840 was not carried forward. There is, however, transition relief in ASC 842 to continue to account for leveraged leases entered into before adoption of the new standard. Additionally, the specific rules around lessor classification of real-estate were not carried forward in ASC 842.

Balance sheet

There are no significant differences in the balance sheet impacts under the standards. A leased asset is removed from the balance sheet if the lease is classified as a finance lease. It is replaced with a net investment in the lease (comprised of the lease payments and any guaranteed residual value) and the unguaranteed residual value of the asset. If the lease is an operating lease, the lessor will leave the asset on the balance sheet.

Income statement

The most significant difference between the standards relates to profit recognition at commencement for a finance lease. To recognize profit at commencement of a finance lease, ASC 842 requires a transfer of control of the asset (a third-party provided residual value guarantee is not a factor in this determination). This is not a requirement under IFRS 16. Interest income will be recognized on the net investment in the lease in a finance lease under the standards.

Income from operating leases is typically recognized on a straight-line basis under both standards.

6.24.1.5 Lease re-assessments and modifications

The consideration of contract modifications and lease re-assessments are generally the same under the standards. However, IFRS 16 will require a lease re-assessment if a change in the lease payments occurs as a result of a change in an index or rate. This would not be a reassessment and remeasurement event under ASC 842.

6.24.1.6 *Sublease transactions*

When classifying a sublease, the asset analyzed under ASC 842 is the underlying asset, whereas under IFRS 16 it is the right-of-use asset from the head lease. For example, if an entity is the lessee in a five-year lease of an office building and then enters into a sublease for the entire five-year lease term, under US GAAP, the entity compares the sublease to the underlying building. Under IFRS, the entity compares the sublease to the five-year right-of-use asset.

6.24.1.7 *Sale and leaseback transactions*

The accounting for sale-lease back transactions are symmetrical between a buyer-lessor and a seller-lessee under the standards.

In a sale-lease back transaction, the transaction will receive sale lease back accounting if the sale criteria are met according to ASC 606 or IFRS 15 as appropriate. For a seller-lessee, if a sale is not recognized, the arrangement will be treated as a financing.

If a sale is recognized, the transaction will be measured based on the fair value of the asset transferred. Any proceeds from the sale that are either above or below the fair value of the asset will be treated as a financing or prepaid rent. The asset will be removed and replaced with a right-of-use asset and lease liability. Under ASC 842, the seller-lessee's gain recognized at the sale date will be measured as the difference between the adjusted sale proceeds (total proceeds less any financing component) and the book value of the asset transferred. The right of use asset arising from the leaseback will be measured under the normal ASC 842 principles. Under IFRS 16, the gain (or loss) is limited to the proportion of the total gain (or loss) that relates to the rights transferred to the buyer-lessor. The right-of-use asset arising from the leaseback will be measured as the proportion of the previous carrying amount of the asset that relates to the right of use retained.

ASC 842 has retained the concept of build-to-suit accounting for the lessee but has shifted the criteria to be focused more on control rather than risks and rewards during the construction period. IFRS 16 does not have the concept of build-to-suit accounting for lessees during construction.

6.24.1.8 *Presentation and disclosure*

For lessees, the presentation of the right-of-use assets and lease liabilities are similar under the standards in that amounts should be presented separate from other assets and liabilities on the balance sheet or in the notes to the financial statements. ASC 842 prohibits assets and liabilities related to operating leases from being presented in the same balance sheet line item as assets and liabilities related to finance leases.

ASC 842 requires presentation of operating lease expense within income from continuing operations. For finance leases under ASC 842, and all leases under IFRS 16, lease expenses should include interest expense and the depreciation of right-of-use assets in the income statement in a manner consistent with how the entity presents other interest expense and depreciation or amortization of similar assets. The presentation of amounts on the cash flow statement are similar between the standards, except that, under ASC 842, lessees will typically report payments under operating leases within operating activities since interest and depreciation are not presented in the income statement for operating leases.

As compared to IFRS 16, ASC 842 contains incremental guidance and accounting elections related to how lessors should account for lessor costs (such as property taxes and insurance of the leased asset) that are paid for directly by a lessee. As originally issued, ASC 842 required lessors to record lessor costs that are paid on behalf of the lessee as revenue and expense on a gross basis. In August 2018, the FASB exposed practical expedients that would allow lessors to report certain of these costs on a net basis. The IASB has not specifically addressed these issues. Companies should continue to monitor standard setting developments in this area.

The disclosure requirements under the standards are similar, however, there are some differences. Refer to each standard for their respective disclosure requirements.

6.24.1.9 Transition

IFRS 16 is effective for periods beginning on or after January 1, 2019. ASC 842 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted under both standards, however, IFRS 16 cannot be adopted prior to the application of IFRS 15, *Revenue from Contracts with Customers*.

There are differences in the transition methods between the standards in that IFRS 16 will have full retrospective application but will allow for a "simplified approach" in which the comparative periods will not be restated and the cumulative effect of applying the new standard will be recorded as an adjustment to the opening balance of retained earnings. ASC 842 provides for a single transition approach, modified retrospective application with the option to elect hindsight and/or a package of practical expedients. It does not permit full retrospective adoption. In July 2018, the FASB issued an ASU allowing entities to elect not to restate the comparative prior periods (similar to the IFRS 16 "simplified approach").

Under both ASC 842 and IFRS 16, a lessee may elect, as a practical expedient in transition, to not reassess whether an arrangement is or contains a lease. However, under ASC 842, lessees may only elect to use this expedient as part of a "package" of expedients to also not reassess lease classification, or existing initial direct costs. Under IFRS 16, lessees do not classify leases; and, if using the "simplified approach," they can separately elect to exclude initial direct costs from the measurement of the right-of-use asset. Under both ASC 842 and IFRS 16 (if using the "simplified approach"), a lessee may apply hindsight when determining lease term.

In 2018, the FASB issued an ASU to permit companies to not revisit how they account for easement arrangements existing at the transition date that were not previously accounted for as leases. They clarified, however, that easement arrangements entered into or modified after the effective date of ASC 842 would have to be evaluated under the lease identification guidance. The IASB has not provided equivalent relief.

6.24.2 *IASB completes comprehensive review of the IFRS for SMEs*

In May 2015, the IASB completed its comprehensive review of IFRS for Small and Medium-sized Entities (SMEs) resulting in limited amendments to the standard. Some areas were identified where targeted improvements could be made. One of the changes arising from the amendment relates to the option to use the revaluation model for property, plant, and equipment. *IFRS for SMEs* required the cost model to be used for property, plant and equipment, while IFRS permits a choice between the cost and revaluation model. Based on comment letters received, the IASB acknowledged that current value information is potentially more useful than historical cost information. As such, the IASB added the revaluation model for property, plant, and equipment in *IFRS for SMEs*.

Entities reporting using *IFRS for SMEs* are required to apply the amendments for annual periods beginning on or after January 1, 2017. Early application is permitted provided all amendments are applied at the same time.

6.24.3 *FASB improvements to the derecognition of nonfinancial assets*

ASC 610-20 addresses the accounting for the derecognition of nonfinancial assets. It was issued in 2014 in connection with the issuance of the new revenue standard. ASC 610-20 refers to in substance nonfinancial assets but did not provide a definition of such term. It also did not provide guidance related to the accounting for partial sale transactions. In February 2017, the FASB issued guidance that clarified the derecognition model within ASC 610-20.

The new guidance clarifies that ASC 610-20 applies to transfers of all nonfinancial assets and in substance nonfinancial assets to parties that are not customers. As a result, real estate sales to non-customers will follow a similar treatment as real estate sales to customers within the scope of the new revenue standard. The guidance does not change the derecognition model for financial assets under the scope of ASC 860, *Transfers and Servicing*, or businesses under the scope of ASC 810, *Consolidation*.

ASC 610-20, as amended, changes the criteria for derecognizing a nonfinancial asset and provides guidance on how and when to measure the resulting gain/loss from derecognition. The recent amendments to ASC 610-20 clarify the scope of the guidance and define "in substance nonfinancial asset." Given the FASB's recently revised definition of a business, more transactions will likely be treated as dispositions of nonfinancial assets (rather than dispositions of businesses), which will increase the number of transactions subject to the new guidance.

If a transaction is within the scope of ASC 610-20, in order for an entity to derecognize nonfinancial assets and recognize a gain or loss, the entity must lose control of the assets (as assessed under ASC 810, *Consolidation*) while also satisfying the criteria for transfer of control to another party under the new revenue recognition guidance (ASC 606, which is leveraged in ASC 610-20). If these criteria are not met, an entity would continue to recognize the asset and record a liability for the consideration received. Situations may arise when a loss of control has occurred, but the transaction does not meet the transfer of control criteria in the revenue standard (e.g., when certain call options are present). In these situations, alternate guidance will need to be followed.

Under the amended guidance, transfers of nonfinancial assets to another entity in exchange for a noncontrolling ownership interest in that entity are accounted for under ASC 610-20, eliminating the specific guidance on such exchanges from current US GAAP.

Also under the amended guidance, when an entity transfers its controlling financial interest in a nonfinancial asset (or in substance nonfinancial asset) but retains a noncontrolling ownership interest, the entity would measure such interest (including interests in joint ventures) at fair value, similar to the current guidance on the sale of businesses. This would result in full gain or loss recognition upon the sale of the nonfinancial or in substance nonfinancial asset.

The amendments to the nonfinancial asset guidance are effective at the same time an entity adopts the new revenue guidance in ASC 606. Therefore, for public business entities with calendar year ends, the standard was effective on January 1, 2018. All other entities have an additional year to adopt the guidance. Early adoption is permitted provided adoption coincides with the adoption of the revenue standard. However, the transition method and practical expedients do not have to be the same. Companies may transition to ASC 610-20 using either the full retrospective approach (i.e., applied retrospectively to all prior periods presented) or the modified retrospective approach (i.e., applied retrospectively by recording the cumulative effect of the change at the beginning of the period of adoption), regardless of the transition approach elected for the revenue standard.

IFRS does not include the concept of in substance nonfinancial assets in its guidance because the derecognition of a subsidiary, regardless of whether it is an asset or a business, is accounted for in accordance with IFRS 10, *Consolidated Financial Statements*. IAS 28, *Investments in Associates and Joint Ventures,* requires entities to recognize partial gain or loss on contribution of nonfinancial assets to equity method investees and joint ventures for an interest in that associate unless the transaction lacks commercial substance.

Chapter 7: Assets—financial assets

7.1 Assets—financial assets

Both the FASB and the IASB have finalized major projects in the area of financial instruments. With the publication of IFRS 9, *Financial Instruments,* in July 2014, the IASB completed its project to replace the classification and measurement, as well as the impairment guidance for financial instruments. In January 2016, the FASB issued its new recognition and measurement guidance – Accounting Standards Update 2016-01, *Financial Instruments–Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*, and in June 2016, the FASB issued its new impairment guidance – Accounting Standards Update 2016-13, *Financial Instruments – Credit Losses (Topic 326)*. The new classification and measurement guidance is effective for both US GAAP and IFRS as of January 1, 2018, and the similarities and differences are covered in detail in this section. The new impairment guidance under ASC 326 is not yet effective for US GAAP, while the IFRS 9 impairment guidance is effective as of January 1, 2018. The impairment guidance in this section therefore compares the current US GAAP guidance (pre-ASC 326) with the new impairment guidance under IFRS 9.

Under US GAAP, various specialized pronouncements provide guidance for the classification of financial assets. Unlike US GAAP, IFRS 9 contains all of the classification and measurement guidance for financial assets, and does not provide any industry-specific guidance. The specialized US guidance and the singular IFRS guidance in relation to classification can drive differences in measurement (because classification drives measurement under both IFRS and US GAAP).

Under IFRS 9, investments in equity instruments are measured at fair value through profit or loss (FVTPL) (with an irrevocable option to measure those instruments at fair value through other comprehensive income (FVOCI) with no subsequent reclassification to profit or loss). Under US GAAP, investments in equity instruments are generally measured at FVTPL, with an alternative measurement option for equity investments without a readily determinable fair value.

Under IFRS 9, investments in debt instruments are either measured at: (1) amortized cost, (2) FVOCI (with subsequent reclassification to profit or loss) or (3) FVTPL, depending on the entity's business model for managing the assets and the cash flows characteristic of the instrument. Under US GAAP, the legal form of a debt instrument primarily drives classification. For example, available-for-sale debt instruments that are securities in legal form are typically carried at fair value, 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 cash flows of the instrument and the entity's business model for managing the debt instruments are the key considerations for classification. In addition to these classification differences, the interest income recognition models also differ between the frameworks.

Additionally, until the new impairment model is effective for US GAAP (beginning in 2020, if not early adopted), there is a fundamental difference in the impairment guidance for debt instruments carried at amortized cost and FVOCI; the current US GAAP guidance is an incurred loss model while the IFRS 9 guidance is an expected loss model.

Finally, this section describes the fundamental differences in the way US GAAP and IFRS assess the derecognition of financial assets. These differences can have a significant impact on a variety of transactions, such as asset securitizations and factoring transactions. 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 in question has been transferred. US GAAP focuses on whether an entity has surrendered effective control over a transferred asset; this assessment also requires the transferor to evaluate whether the financial asset has been "legally isolated," even in the event of the transferor's bankruptcy or receivership.

This chapter focuses on financial assets – both debt and equity investments – which do not result in the investor having significant influence or control over the investee. The consolidation and equity method of accounting models are covered in Chapter 12.

Technical references

US GAAP

ASC 310, ASC 310-10-30, ASC 310-10-35, ASC 320, ASC 321, ASC 325, ASC 815, ASC 815-15-25-4 through 25-5, ASC 820, ASC 825, ASC 860

IFRS

IFRS 9, IFRS 13, IAS 32

Note

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

Classification and Measurement

7.2 Determining the overall appropriate classification model

Under both frameworks, the determination of whether a financial asset is considered debt or equity has implications on its classification and subsequent measurement. However, the criteria for making this determination are different. Therefore, certain investments could be accounted for as a debt investment under one framework and as an equity investment under the other.

US GAAP	IFRS
To determine the appropriate accounting treatment for a financial interest not consolidated or accounted for under the equity method, a reporting entity should first determine whether the interest meets the definition of a security, which, to a large extent, is a legal determination. If the entity determines that an interest meets the definition of a security, it should then determine whether that security meets the definition of an equity or debt security based on the definitions in ASC 321 and ASC 320 and follow the measurement models described in those sections unless industry-specific guidance applies. If the entity determines that the interest does not meet the definition of an equity security, it may still have to follow the guidance in ASC 321 if the interest is in the form of an investment in a partnership, unincorporated joint venture, or LLC (See SD 7.3). If the entity determines that the interest is not a security, and does not represent a partnership or similar interest, other guidance would apply. For example, for trade account receivables, loans, and other similar assets, ASC 310 would generally be applicable, unless the entity follows industry-specific guidance (See SD 7.4).	For financial assets that are not consolidated or accounted for using the equity method, an entity first considers whether the financial asset is an investment in an equity instrument by evaluating the classification of the instrument from the perspective of the issuer under IAS 32 (see SD chapter 10 for a discussion of the issuer's classification model). If the financial asset is an investment in an equity instrument, the entity should follow the guidance for equity instruments. If the financial asset is not an investment in an equity instrument, the entity should follow the guidance for debt investments. There is one exception to this rule, which applies to instruments that are classified as equity under the "puttable instruments" provisions of IAS 32, such as investments in mutual funds (see SD 10.8). An entity should follow the guidance for debt investments for these instruments (even when they are presented as equity from the issuer's perspective).

7.3 Equity investments

Under both IFRS and US GAAP, equity investments are generally required to be measured at fair value with changes in fair value recognized in earnings. Unlike US GAAP, IFRS does not include simplifications such as the "NAV exception" or "measurement alternative," which exist under US GAAP. However, IFRS provides an option to recognize the changes in the fair value of equity investments in other comprehensive income, with no subsequent reclassification to profit or loss.

US GAAP	IFRS
All equity investments are generally measured at fair value with changes in fair value recognized through earnings. ASC 321 no longer provides an available for-sale classification for equity securities with changes in fair value recognized in other comprehensive income. If certain conditions are met, entities can use net asset value (NAV), without adjustment, as a practical expedient to measure the fair value of investments in certain funds (e.g., hedge funds, private equity funds, real estate funds, venture capital funds, commodity funds, funds of funds) when fair value is not readily determinable.	Investments in equity instruments (as defined in IAS 32, from the perspective of the issuer) are always measured at fair value. Equity instruments that are held for trading are required to be classified at FVTPL. For all other investment in equity instruments, an entity can irrevocably elect on initial recognition, on an instrument-by-instrument basis, to present changes in fair value in OCI rather than profit or loss. Under that option, there is no subsequent reclassification of amounts from AOCI to profit or loss – for example, on sale of the equity investment – and no requirement to assess the equity investment for impairment. However, an entity may transfer amounts within equity; for example, from AOCI to retained earnings.
Entities are able to elect the "measurement alternative" in ASC 321 for equity interests without readily determinable fair value and for which the NAV practical expedient does not apply. Under that alternative, the equity interest is recorded at cost, less impairment. The carrying amount is subsequently adjusted up or down for observable price changes (i.e., prices in orderly transactions for the identical investment or similar investment of the same issuer); any adjustments to the carrying amount are recorded in net income. The selection of the measurement alternative is optional, but should be applied upon acquisition of an equity instrument on an instrument-by-instrument basis.	Under IFRS, since NAV is not defined or calculated in a consistent manner in different parts of the world, IFRS does not include a similar practical expedient.

7.4 Loans and receivables

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

US GAAP	IFRS
The classification and accounting treatment of loans and receivables generally depends on whether the asset in question meets the definition of a debt security under ASC 320. To meet the definition of a security under ASC 320, the asset is required to be of a type commonly available on securities exchanges or in markets, or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment. Loans and receivables are also evaluated for embedded derivative features, which could require separate fair value accounting. Loans and receivables that are not within the scope of ASC 320 fall within the scope of other guidance, such as ASC 310, *Receivables*. Loans are generally: □ Classified as loans held for investment, in which case they are measured at amortized cost, □ Classified as loans held for sale, in which case they are measured at the lower of cost or fair value (market), or □ Carried at fair value if the fair value option is elected.	Classification under IFRS 9 of all debt investments – including debt securities, loans, and receivables – is based on a single model, which is driven by: □ The entity's business model for managing the assets, and □ The instrument's characteristics (i.e., the Solely Payment of Principal and Interest (SPPI) test). The business model determination is not made at the individual asset level; rather, it is performed at a higher level of aggregation. An entity can have different business models for different portfolios. Business practices, such as factoring, might affect the business model (and hence, classification and measurement). Under the SPPI test, an entity needs to determine whether the contractual cash flows of the financial asset represent solely payments of principal and interest. Contractual features that introduce exposure to risks or volatility unrelated to a basic lending arrangement, such as exposure to changes in equity or commodity prices, do not give rise to contractual cash flows that are SPPI. The financial asset should be subsequently measured at amortized cost if both of the following conditions are met: □ The financial asset is held within a "hold to collect" business model. Although the objective of an entity's business model might be to hold financial assets in order to collect contractual cash flows, the entity does not necessarily need to hold all of those instruments until maturity; and □ The contractual terms of the financial asset give rise, on specified dates, to cash flows that are SPPI. A financial asset should be subsequently measured at FVOCI if both of the following conditions are met: □ The financial asset is held within a business model whose objective is achieved by both holding financial assets in order to collect contractual cash flows and selling financial assets; and

US GAAP	IFRS
	◻ The contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI. If the financial asset is measured at FVOCI, movements in fair value are recorded through OCI. However, interest income computed using the effective interest method, foreign exchange gains and losses, impairment losses, and gains and losses arising on derecognition of the asset, are recognized in profit or loss. If the financial asset does not pass the business model assessment or SPPI test, it is measured at FVTPL. This is the residual measurement category under IFRS 9.

7.5 Debt securities

Classification is not driven by legal form under IFRS, whereas legal form drives the classification of debt securities under US GAAP.

US GAAP	IFRS
If the asset meets the definition of a security under ASC 320, 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. Held-to-maturity securities are carried at amortized cost. Debt securities are also evaluated for embedded derivative features that could require separate fair value accounting.	The same general model described in SD 7.4 applies to investments in debt securities.

7.6 Debt investments accounted for at FVOCI—foreign exchange gains/losses

The treatment of foreign exchange gains and losses on debt securities measured at FVOCI (available-for-sale under US GAAP) will create more income statement volatility under IFRS.

US GAAP	IFRS
The *total* change in fair value of available-for-sale debt securities—net of associated tax effects—is recorded in OCI. 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.	For debt instruments measured at FVOCI, 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 (except for impairment losses) is recognized in OCI, net of tax effect.

7.7 Embedded derivatives in financial assets

Under IFRS 9, an entity does not need to determine whether embedded derivatives need to be bifurcated from financial assets. The contractual features of the financial asset are assessed as part of the SPPI test, which drives the classification of the instrument as a whole. Under US GAAP, bifurcation of embedded derivatives is required. This can create a significant difference between the models, since under US GAAP only a particular feature may require bifurcation and measurement at fair value through profit or loss, whereas under IFRS 9, the entire instrument may require measurement at fair value through profit or loss.

US GAAP	IFRS
When the terms of a financial asset involve returns that vary in timing or amounts, the asset should be evaluated to determine if there are any embedded derivatives that should be accounted for separately and measured at fair value through profit or loss.	A financial asset that is within the scope of IFRS 9 is not assessed for embedded derivatives because the SPPI test is applied to the entire hybrid contract to determine the appropriate measurement category. If an entity fails the SPPI test, the entire instrument is measured at FVTPL.

7.8 Effective interest rates—expected versus contractual cash flows

Differences between the expected and contractual lives of financial assets carried at amortized cost have different implications under the two frameworks. The difference in where the two accounting frameworks place their emphasis (contractual term for US GAAP and expected life for IFRS) can affect the asset's carrying values and the timing of income recognition.

US GAAP	IFRS
Under US GAAP, to determine the appropriate interest income recognition model, an entity must first consider the nature of the financial instrument, any industry-specific guidance, and the accounting model being applied to the instrument. US GAAP can be prescriptive in certain instances, such as interest income recognition for beneficial interests or structured notes. However, generally, for loans, receivables, and debt securities, the interest method is applied over the contractual life of the asset for purposes of recognizing accretion and amortization associated with premiums, discounts, and deferred origination fees and costs. However, estimated cash flows can be used when certain criteria are met. For example, when a reporting entity holds a large number of similar loans, investments in debt securities, or other receivables for which prepayments are probable, and the timing and amount of prepayments can be reasonably estimated, an entity may elect to consider estimates of future principal prepayments in the calculation of the effective interest rate.	Under IFRS 9, there is only one effective interest model. The calculation of the effective interest rate is based on the *estimated* cash flows (excluding expected credit losses) over the *expected* life of the asset. Contractual cash flows over the full contractual term of the financial asset are used in the rare case when it is not possible to reliably estimate the cash flows or the expected life of a financial asset.

7.9 Effective interest rates—changes in expectations

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

US GAAP	IFRS
Different models apply to the way revised estimates are treated depending on the nature of the asset. Changes may be reflected prospectively or retrospectively. However, none of the prescribed US GAAP models is the equivalent of the IFRS cumulative-catch-up-based approach.	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. Revisions of the expected life or the estimated future cash flows may occur, for example, in connection with debt instruments that contain a put or call option that does not cause the asset to fail the SPPI test described in SD 7.4. The carrying amount is recalculated by computing the present value of estimated future cash flows at the financial asset's original effective interest rate. The adjustment is recognized as income or expense in the income statement (i.e., by the cumulative-catch-up approach). Generally, floating rate instruments (e.g., LIBOR plus spread) issued at par are not subject to the cumulative-catch-up approach; rather, the effective interest rate is revised as market rates change.

7.10 Restructuring of debt investments

The guidance to determine whether a restructuring of a debt investment represents an extinguishment or a modification varies between the two frameworks. Additionally, under IFRS, there is a requirement to recognize a modification gain or loss when a restructuring of a debt investment is accounted for as a modification. Under US GAAP, a restructuring (that is not a troubled debt restructuring) accounted for as a modification does not have a "day 1" impact to the income statement.

US GAAP	IFRS
When a creditor and a debtor agree to modify the terms of an existing debt instrument (or to exchange debt instruments) the creditor should first evaluate whether the restructuring constitutes a troubled debt restructuring (i.e., whether the debtor is experiencing financial difficulties and the creditor has granted a concession). For debt restructurings that are not considered troubled debt restructurings,	When a change in cash flow arises in connection with a renegotiation or other modification, a careful analysis is required. An entity first needs to determine whether the change in cash flows arises under the contractual terms. For example, a fixed rate loan that is prepayable at par (or with only an insignificant amount of compensation), when the lender only agrees to reset the

US GAAP	IFRS
a creditor and debtor each must determine whether the modification or exchange should be accounted for as (a) the creation of a new debt instrument and the extinguishment of the original debt instrument or (b) the modification of the original debt instrument.	interest rate to market may be considered a change in contractual terms, and thus follow the guidance for changes in interest rates applicable to floating rate instruments.
A new or restructured debt instrument is considered an extinguishment of the existing instrument and origination of a new instrument by the lender/investor when both of the following conditions are met: □ The terms of the new or restructured debt instrument are at least as favorable to the lender as the terms for comparable debt instruments to customers with similar creditworthiness. □ A modification is more than minor quantitatively or if facts and circumstances (and other relevant considerations) indicate that the modification is more than minor.	Where an entity determines that the change is due to a renegotiation, the entity then needs to determine whether the modification is substantial. If the change in terms is considered substantial, it is accounted for as a derecognition of a financial asset and the recognition of a new financial asset (i.e., an extinguishment). If the renegotiation does not result in a substantial change in terms, it is accounted for as a modification. Judgment is required to assess whether the change in terms is substantial enough to represent an extinguishment (i.e., derecognition of the asset). The assessment is based on all relevant factors, such as deferral of certain payments to cover a shortfall, insertion of substantial new terms, significant extension of the term, change in interest rate, insertion of collateral or other credit enhancement, changes to loan covenants, or change in the currency of the instrument.
For a refinancing or restructuring that is not a troubled debt restructuring and is considered a modification of the debt instrument, the amortized cost basis of the new loan should comprise the remaining amortized cost basis in the original loan, any additional amounts loaned, any fees received, and direct loan origination costs associated with the refinancing or restructuring. A new effective interest rate is calculated using the new contractual cash flows.	IFRS does not have the concept of a troubled debt restructuring. For a modification or renegotiation that does not result in derecognition, an entity is required to recognize a modification gain or loss immediately in profit or loss. The gain or loss is determined by recalculating the gross carrying amount of the financial asset by discounting the new contractual cash flows using the original effective interest rate.

7.11 Eligibility for the fair value option

The IFRS eligibility criteria for use of the fair value option are much more restrictive than the US GAAP criteria.

US GAAP	IFRS
With some limited exceptions for certain financial assets addressed by other applicable guidance (e.g., an investment in a consolidated subsidiary, employer's rights under employee benefit plans), US GAAP permits entities to elect the fair value option for any recognized financial asset. The fair value option may only be elected upon initial recognition of the financial asset or upon some other specified election dates identified in ASC 825-10-25-4.	Under IFRS 9, the only instance when an entity can irrevocably designate financial assets as measured at FVTPL at initial recognition is when doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as "an accounting mismatch") that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases.
See SD 12.10 for differences related to the fair value option for equity-method investments.	See SD 12.10 for differences related to the fair value option for equity-method investments.

7.12 Reclassifications

Transfers of financial assets into or out of different categories are only permitted in limited circumstances under both frameworks.

US GAAP	IFRS
Changes in classification between trading, available-for-sale, and held-to-maturity categories can 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. For loans, reclassification between the held for sale and held for investment categories should generally occur at the point the intent changes.	Once the initial classification has been determined, reclassification of investments in debt instruments is only permitted when an entity changes its business model for managing the financial assets. Changes to the business model are expected to be infrequent; the change is determined by the entity's senior management as a result of external or internal changes. It must be significant to the entity's operations and should be evident to external parties. Changes in intention related to particular financial assets (even in circumstances of significant changes in market conditions) and transfers of financial assets between parts of the entity with different business models, are examples for circumstances that are not considered changes in business model.

US GAAP	IFRS
	For equity investments, the initial election to present fair value changes in OCI is irrevocable.

Impairments and subsequent losses

7.13 *Impairment principles—overall model*

The IFRS 9 impairment model is an expected loss model. Current US GAAP (until the effective date of the CECL model – see SD 7.19) is an incurred loss model. The impairment models are therefore currently fundamentally different. The models will be more converged when the US GAAP CECL model is effective; however, many significant differences will still exist.

For a comparison of the impairment models after the CECL model is effective for US GAAP, refer to our In depth US2017-24, *Contrasting the new US GAAP and IFRS credit impairment models*.

US GAAP	IFRS
Under current US GAAP, a number of impairment models exist for various types of financial instruments not measured at fair value through net income (i.e., assets measured at amortized cost or at fair value through other comprehensive income). These models recognize impairments when losses have been incurred, as opposed to expected in the future. For loans, the overriding concept in US GAAP is that impairment losses should be recognized when, based on all available information, it is probable that a loss has been incurred based on events and conditions existing at the date of the financial statements. Losses are not to be recognized before it is probable that they have been incurred, even though it may be probable or expected based on past experience that losses will be incurred in the future. For trade receivables, most entities use reserving matrices in which historical loss percentages are applied to the respective aging categories. Those historical loss percentages typically are not adjusted for future expectations.	IFRS 9 introduced an expected loss model for financial assets. While certain simplifications exist for trade receivables, contract assets, and lease receivables, the overall model applies to assets at amortized cost and FVOCI. Unlike current US GAAP, the model is forward looking and incorporates historical information, current information, and reasonable and supportable forecasts of future conditions. The model contains three stages for measuring impairment losses based on the changes in credit quality of the instrument since inception. **Stage 1** includes financial instruments that have not had a significant increase in credit risk (SICR) since initial recognition or that have low credit risk at the reporting date. For these assets, an entity will typically record a 12-month Expected Credit Losses (ECL) (i.e., the expected credit loss that result from default events that are possible within 12 months after the reporting date). It is not the expected cash shortfalls over the 12-month period, but

US GAAP	IFRS
Receivables that are either current or not yet due do not generally have a reserve. For available for sale securities, entities generally record an impairment loss when the decline in fair value is "other than temporary."	the entire credit loss on an asset weighted by the probability that the loss will occur in the next 12 months. **Stage 2** includes financial instruments that have had a SICR since initial recognition (unless they have low credit risk at the reporting date and elect the practical expedient described in SD 7.14). For these assets, lifetime ECL is recognized, but interest revenue is still recognized on the gross carrying amount of the asset. **Stage 3** includes financial assets that have objective evidence of impairment at the reporting date. For these assets, lifetime ECL is recognized and interest revenue is calculated on the net carrying amount (i.e., net of the credit allowance). An entity is required to continually assess whether a SICR has occurred. The ECL measurement must reflect the time value of money. The entity should discount the cash flows that it expects to receive at the effective interest rate determined at initial recognition, or an approximation thereof, in order to calculate ECL.

7.14 Impairment principles—available-for-sale debt securities (measured at FVOCI)

US GAAP has a trigger-based two-step test that considers the intent and ability to hold the debt securities, as well as the expected recovery of the cash flows. Under IFRS, the general "expected loss" model applies. Generally, an allowance for the 12-month expected loss is recorded on initial recognition, and an allowance for lifetime expected losses is recognized upon a significant increase in credit risk.

US GAAP	IFRS
An investment in certain debt securities classified as available for sale is assessed for impairment if the fair value is less than amortized cost. When fair value is less than amortized cost, an entity needs to determine whether the shortfall in fair value is temporary or other than temporary.	As described in SD 7.13, IFRS 9 has a three-stage model for impairment based on the changes in credit quality of the instrument since inception. The same general impairment model applies to debt investments measured at FVOCI. Upon initial recognition of a financial asset, an entity will typically record a

US GAAP	IFRS
In determining whether an impairment is other than temporary, the following factors are assessed for available-for-sale securities: **Step 1**—Can management assert (1) it does not have the intent to sell and (2) it is more likely than not that it will not have to sell before recovery of the amortized cost basis? If no, then impairment is triggered. If yes, then move to Step 2. **Step 2**—Does management expect recovery of the entire cost basis of the security? If yes, then impairment is not triggered. If no, then impairment is triggered. Once it is determined that impairment is other than temporary, the impairment loss recognized in the income statement depends on the impairment trigger: □ If impairment is triggered as a result of Step 1, the loss in AOCI due to changes in fair value is released into the income statement. □ If impairment is triggered in Step 2, the 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 described; one method could be to discount the best estimate of cash flows by the original effective interest rate. The difference between the fair value and the post-impairment amortized cost is recorded within OCI.	12-months ECL. Subsequently, the entity is required to continually assess whether a SICR has occurred. If such an increase occurs, the allowance is increased to an amount equal to lifetime ECL. Movements in the ECL allowance are recognized in the income statement. However, the allowance itself is credited to a FVOCI reserve. A practical expedient is available for assets with low credit risk. This expedient applies, for example, to investment grade assets. For such assets, an entity can choose to measure the impairment loss at the 12-months ECL and assume that no significant increase in credit risk has occurred, as long as the asset continues to be low credit risk.

7.15 *Impairment principles—held-to-maturity debt instruments (measured at amortized cost)*

US GAAP is an “incurred loss” model whereas IFRS is an “expected loss” model. US GAAP looks to a two-step test based on intent and ability to hold and expected recovery of the cash flows.

US GAAP	IFRS
The two-step impairment test described in SD 7.14 is also applicable to certain investments classified as held-to-maturity. Held-to-maturity investments would generally not trigger Step 1 (as tainting would result). Rather, evaluation of Step 2 may trigger impairment. Once triggered, impairment is measured with reference to expected credit losses, as described for available-for-sale debt securities.	The same general model (and practical expedient for investment grade assets) described in SD 7.14 applies to investments measured at amortized cost.

7.16 Impairment principles—Equity investments

Under US GAAP, for equity investments accounted for under the measurement alternative, an impairment assessment is required every reporting period. Under IFRS, there is no impairment requirement for investments in equity instruments (including those classified at FVOCI).

US GAAP	IFRS
For equity investments without readily determinable fair values, for which the "measurement alternative" was elected, there is a single-step impairment model. An entity is required to perform a qualitative assessment at each reporting period to identify impairment. When a qualitative assessment indicates that an impairment exists, the entity will need to estimate the fair value of the investment and recognize in current earnings an impairment loss equal to the difference between the fair value and the carrying amount of the equity investment. The impairment charge is a basis adjustment, which reduces the carrying amount of the equity investment to its fair value; it is not a valuation allowance.	There are no impairment requirements for investments in equity investments. For those equity investments measured at FVTPL all decreases in value are reflected in profit and loss, eliminating the need for an impairment assessment. For those equity investments measured at FVOCI, all changes in fair value are recorded through OCI with no subsequent reclassification to profit or loss.

7.17 Impairments—reversal of losses

Under the IFRS "expected loss" model, the allowance is updated every period to reflect the current assessment of expected losses. Under US GAAP, reversals are permitted for debt instruments classified as loans; however, reversal of impairment losses on debt securities is prohibited. Expected recoveries are reflected over time by adjusting the interest rate used to accrue interest income.

US GAAP	IFRS
Impairments of loans held for investment measured under ASC 310-10-35 and ASC 450 are permitted to be reversed; however, the carrying amount of the loan can at no time exceed the recorded investment in the loan. Reversals of impairment losses for debt securities classified as available-for-sale or held-to-maturity securities are prohibited. Rather, any expected recoveries in future cash flows are reflected as a prospective yield adjustment.	The amount of ECL or reversal that is required to adjust the loss allowance at the reporting date to the amount necessary under IFRS 9 is recognized in the income statement as an impairment loss or gain.

Financial asset derecognition

7.18 Derecognition

The determination of whether transferred financial assets should be derecognized (e.g., in connection with securitizations of loans or factorings of trade receivables) is based on different models under the two frameworks. Under US GAAP, the derecognition framework focuses exclusively on control, unlike IFRS, which requires consideration of risks and rewards.

The IFRS model also includes a continuing involvement accounting model that has no equivalent under US GAAP. Under US GAAP, either the transferred asset is fully derecognized or the transfer is accounted for as a collateralized borrowing. There is no concept of a "partial sale" under US GAAP.

US GAAP	IFRS
ASC 860 does not apply to transfers in which the transferee is a consolidated affiliate of the transferor, as defined in the standard. If this is the case, regardless of whether the transfer criteria are met, derecognition is not possible as the assets are, in effect, transferred within the consolidated entity. The guidance focuses on an evaluation of the transfer of control. The evaluation is governed by three key considerations: □ Legal isolation of the transferred asset from the transferor □ The ability of the transferee (or, if the transferee is a securitization vehicle, each third-party beneficial	The transferor first applies the consolidation guidance and consolidates any and all subsidiaries or special purpose entities it controls. 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 in question has been transferred. 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).

US GAAP	IFRS
interest holder) to pledge or exchange the asset (or the beneficial interest) □ The transferor has no right or obligation to repurchase the transferred assets As such, derecognition can be achieved even if the transferor has significant ongoing involvement with the transferred assets, such as significant exposure to credit risk. If a transfer of an entire financial asset qualifies for sale accounting, the transferred asset must be derecognized from the transferor's balance sheet. All assets received and obligations assumed in exchange are recognized at fair value. If the transferor continues to service the transferred assets, a related servicing asset or servicing liability should be recorded at its fair value. Any gain or loss on the transfer should be recognized, calculated as the difference between the net proceeds received and the carrying value of the assets sold. A transfer may comprise only a portion of an entire financial asset (e.g., a transfer involving a loan participation). To potentially qualify for sale accounting, the transferred portion must first meet the stringent accounting definition of a "participating interest." If the transferred portion does not satisfy this definition, the exchange must be accounted for as a secured borrowing. If the definition is met, the transfer of the participating interest must then satisfy the three derecognition criteria cited above to qualify for sale accounting. If a transfer of a participating interest qualifies for derecognition, the transferor must allocate the carrying value of the entire financial asset between the participating interest sold and the portion retained on a pro-rata basis. All assets received and obligations assumed in exchange are recognized at fair value, consistent with the measurement principles that govern derecognition of an entire financial asset.	Under IFRS 9, full derecognition is appropriate once both of the following conditions have been met: □ The financial asset has been transferred outside the consolidated group. □ The entity has transferred substantially all of the risks and rewards of ownership of the financial asset. The first condition is achieved in one of two ways: □ When an entity transfers the contractual rights to receive the cash flows of the financial asset, or □ When an entity retains the contractual rights to the cash flows but assumes a contractual obligation to pass the cash flows on to one or more recipients (referred to as a pass-through arrangement) Many securitizations do not meet the strict pass-through criteria to recognize a transfer of the asset outside of the consolidated group and as a result fail the first condition for derecognition. If there is a qualifying transfer, an entity must determine the extent to which it retains the risks and rewards of ownership of the financial asset. IFRS 9 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. If the entity's exposure does not change substantially, derecognition would be precluded. Rather, a liability equal to the consideration received would be recorded (i.e., a financing transaction). If, however, substantially all risks and rewards are transferred, the entity would derecognize the financial asset transferred and recognize separately any asset or liability created through any rights and obligations retained in the transfer (e.g., servicing assets). Many securitization transactions include some ongoing involvement by the transferor that causes the transferor to retain substantial risks and rewards, thereby failing the second condition for derecognition, even if the pass-through test is met.

7.19 Recent/proposed guidance

7.19.1 FASB Accounting Standards Update 2016-13, Financial Instruments—Credit Losses (Topic 326)

On June 16, 2016, the FASB issued Accounting Standards Update 2016-13, *Financial Instruments – Credit Losses (Topic 326)*, which introduces new guidance for the accounting for credit losses on instruments within its scope.

The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale (AFS) debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination.

The FASB's model requires recognition of full lifetime expected credit losses upon initial recognition of the financial asset, whereas the IASB's model requires recognition of full lifetime expected credit losses upon a significant deterioration in credit risk. Absent a significant deterioration in credit risk, the IASB model requires a provision for credit losses that result from default events that are possible within 12 months after the reporting date. Additional differences exist between the two models. For example: (1) with regard to instruments measured at fair value through other comprehensive income, (2) the period to consider when measuring expected credit losses for certain instruments and (3) the accounting for purchased financial assets with credit deterioration.

Scope

The new FASB model, referred to as the current expected credit losses (CECL) model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost and (2) certain off-balance sheet credit exposures. This includes loans, held-to-maturity debt securities, loan commitments, financial guarantees, and net investments in leases, as well as reinsurance and trade receivables.

Measurement of expected credit losses

Upon initial recognition of the exposure, the CECL model requires an entity to estimate the credit losses expected over the life of an exposure (or pool of exposures). The estimate of expected credit losses (ECL) should consider historical information, current information, and reasonable and supportable forecasts, including estimates of prepayments. Financial instruments with similar risk characteristics are grouped together when estimating ECL. ASU 2016-13 does not prescribe a specific method to make the estimate so its application will require significant judgment. Generally, the initial estimate of the ECL and subsequent changes in the estimate will be reported in current earnings. The ECL will be recorded through an allowance for loan and lease losses (ALLL) in the statement of financial position. See below for different accounting that may apply for purchased financial assets with credit deterioration.

Available-for-sale (AFS) debt securities

ASU 2016-13 amends the current US GAAP other-than-temporary impairment model for AFS debt securities. The new model will require an estimate of ECL only when the fair value is below the amortized cost of the asset. The length of time the fair value of an AFS debt security has been below the amortized cost will no longer impact the determination of whether a credit loss exists. As such, it is no longer an other-than-temporary model. In addition, credit losses on AFS debt securities will now be limited to the difference between the security's amortized cost basis and its fair value. The AFS debt security model will also require the use of an allowance to record estimated credit losses (and subsequent recoveries). This is a significant change from the current model. Consideration of the time value of money is required, and therefore, a discounted cash flow calculation must be performed.

Purchased financial assets with credit deterioration

The purchased financial assets with credit deterioration (PCD) model applies to purchased financial assets (measured at amortized cost or AFS) that have experienced more than insignificant credit deterioration since origination. This represents a change from today's model, under which a purchased credit impaired asset is one for which it is probable that not all contractual cash flows will be collected and that has experienced a deterioration in credit quality. The new model does not require an assessment of probability. The initial estimate of expected credit losses for a PCD under the new model would be recognized through an ALLL with an offset to the cost basis of the related financial asset at acquisition (i.e., there is no impact to net income at initial recognition). Subsequently, the accounting will follow the applicable CECL or AFS debt security impairment model with all adjustments of the ALLL recognized through earnings.

Disclosure

ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the ALLL. In addition, public business entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination (i.e., by vintage year). This disclosure will not be required for other reporting entities.

Effective date

The ASU is effective for public business entities that are SEC filers in fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. All other entities have one additional year. Non-public business entities are not required to apply the provisions to interim periods until fiscal years beginning after December 15, 2021. Early application of the guidance is permitted for all entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

7.19.2 Premium Amortization on purchased callable debt securities

In March 2017, the FASB issued Accounting Standards Update 2017-08, *Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*.

The new guidance shortens the amortization period for certain purchased callable debt securities held at a premium. Specifically, it requires the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity.

The new guidance is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the new guidance is effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, including adoption in an interim period.

7.19.3 Amendments to IFRS 9: prepayment features with negative compensation

In October 2017, the IASB issued a narrow-scope amendment to IFRS 9. The amendment permits more assets to be measured at amortized cost than under the previous version of IFRS 9 (in particular, certain prepayable financial assets with negative compensation). Negative compensation arises where the contractual terms permit the borrower to prepay the instrument before its contractual maturity, but the prepayment amount could be less than unpaid amounts of principal and interest.

The amendment is effective for annual periods beginning on or after January 1, 2019, that is, one year later than the effective date of IFRS 9. Early adoption is permitted.

Chapter 8: Liabilities—taxes

8.1 Liabilities—taxes

Both US GAAP and IFRS base their deferred tax accounting requirements on balance sheet temporary differences, measured at the tax rates expected to apply when the differences reverse. Discounting of deferred taxes is also prohibited under both frameworks. Although the two frameworks share many fundamental principles, they are at times applied in different manners and there are different exceptions to the principles under each framework. This may result in differences in income tax accounting between the two frameworks. Some of the more significant differences relate to the allocation of tax expense/benefit to financial statement components ("intraperiod allocation"), income tax accounting with respect to share-based payment arrangements, and some elements of accounting for uncertain tax positions. Recent developments in US GAAP and IFRS will eliminate or reduce certain of these differences, as discussed below. Refer to SD 8.20 for the detail of recent/proposed guidance.

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

Technical references

US GAAP

ASC 740

IFRS

IAS 1, IAS 12, IAS 34, IAS 37

Note

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

8.2 Hybrid taxes

Hybrid taxes are based on the higher or lower of a tax applied to (1) a net amount of income less expenses, such as taxable profit or taxable margin, (generally considered an income tax) and (2) a tax applied to a gross amount, such as revenue or capital, (generally not considered income taxes). Hybrid taxes are assessed differently under the two frameworks, which could lead to differences in presentation in the income statement and recognition and measurement of deferred taxes.

US GAAP	IFRS
Taxes based on a gross amount are not accounted for as income taxes and should be reported as pre-tax items. A hybrid tax is considered an income tax and is presented as income tax expense only to the extent that it *exceeds* the tax based on the amount not considered income in a given year. Deferred taxes should be recognized and measured according to that classification.	Accounting for hybrid taxes is not specifically addressed within IFRS. Applying the principles in IAS 12 to the accounting for hybrid taxes, entities can adopt either one of the following approaches and apply it consistently: □ Designate the tax based on the gross amount not considered income as the minimum amount and recognize it as a pre-tax item. Any excess over that minimum amount would then be reported as income tax expense; or □ Designate the tax based on the net amount of income less expenses as the minimum amount and recognize it as income tax expense. Any excess over that minimum would then be reported as a pre-tax item. □ Deferred taxes should be recognized and measured according to the classification chosen.

8.3 Tax base of an asset or a liability

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

US GAAP	IFRS
Tax base is based upon the relevant tax law. It is generally determined by the amount that is depreciable for tax purposes or deductible upon sale or liquidation of the asset or settlement of the liability.	Tax base is based on the tax consequences that will occur based upon how an entity is expected to recover or settle the carrying amount of assets and liabilities. The carrying amount of assets or liabilities can be recovered or settled through use or through sale. Assets and liabilities may also be recovered or settled both through use and 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. Exceptions to these requirements include:

US GAAP	IFRS
	▫ A rebuttable presumption exists that investment property measured at fair value will be recovered through sale. ▫ Non-depreciable assets measured using the revaluation model in IAS 16 are presumed to be recovered through sale.

8.4 Initial recognition of an asset or a liability

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

US GAAP	IFRS
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. An exemption exists from the initial recognition of temporary differences in connection with transactions that qualify as leveraged leases under the historical lease-accounting guidance in ASC 840. While the new lease guidance in ASC 842 does not permit any new leases to be classified as leveraged leases, existing leases that met the definition in ASC 840 at inception are grandfathered and, assuming they are not modified, continue to follow the prior accounting.	An exception exists that deferred taxes should not be recognized on the initial recognition of an asset or liability in a transaction which is not a business combination and affects neither accounting profit nor taxable profit/loss at the time of the transaction. No special treatment of leveraged leases exists under IFRS.

8.5 Recognition of deferred tax assets

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

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

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

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

US GAAP	IFRS
With respect to undistributed profits and other outside basis differences, different requirements exist depending on whether they involve investments in subsidiaries, joint ventures, or equity investees. As it relates to investments in domestic subsidiaries, deferred tax liabilities are required on undistributed profits arising after 1992 unless the amounts can be recovered on a tax-free basis and the entity anticipates utilizing that method. As it relates to investments in domestic corporate joint ventures, deferred tax liabilities are required on undistributed profits that arose after 1992. No deferred tax liabilities are recognized on undistributed profits and other outside basis differences of foreign subsidiaries and corporate joint ventures that meet the indefinite reversal criterion. Deferred taxes are generally recognized on temporary differences related to investments in equity investees.	With respect to undistributed profits and other outside basis differences related to investments in foreign and domestic subsidiaries, branches and associates, and interests in joint arrangements, deferred tax liabilities are recognized except when a parent company, investor, joint venturer or joint operator is able to control the timing of reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. The general guidance regarding deferred taxes on undistributed profits and other outside basis differences is applied when there is a change in the status of an investment. Deferred tax assets for investments in foreign and domestic subsidiaries, branches and associates, and interests in joint arrangements are recorded only to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

US GAAP	IFRS
US GAAP contains specific guidance on how to account for deferred taxes when there is a change in the status of an investment. If an investee becomes a subsidiary, the temporary difference for the investor's share of the undistributed earnings of the investee prior to the date it becomes a subsidiary is "frozen" and continues to be recognized as a temporary difference for which a deferred tax liability will be recognized. If a foreign subsidiary becomes an investee, the amount of outside basis difference of the foreign subsidiary for which deferred taxes were not provided on the basis of the indefinite reversal exception is effectively "frozen" until the period in which it becomes apparent that any of those undistributed earnings (prior to the change in status) will be remitted. US GAAP notes that the change in status of an investment would not by itself mean that remittance of those undistributed earnings is considered apparent. 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.	

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

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

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

8.8 Uncertain tax positions

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

US GAAP	IFRS
Uncertain tax positions are recognized and measured using a two-step process: (1) determine whether a benefit may be recognized and (2) measure the amount of the benefit. Tax benefits from uncertain tax positions may be recognized only if it is more likely than not that the tax position is sustainable based on its technical merits. Uncertain tax positions are evaluated at the individual tax position level. The tax benefit is measured by using a cumulative probability model: the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement.	The IFRS Interpretations Committee issued new guidance that clarifies how the recognition and measurement requirements of IAS 12 are applied when there is uncertainty over income tax treatments. Refer to SD 8.20.4 for further details. Under current guidance prior to adoption of IFRIC 23, accounting for uncertain tax positions is not specifically addressed within IFRS. IAS 37 excludes income taxes from its scope and is not used to recognize or measure uncertain tax positions. The principles in IAS 12 are applied to uncertain tax positions. The tax accounting should follow the manner in which an entity expects the tax position to be resolved with the taxation authorities at the balance sheet date. Practice has developed such that uncertain tax positions may be evaluated at the level of the individual uncertainty or group of related uncertainties. Alternatively, they may be considered at the level of total tax liability to each taxing authority. Acceptable methods by which to measure tax positions include (1) the expected-value/probability-weighted-average approach and (2) the single-best-estimate/most-likely-outcome method. Use of the cumulative probability model required by US GAAP is not consistent with IFRS.

US GAAP	IFRS
Relevant developments affecting uncertain tax positions after the balance sheet date but before issuance of the financial statements (including the discovery of information that was not available as of the balance sheet date) would be considered a non-adjusting subsequent event for which no effect would be recorded in the current-period financial statements.	Relevant developments affecting uncertain tax positions occurring after the balance sheet date but before issuance of the financial statements (including the discovery of information that was not available as of the balance sheet date) would be considered either an adjusting or non-adjusting event depending on whether the new information provides evidence of conditions that existed at the end of the reporting period.
Interest and penalties	**Interest and penalties**
The income statement 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.	An entity needs to consider the specific nature of interest and penalties to determine whether they are income taxes or not. If a particular amount is an income tax, it should apply IAS 12 to that amount. Otherwise, it should apply IAS 37. This determination is not an accounting policy choice.

8.9 *Special deductions, investment tax credits, and tax holidays*

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

US GAAP	IFRS
Special deductions	**Special deductions**
Several specific deductions under US tax law have been identified under US GAAP as special deductions. Special deductions are recognized in the period in which they are claimed on the tax return. Entities subject to graduated tax rates should evaluate whether the ongoing availability of special deductions is likely to move the entity into a lower tax band which might cause deferred taxes to be recorded at a lower rate.	Special deductions are not defined under IFRS but are treated in the same way as tax credits. Tax credits are recognized in the period in which they are claimed on the tax return, however certain credits may have the substantive effect of reducing the entity's effective tax rate for a period of time. The impact on the tax rate can affect how entities should record their deferred taxes. In other cases the availability of credits might reduce an entity's profits in a way that moves it into a lower tax band, and again this may impact the rate at which deferred taxes are recorded.

US GAAP	IFRS
Investment tax credits	**Investment tax credits**
It is preferable to account for investment tax credits using the "deferral method" in which the entity spreads the benefit of the credit over the life of the asset. However, entities might alternatively elect to recognize the benefit in full in the year in which it is claimed (the "flow-through method").	IAS 12 states that investment tax credits are outside the scope of the income taxes guidance. IFRS does not define investment tax credits, but we believe that it is typically a credit received for investment in a recognized asset. Depending on the nature of the credit it might be accounted for in one of three ways: □ In the same way as other tax credits; □ As a government grant under IAS 20; or □ As an adjustment to the tax base of the asset to which the initial recognition exception is likely to apply.
Tax holidays	**Tax holidays**
Deferred taxes are not recorded for any tax holiday but rather the benefit is recognized in the periods over which the applicable tax rate is reduced or that the entity is exempted from taxes. Entities should, however, consider the rate at which deferred taxes are recorded on temporary differences. Temporary differences expected to reverse during the period of the holiday should be recorded at the rate applicable during the holiday rather than the normal statutory income tax rate.	While IFRS does not define a tax holiday, the treatment is in line with US GAAP in that the holiday itself does not create deferred taxes, but it might impact the rate at which deferred tax balances are measured.

8.10 Intercompany transfers of inventory

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

US GAAP	IFRS
The FASB issued guidance that eliminates the deferral of recognition of tax impacts for intercompany sales or transfers of assets (other than inventory). The guidance is currently effective for public business entities, and may be early adopted by all other entities. Once adopted, the difference between US GAAP and IFRS guidance	There is no exception to the model for the income tax effects of transferring assets between the entities in the consolidated groups. Any tax impacts to the consolidated financial statements as a result of the intercompany transaction are recognized as incurred. If the transfer results in a change in the tax base of the asset transferred,

US GAAP	IFRS
will be reduced to intercompany sales or transfers of inventory. Refer to SD 8.20.2 for further details. For purposes of the consolidated financial statements, any tax impacts to the seller as a result of an intercompany sale or transfer of inventory are deferred until the asset is sold to a third-party or otherwise recovered (e.g., written down). In addition, the buyer is prohibited from recognizing a deferred tax asset resulting from the difference between the tax basis and consolidated carrying amount of the asset.	deferred taxes resulting from the intragroup sale are recognized at the buyer's tax rate.

8.11 Change in tax laws and rates

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

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

8.12 Tax rate on undistributed earnings of a subsidiary

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

US GAAP	IFRS
For jurisdictions that have a tax system under which undistributed profits are subject to a corporate tax rate higher than distributed profits, effects of temporary differences should be measured using the undistributed tax rate. Tax benefits of future tax credits that will be realized when the income is distributed cannot be recognized before the period in which those credits are included in the entity's tax return.	Where income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings are distributed as dividends, deferred taxes are measured at the tax rate applicable to undistributed profits. In consolidated financial statements, when a parent has a subsidiary in a dual-rate tax jurisdiction and expects to distribute profits of the subsidiary in the foreseeable future, it should measure

US GAAP	IFRS
A parent company with a subsidiary entitled to a tax credit for dividends paid should use the distributed rate when measuring the deferred tax effects related to the operations of the foreign subsidiary. However, the undistributed rate should be used in the consolidated financial statements if the parent, as a result of applying the indefinite reversal criteria, has not provided for deferred taxes on the unremitted earnings of the foreign subsidiary. For jurisdictions where the undistributed rate is lower than the distributed rate, the use of the distributed rate is preferable but the use of the undistributed rate is acceptable provided appropriate disclosures are added.	the temporary differences relating to the investment in the subsidiary at the rate that would apply to distributed profits. This is on the basis that the undistributed earnings are expected to be recovered through distribution and the deferred tax should be measured according to the expected manner of recovery.

8.13 Presentation

Presentation differences related to uncertain tax positions could affect the calculation of certain ratios from the face of the balance sheet (including an entity's current ratio).

US GAAP	IFRS
A liability for uncertain tax positions is classified as a current liability only to the extent that cash payments are anticipated within 12 months of the reporting date. Otherwise, such amounts are reflected as noncurrent liabilities. A liability for an unrecognized tax benefit should be presented as a reduction to a deferred tax asset for a net operating loss or tax credit carryforward if the carryforward is available at the reporting date to settle any additional income taxes that would result from the disallowance of the uncertain tax position. Netting would not apply, however, if the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the carryforward for such purpose.	A liability for uncertain tax positions relating to current or prior year returns is generally classified as a current liability on the balance sheet because entities typically do not have the unconditional right to defer settlement of uncertain tax positions for at least 12 months after the end of the reporting period. There is no specific guidance under IFRS on the presentation of liabilities for uncertain tax positions when a net operating loss carryforward or a tax credit carryforward exists. The general guidance in IAS 12 on the presentation of income taxes applies.

8.14 *Intraperiod allocation*

Differences can arise in accounting for the tax effect of a loss from continuing operations. Subsequent changes to deferred taxes could result in less volatility in the statement of operations under IFRS.

US GAAP	IFRS
The tax expense or benefit is allocated between the financial statement components (such as continuing operations, discontinued operations, other comprehensive income, and equity) following a "with and without" approach: □ First, the total tax expense or benefit for the period is computed, □ Then the tax expense or benefit attributable to continuing operations is computed separately without considering the other components, and □ The difference between the total tax expense or benefit for the period and the amount attributable to continuing operations is allocated amongst the other components. An exception to that model requires that all components be considered to determine the amount of tax benefit that is allocated to a loss from continuing operations. Subsequent changes in deferred tax balances due to enacted tax rate and tax law changes are taken through profit or loss regardless of whether the deferred tax was initially created through profit or loss or other comprehensive income, through equity, or in acquisition accounting. The same principle applies to changes in assertion with respect to unremitted earnings of foreign subsidiaries; deferred taxes are recognized in continuing operations even if some of the temporary difference arose as a result of foreign exchange recognized in OCI (with the exception of current-year foreign exchange that is recognized in CTA). Changes in the amount of valuation allowance due to changes in assessment	Tax follows the pre-tax item. Current and deferred tax on items recognized in other comprehensive income or directly in equity should be similarly recognized in other comprehensive income or directly in equity. When an entity pays tax on all of its profits, including elements recognized outside of profit or loss, it can be difficult to determine the share attributable to individual components. Under such circumstances, tax should be allocated on a pro rata basis or other basis that is more appropriate in the circumstances. Subsequent changes in deferred tax are recognized in profit or loss, OCI, or equity depending on where the transaction(s) giving rise to the deferred tax were recorded. Entities must "backwards trace" based upon how the deferred tax balance arose to determine where the change in deferred tax is recorded.

US GAAP	IFRS
about realization in future periods are generally taken through the income statement, with limited exceptions for certain equity-related items.	

8.15 Disclosures

The disclosures required by the frameworks differ in a number of respects, but perhaps the two most significant differences relate to uncertain tax positions and the rate used in the effective tax rate reconciliation. Other disclosure differences are largely a consequence of differences in the underlying accounting models.

US GAAP	IFRS
Public entities are required to present a tabular reconciliation of unrecognized tax benefits relating to uncertain tax positions from one year to the next. The effective tax rate reconciliation is presented using the statutory tax rate of the parent company.	Entities with contingent tax assets and liabilities are required to provide IAS 37 disclosures in respect of these contingencies, but there is no requirement for a tabular reconciliation. The effective tax rate reconciliation can be presented using either the applicable tax rates or the weighted average tax rate applicable to profits of the consolidated entities.

8.16 Interim reporting

A worldwide effective tax rate is used to record interim tax provisions under US GAAP. Under IFRS, a separate estimated average annual effective tax rate is used for each jurisdiction.

US GAAP	IFRS
In general, the interim tax provision is determined by applying the estimated annual worldwide effective tax rate for the consolidated entity to the worldwide consolidated year-to-date pretax income.	The interim tax provision is determined by applying an estimated average annual effective tax rate to interim period pretax income. To the extent practicable, a separate estimated average annual effective tax rate is determined for each material tax jurisdiction and applied individually to the interim period pretax income of each jurisdiction.

8.17 Separate financial statements

US GAAP provides guidance on the accounting for income taxes in the separate financial statements of an entity that is part of a consolidated tax group.

US GAAP	IFRS
The consolidated current and deferred tax amounts of a group that files a consolidated tax return should be allocated among the group members when they issue separate financial statements using a method that is systematic, rational and consistent with the broad principles of ASC 740. An acceptable method is the "separate return" method. It is also acceptable to modify this method to allocate current and deferred income taxes using the "benefits-for-loss" approach.	There is no specific guidance under IFRS on the methods that can be used to allocate current and deferred tax amounts of a group that files a consolidated tax return among the group members when they issue separate financial statements.

8.18 Share-based payment arrangements

Significant differences in current and deferred taxes exist between US GAAP and IFRS with respect to share-based payment arrangements. The relevant differences are described in the Expense recognition—share-based payments chapter.

8.19 Accounting considerations of US tax reform

The Tax Cuts and Jobs Act of 2017 (the 2017 Act) significantly changed many provisions of US tax law, and those tax law changes could have a significant impact on the current and deferred taxes of entities with US operations. In response, the FASB staff issued several FASB Staff Q&As that address accounting for the 2017 Act under US GAAP. The FASB also issued new guidance related to the reclassification of certain tax effects from accumulated other comprehensive income. Refer to SD 8.20.6 for details.

Since the FASB guidance is applied only to entities under US GAAP, the accounting impact of the 2017 Act could be different between IFRS and US GAAP in certain areas, as summarized below. Additionally, an entity would need to consider other differences discussed in this publication when considering the accounting impact of the 2017 Act.

8.19.1 Deemed mandatory repatriation ("toll tax")

The 2017 Act required a deemed mandatory repatriation of previously undistributed earnings and profits (E&P) of foreign corporations owned by US parents.

US GAAP	IFRS
The FASB staff concluded that the toll tax liability should not be discounted under US GAAP.	IAS 12 is silent on discounting current tax balances. There is an accounting policy choice of whether to discount the toll tax liability.

8.19.2 Alternative minimum tax (AMT) credit carryforwards

The 2017 Act repealed the AMT. AMT credit carryforwards at January 1, 2018 can now be offset against regular tax, and any remaining balances will be refundable over the next four years. An entity should decide whether to reclassify the AMT credit carryforwards as a receivable. An entity might classify them as a deferred tax asset if they will be recovered against future tax liabilities, or as a receivable if they will be refunded in cash.

US GAAP	IFRS
The FASB staff concluded that the AMT credit carryforwards should not be discounted under US GAAP, regardless of the expected manner of recovery.	IAS 12 is silent on discounting current tax balances. There is an accounting policy choice of whether to discount the receivable for AMT credit carryforwards.

8.19.3 Base erosion anti-abuse tax (BEAT)

The 2017 Act introduced a new minimum tax on certain international intercompany payments as a means to reduce the ability of multi-national companies to erode the US tax base through deductible related-party payments. The minimum tax, known as BEAT, is imposed when the tax calculated under BEAT exceeds an entity's regular tax liability determined after the application of certain credits allowed against the regular tax.

US GAAP	IFRS
The FASB staff concluded that temporary differences should be measured at regular statutory tax rates versus considering the impact of BEAT in determining the rate expected to apply. Therefore, the effects of BEAT should be recognized as a period cost when incurred versus being considered in the measurement of deferred taxes.	No specific guidance related to BEAT exists under IFRS. It would be acceptable for an entity to measure deferred taxes at the regular statutory tax rate and account for the effects of BEAT in the year in which they are incurred.
The FASB staff also concluded that an entity does not need to evaluate the effect of potentially paying the BEAT tax in future years on the realization of deferred tax assets. While not required, we believe that companies may elect to do so.	There is no similar guidance under IFRS on the potential impact of BEAT on the realizability of deferred tax assets.

8.19.4 Global intangible low-taxed income (GILTI)

The 2017 Act introduced a new tax on certain global intangible low-taxed income (GILTI) of a US shareholder's controlled foreign corporations. The GILTI inclusion will be part of the entity's taxable income for US tax purposes each year.

US GAAP	IFRS
The FASB staff concluded that an entity that is subject to GILTI must make an accounting policy election to either treat GILTI as a period cost, or to record deferred taxes for basis differences that are expected to reverse as GILTI in future years.	It would be acceptable to recognize any taxes for GILTI as a period cost when GILTI is included on the tax return. It would also be acceptable to reflect the impact of the GILTI inclusion in the tax rate used to measure deferred taxes for temporary differences expected to reverse as GILTI. Judgment will be required to determine which approach is more appropriate.

8.19.5 *Foreign derived intangible income (FDII)*

The 2017 Act introduced an additional deduction for US companies that produce goods and services domestically and sell them abroad, known as foreign derived intangible income (FDII).

US GAAP	IFRS
We believe that FDII should be accounted for as a special deduction. Under US GAAP, special deductions are recognized in the period in which they are included in the tax return, instead of being reflected in the measurement of deferred taxes (refer to SD 8.9).	IFRS does not address special deductions. It would be acceptable to recognize FDII in the period in which the deduction is included in the tax return. It might also be acceptable to reflect the impact in the measurement of deferred taxes on temporary differences that will be subject to FDII upon reversal.

8.20 *Recent/proposed guidance*

8.20.1 *FASB's ongoing project*

In July 2016, the FASB issued an exposure draft of a proposed Accounting Standards Update regarding income tax disclosures as a part of its Disclosure Framework project. The exposure draft proposed requirements for disaggregated disclosure of domestic and foreign taxes, information about cash and cash equivalents held by foreign subsidiaries, and other enhancements of disclosure regarding tax law changes, changes in valuation allowances, tax attributes, and uncertain tax positions. In addition, the exposure draft proposed the disclosure of the terms of any rights or privileges granted by a governmental entity directly to the reporting entity that have reduced, or may reduce, the entity's income tax burden. The IASB is not planning to make any equivalent changes to IAS 12.

8.20.2 *FASB guidance on intra-entity asset transfers*

In October 2016, the FASB issued Accounting Standards Update No. 2016-16, *Income Taxes (Topic 740) – Intra-Entity Transfers of Assets Other Than Inventory*, which eliminates the current exception for the recognition of taxes on intercompany transfers of assets. The guidance does not apply to intra-entity transfers of inventory. The income tax consequences from the sale of inventory from one member of a consolidated entity to another will continue to be deferred until the inventory is sold to a third party. As a result, a difference will remain between US GAAP and IFRS with regard to intra-entity inventory transactions.

The guidance is effective for public business entities in fiscal years beginning after December 15, 2017, including interim periods within those years. For entities other than public business entities, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted, but only in the first interim period of a fiscal year.

8.20.3 FASB and IASB guidance on the recognition of deferred tax assets arising from unrealized losses on debt investments

In Accounting Standards Update No. 2016-01, *Financial Instruments–Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*, issued in January 2016, the FASB clarified that the assessment of whether a valuation allowance is needed on deferred tax assets that arise from unrealized losses on debt investments measured at fair value through other comprehensive income should be evaluated in combination with the other deferred tax assets, based on available future taxable income of the appropriate character. The ASU is effective for public business entities in fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities, the guidance will be effective in fiscal years beginning after December 15, 2018 and interim periods within fiscal years beginning after December 15, 2019, and may be early adopted coincident with the public business entities' effective date.

In January 2016, the IASB made equivalent amendments to IAS 12. The amendments are already effective for annual periods beginning on or after January 1, 2017 under IFRS.

8.20.4 IASB guidance on uncertainty over income tax treatments

In June 2017, the IFRS Interpretations Committee issued IFRIC Interpretation 23, *Uncertainty over Income Tax Treatments,* which clarifies how the recognition and measurement requirements of IAS 12 should be applied when there is uncertainty over income tax treatments. IFRIC 23 applies to all aspects of income tax accounting when there is an uncertainty regarding the treatment of an item, including taxable profit or loss, the tax bases of assets and liabilities, tax losses and credits, and tax rates.

The interpretation requires an entity to assess whether to consider individual uncertainties separately or collectively based on which method better predicts the resolution of the uncertainty. IFRIC 23 also reaffirms that an entity should assume that the tax authority with the right to examine amounts reported to it will examine those amounts and have full knowledge of all relevant information. The interpretation further notes that tax assets or liabilities arising from uncertain tax treatments should be assessed using a "probable" recognition threshold. For those items that meet the probable recognition threshold, IFRIC 23 requires an entity to measure the impact of the uncertainty using the method that better predicts the resolution of the uncertainty - either the most likely amount method or the expected value method. The interpretation also reaffirms that the judgments and estimates made to recognize and measure the effect of uncertain tax treatments should be reassessed whenever circumstances change or when there is new information that affects those judgments.

The interpretation is effective for annual periods beginning on or after January 1, 2019 with earlier adoption permitted.

In September 2017, the IFRS Interpretations Committee issued an agenda decision on interest and penalties related to income taxes and decided not to develop guidance. Refer to SD 8.8 for details.

8.20.5 New IASB guidance on income tax consequences of payments on financial instruments classified as equity

In December 2017, the IASB amended IAS 12 to clarify that the income tax consequences of dividends on financial instruments classified as equity should be recognized according to where the past transactions or events that generated distributable profits were recognized. These requirements apply to all income tax consequences of dividends. Previously, it was unclear whether the income tax consequences of dividends should be recognized in profit or loss, or in equity, and the scope of the existing guidance was ambiguous. The IASB noted that the amendments do not suggest that an entity is required to recognize the income tax consequences of all payments on financial instruments classified as equity in profit or loss. Rather, the tax consequences are recognized in profit or loss only when an entity determines payments on such instruments are distributions of profits (that is, dividends). An entity may need to apply judgment in making this determination.

The amendments are effective for annual periods beginning on or after January 1, 2019 and should be applied to the income tax consequences of dividends recognized on or after the beginning of the earliest period presented. Earlier application is permitted.

8.20.6 New FASB guidance on reclassification of certain tax effects from accumulated other comprehensive income

In February 2018, the FASB issued Accounting Standards Update No. 2018-02, *Income Statement — Reporting Comprehensive Income (Topic 220) - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*, which permits an entity to reclassify the disproportionate income tax effects of the 2017 Act on items within accumulated other comprehensive income to retained earnings. The ASU is not applicable to the impact of any other prior or future changes in tax laws or rates.

The guidance is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Public business entities may early adopt the guidance for financial statements that have not yet been issued. All other entities may early adopt the guidance for financial statements that have not yet been made available for issuance. Entities may adopt the new guidance using one of two transition methods: (1) retrospective to each period (or periods) in which the income tax effects of the 2017 Act related to items remaining in accumulated other comprehensive income are recognized, or (2) at the beginning of the period of adoption.

Chapter 9: Liabilities—other

9.1 Liabilities—other

The guidance in relation to nonfinancial liabilities (e.g., provisions, contingencies, and government grants) includes some fundamental differences with potentially significant implications.

For instance, a difference exists in the interpretation of the term "probable." IFRS defines probable as "more likely than not," but US GAAP defines probable as "likely to occur." Because both frameworks reference probable within the liability recognition criteria, this difference could lead companies to record provisions earlier under IFRS than they otherwise would have under US GAAP. The use of the midpoint of a range when several outcomes are equally likely (rather than the low-point estimate, as used in US GAAP) might also lead to higher expense recognition under IFRS.

IFRS does not have the concept of an ongoing termination plan, whereas severance is recognized under US GAAP once probable and reasonably estimable. This could lead companies to record restructuring provisions in periods later than they would under US GAAP.

As it relates to reimbursement rights, IFRS has a higher threshold for the recognition of reimbursements of recognized losses by requiring that they be virtually certain of realization, whereas the threshold is lower under US GAAP.

Technical references

US GAAP

ASC 410-30, ASC 420, ASC 450, ASC 460-10, ASC 958-605

IFRS

IAS 19, IAS 20, IAS 37, IFRIC 21

Note

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

9.2 Recognition of provisions

Differences in the definition of "probable" may result in earlier recognition of liabilities under IFRS.

The IFRS "present obligation" criteria might result in delayed recognition of liabilities when compared with US GAAP.

US GAAP	IFRS
A loss contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. An accrual for a loss contingency is required if two criteria are met: (1) if it is probable that a liability has been incurred and (2) the amount of loss can be reasonably estimated.	A contingent liability is defined as a possible obligation from a past event whose outcome will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the entity's control. A contingent liability is not recognized. A contingent liability becomes a provision and is recorded when three criteria are met: (1) a present obligation from a past event exists, (2) it is probable that an outflow of resources will be required to settle the obligation, and (3) a reliable estimate can be made.
Implicit in the first condition above is that it is probable that one or more future events will occur confirming the fact of the loss. The guidance uses the term "probable" to describe a situation in which the outcome is likely to occur. While a numeric standard for probable does not exist, practice generally considers an event that has a 75% or greater likelihood of occurrence to be probable.	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%.

9.3 *Measurement of provisions*

In certain circumstances, the measurement objective of provisions varies under the two frameworks.

IFRS results in a higher liability being recorded when there is a range of possible outcomes with equal probability.

US GAAP	IFRS
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. 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	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). 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.

US GAAP	IFRS
accumulation of the entity's cost estimates. When no amount within a range is a better estimate than any other amount, the low end of the range is accrued.	

9.4 *Discounting of provisions*

Provisions will be discounted more frequently under IFRS. At the same time, greater charges will be reflected as operating (versus financing) under US GAAP.

US GAAP	IFRS
For losses that meet the accrual criteria of ASC 450, an entity will generally record them at the amount that will be paid to settle the contingency, without considering the time that may pass before the liability is paid. Discounting these liabilities is acceptable when the aggregate amount of the liability and the timing of cash payments for the liability are fixed or determinable. Entities with these liabilities that are eligible for discounting are not, however, required to discount those liabilities; the decision to discount is an accounting policy choice. The classification in the statement of operations of the accretion of the liability to its settlement amount is an accounting policy decision that should be consistently applied and disclosed. When discounting is applied, the discount rate applied to a liability should not change from period to period if the liability is not recorded at fair value. There are certain instances outside of ASC 450 (e.g., in the accounting for asset retirement obligations) where discounting is required.	IFRS requires that the amount of a provision be the present value of the expenditure expected to be required to settle the obligation. The anticipated cash flows are discounted using a pre-tax discount rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability (for which the cash flow estimates have not been adjusted) if the effect is material. Provisions shall be reviewed at the end of each reporting period and adjusted to reflect the current best estimate. The carrying amount of a provision increases in each period to reflect the passage of time with said increase recognized as a borrowing cost.

9.5 Restructuring provisions (excluding business combinations)

IFRS does not have the concept of an ongoing termination plan, whereas a severance liability is recognized under US GAAP once it is probable and reasonably estimable. This could lead companies to record restructuring provisions in periods later than they would under US GAAP.

US GAAP	IFRS
Guidance exists for different types of termination benefits (e.g., special termination benefits, contractual termination benefits, severance benefits, and one-time benefit arrangements). If there is a pre-existing arrangement such that the employer and employees have a mutual understanding of the benefits the employee will receive if involuntarily terminated, the cost of the benefits are accrued when payment is probable and reasonably estimable. In this instance, no announcement to the workforce (nor initiation of the plan) is required prior to expense recognition.	IFRS requires that a single approach be used to account for all types of termination benefits. Termination benefits are recognised at the earlier of (1) when an entity can no longer withdraw an offer of termination benefits, or (2) when it would recognise restructuring costs in accordance with IAS 37, i.e., upon communication to those affected employees laid out in a detailed formal restructuring plan.

9.6 Onerous contracts

Onerous contract provisions may be recognized earlier and in different amounts under IFRS.

US GAAP	IFRS
Provisions are not recognized for unfavorable contracts unless the entity has ceased using the rights under the contract (i.e., the cease-use date). One of the most common examples of an unfavorable contract has to do with leased property that is no longer in use. With respect to such leased property, estimated sublease rentals are to be considered in a measurement of the provision to the extent such rentals could reasonably be obtained for the property, even if it is not management's intent to sublease or if the lease terms prohibit subleasing. Incremental expense in either instance is recognized as incurred.	Provisions are recognized when a contract becomes onerous regardless of whether the entity has ceased using the rights under the contract. When an entity commits to a plan to exit a lease property, sublease rentals are considered in the measurement of an onerous lease provision only if management has the right to sublease and such sublease income is probable. IFRS requires recognition of an onerous loss for executory contracts if the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

US GAAP	IFRS
Recording a liability is appropriate only when a lessee permanently ceases use of functionally independent assets (i.e., assets that could be fully utilized by another party). US GAAP generally does not allow the recognition of losses on executory contracts prior to such costs being incurred.	

9.7 Accounting for government grants

IFRS permits the recognition of government grants once there is reasonable assurance that requisite conditions will be met, rather than waiting for the conditions to be fulfilled, as is usually the case under US GAAP. As a result, government grants may be recognized earlier under IFRS.

US GAAP	IFRS
If conditions are attached to the grant, recognition of the grant is delayed until such conditions have been fulfilled. Contributions of long-lived assets or for the purchase of long-lived assets are to be credited to income over the expected useful life of the asset for which the grant was received.	Government grants are recognized once there is reasonable assurance that both (1) the conditions for their receipt will be met and (2) the grant will be received. Income-based grants are deferred in the balance sheet and released to the income statement to match the related expenditure that they are intended to compensate. Asset-based grants are deferred and matched with the depreciation on the asset for which the grant arises. Grants that involve recognized assets are presented in the balance sheet either as deferred income or by deducting the grant in arriving at the asset's carrying amount, in which case the grant is recognized as a reduction of depreciation.

9.8 Reimbursement and contingent assets

Guidance varies with respect to when these amounts should be recognized. As such, recognition timing differences could rise.

US GAAP	IFRS
Recovery of recognized losses—An asset relating to the recovery of a recognized loss shall be recognized when realization of the claim for recovery is deemed probable. **Recoveries representing gain contingencies**—Gain contingencies should not be recognized prior to their realization. In certain situations a gain contingency may be considered realized or realizable prior to the receipt of cash.	**Reimbursements**—Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognized when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The amount recognized for the reimbursement shall be treated as a separate asset and shall not exceed the amount of the provision. The virtually certain threshold may, in certain situations, be achieved in advance of the receipt of cash. **Contingent assets**—Contingent assets are not recognized in financial statements because this may result in the recognition of income that may never be realized. If the inflow of economic benefits is probable, the entity should disclose a description of the contingent asset. However, when the realization of income is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate.

9.9 Levies

IFRS includes specific guidance related to the treatment of levies. US GAAP does not include specific guidance. This could result in differences between the timing and measurement of contingencies related to levies.

US GAAP	IFRS
Specific guidance does not exist within US GAAP. Levies and their related fines and penalties follow the guidance in ASC 450 unless other guidance established for the specific obligation exists (e.g., environmental).	Levies are defined as a transfer of resources imposed by a government on entities in accordance with laws and/or regulations, other than those within the scope of other standards (such as IAS 12); and fines or other penalties imposed for breaches of laws and/or regulations.

US GAAP	IFRS
	The obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. The fact that an entity is economically compelled to continue operating in a future period, or prepares its financial statements under the going concern principle, does not create an obligation to pay a levy that will arise from operating in the future. A liability to pay a levy is recognised when the obligating event occurs, at a point in time or progressively over time, and an obligation to pay a levy triggered by a minimum threshold is recognised when the threshold is reached.

Chapter 10: Financial liabilities and equity

10.1 Financial liabilities and equity

Under current standards, both US GAAP and IFRS require the issuer of financial instruments to determine whether either equity or financial liability classification (or both) is required. Although the IFRS and US GAAP definitions of a financial liability bear some similarities, differences exist that could result in varying classification of identical instruments.

As an overriding principle, IFRS requires a financial instrument to be classified as a financial liability if the issuer can be required to settle the obligation in cash or another financial asset. US GAAP, on the other hand, defines a financial liability in a more specific manner. Unlike IFRS, financial instruments may potentially be equity-classified under US GAAP if the issuer's obligation to deliver cash or another financial asset at settlement is conditional. As such, US GAAP will permit more financial instruments to be equity-classified as compared to IFRS.

Many financial instruments contain provisions that require settlement in cash or another financial asset if certain contingent events occur. Under IFRS, contingently redeemable (settleable) instruments are more likely to result in financial liability classification, and financial instruments that are puttable are generally financial liabilities with very limited exceptions. This is because the issuer cannot unconditionally avoid delivering cash or another financial asset at settlement. Identical contingently redeemable (settleable) and/or puttable instruments may be equity-classified under US GAAP due to the conditional nature of the issuer's obligation to deliver cash (or another financial asset) at settlement.

Oftentimes, reporting entities issue financial instruments that have both a liability and an equity component (e.g., convertible debt and redeemable preferred stock that is convertible into the issuer's common equity). Such instruments are referred to as compound financial instruments under IFRS and hybrid financial instruments under US GAAP. IFRS requires a compound financial instrument to be separated into a liability and an equity component (or a derivative component, if applicable). Notwithstanding convertible debt with a cash conversion feature, which is accounted for like a compound financial instrument, hybrid financial instruments are evaluated differently under US GAAP. Unless certain conditions requiring bifurcation of the embedded feature(s) are met, hybrid financial instruments are generally accounted for as a financial liability or equity instrument in their entirety. The accounting for compound/hybrid financial instruments can result in significant balance sheet presentation differences while also impacting earnings.

Settlement of a financial instrument (freestanding or embedded) that results in delivery or receipt of an issuer's own shares may also be a source of significant differences between IFRS and US GAAP. For example, net share settlement would cause a warrant or an embedded conversion feature to require financial liability classification under IFRS. A similar feature would not automatically taint equity classification under US GAAP, and further analysis would be required to determine whether equity classification is appropriate. Likewise, a derivative contract providing for a choice between gross settlement and net cash settlement would fail equity classification under IFRS even if the settlement choice resides with the issuer. If net cash settlement is within the issuer's control, the same derivative contract may be equity-classified under US GAAP.

Written options are another area where US GAAP and IFRS produce different accounting results. Freestanding written put options on an entity's own shares are classified as financial liabilities and recorded at fair value through earnings under US GAAP. Under IFRS, such instruments are recognized and measured as a gross financial liability at the discounted value of the settlement amount and accreted to their settlement amount.

In addition to the subsequent remeasurement differences described above, the application of the effective interest method when accreting a financial liability to its settlement amount differs under IFRS and US GAAP. The effective interest rate is calculated based on the estimated future cash flows of the instrument under IFRS, whereas the calculation is performed using contractual cash flows under US GAAP (with two limited exceptions, puttable and callable debt).

Technical references

US GAAP

ASC 470, ASC 480, ASC 815, ASC 820, ASC 825, ASC 850, ASC 860, ASR 268, CON 6

IFRS

IAS 32, IFRS 9, IFRS 13, IFRIC 2

Note

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

Classification

10.2 *Contingent settlement provisions*

Contingent settlement provisions, such as provisions requiring redemption upon a change in control, result in financial liability classification under IFRS unless the contingency arises only upon liquidation or is not genuine.

Items classified as mezzanine equity under US GAAP are generally classified as financial liabilities under IFRS.

US GAAP	IFRS
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.	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.
For SEC-listed companies applying US GAAP, certain types of securities require classification as mezzanine equity on the balance sheet. Examples of items requiring mezzanine classification are instruments with contingent settlement provisions or puttable shares as discussed in the Puttable shares section. Mezzanine classification is a US public company concept that is also encouraged (but not required) for private companies.	If the contingency is outside of the issuer's and holder's control, the issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset. Therefore, except in limited circumstances (such as if the contingency is not genuine or if it is triggered only in the event of a liquidation of the issuer), instruments with contingent settlement provisions represent financial liabilities. The guidance focuses on the issuer's unconditional right to avoid settlement no matter whether the contingencies may or may not be triggered. There is no concept of mezzanine classification under IFRS.

10.3 Derivative on own shares—fixed-for-fixed versus indexed to issuer's own shares

When determining the issuer's classification of a derivative on its own shares, IFRS looks at whether the equity derivative meets a fixed-for-fixed requirement, while US GAAP uses a two-step model. Although Step 2 of the US GAAP model uses a similar fixed-for-fixed concept, the application of the concept differs significantly between US GAAP and IFRS.

These differences can impact classification as equity or a derivative asset or liability (with derivative classification more common under IFRS).

US GAAP	IFRS
Equity derivatives need to be indexed to the issuer's own shares to be classified as equity. The assessment follows a two-step approach under ASC 815-40-15. **Step 1**—Considers whether 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.	For derivatives, only contracts that provide for gross physical settlement and meet the fixed-for-fixed criteria (i.e., a fixed number of shares for a fixed amount of cash) are classified as equity. Variability in the amount of cash or the number of shares to be delivered results in financial liability classification.
Step 2—Considers the settlement amount. Only settlement amounts equal to the difference between the fair value of a fixed number of the entity's equity shares and a fixed monetary amount, or a fixed amount of a debt instrument issued by the entity, will qualify for equity classification. If the instrument's strike price (or the number of shares used to calculate the settlement amount) is not fixed as outlined above, the instrument may still meet the equity classification criteria; this could occur where the variables that might affect settlement include inputs to the fair value of a fixed-for-fixed forward or option on equity shares and the instrument does not contain a leverage factor.	For example, a warrant issued by Company X has a strike price adjustment based on the movements in Company X's stock price. This feature would fail the fixed-for-fixed criteria under IFRS, but the same adjustment would meet the criteria under US GAAP.
In case of rights issues, if the strike price is denominated in a currency other than the issuer's functional currency, it should 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.	There is a narrow exception to the fixed-for-fixed criteria in IAS 32 for rights issues. Under this exception, rights issues are classified as equity if they are issued for a fixed amount of cash regardless of the currency in which the exercise price is denominated, provided they are offered on a pro rata basis to all owners of the same class of equity.

10.4 Derivatives on own shares—settlement models

Entities will need to consider how derivative contracts on an entity's own shares will be settled. Many of these contracts that are classified as equity under US GAAP (e.g., warrants that will be net share settled or those where the issuer has settlement options) will be classified as derivatives under IFRS. Derivative classification will create additional volatility in the income statement.

US GAAP	IFRS
Derivative contracts that are in the scope of ASC 815-40 and either (1) require physical settlement or net share settlement, or (2) give the issuer a choice of net cash settlement or settlement in its own shares are considered equity instruments, provided they meet the criteria set forth within the literature. Analysis of a contract's terms is necessary to determine whether the contract meets the qualifying criteria, some of which can be difficult to meet in practice. Similar to IFRS, derivative contracts that require net cash settlement are assets or liabilities.	Contracts that are net settled (net cash or net shares) are classified as liabilities or assets. This is also the case even if the settlement method is at the issuer's discretion. Gross physical settlement is required to achieve equity classification.
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.	Unlike US GAAP, under IFRS, a derivative contract that gives one party (either the holder or the issuer) a choice over how it is settled (net in cash, net in shares, or by gross delivery) is a derivative asset/liability unless all of the settlement alternatives would result in the contract being an equity instrument.

10.5 Written put option on the issuer's own shares

Written puts that are to be settled by gross receipt of the entity's own shares are treated as derivatives under US GAAP, while IFRS requires the entity to set up a financial liability for the discounted value of the amount of cash the entity may be required to pay.

US GAAP	IFRS
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.	If the contract meets the definition of an equity instrument (because it requires the entity to purchase a fixed amount of its own shares for a fixed amount of cash), any premium received or paid must be recorded in equity. Therefore, the premium received on such a written put is classified as equity (whereas under US GAAP, the fair value of the written put is recorded as a financial liability).

US GAAP	IFRS
ASC 480 requires written put options to be measured at fair value, with changes in fair value recognized in current earnings.	In addition, the issuer records a financial liability for the discounted value of the amount of cash that the entity may be required to pay. The financial liability is recorded against equity.

10.6 Compound instruments that are not convertible instruments (that do not contain equity conversion features)

Bifurcation and split accounting under IFRS may result in significantly different treatment, including increased interest expense, as compared to US GAAP.

US GAAP	IFRS
There is no concept of compound financial instruments outside of instruments with certain equity conversion features. As such, under US GAAP the instrument would be classified wholly within liabilities or equity.	If an instrument has both a liability component and an equity component—known as a compound instrument (e.g., redeemable preferred stock with dividends paid solely at the discretion of the issuer)—IFRS requires separate accounting for each component of the compound instrument. The liability component is recognized at fair value calculated by discounting the cash flows associated with the liability component at a market rate for a similar debt host instrument excluding the equity feature, and the equity component is measured as the residual amount. The accretion calculated in the application of the effective interest rate method on the liability component is classified as interest expense.

10.7 Convertible instruments (compound instruments that contain equity conversion features)

Differences in how and when convertible instruments get bifurcated and/or how the bifurcated portions get measured can drive substantially different results.

US GAAP	IFRS
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).	For convertible instruments with a liability component and a conversion feature that exchanges a fixed amount of cash for a fixed number of shares, IFRS requires split accounting between the liability and equity components of the instrument. 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.
If the conversion feature is not recorded separately, then the entire convertible instrument may be considered one unit of account—interest expense would reflect cash interest if issued at par. However, there are a few exceptions: □ For certain convertible debt instruments with a cash conversion feature, the liability and equity components of the instrument should be separately accounted for by allocating the proceeds from the issuance of the instrument between the liability component and the embedded conversion option (i.e., the equity component). This allocation is done by first determining the carrying amount of the liability component based on the fair value of a similar liability excluding the embedded conversion option, and then allocating to the embedded conversion option the excess of the initial proceeds ascribed to the convertible debt instrument over the amount allocated to the liability component. □ A convertible debt instrument 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	When split accounting applies, 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. The equity conversion feature is measured as the residual amount and recognized in equity with no subsequent remeasurement. IFRS does not have the concept of a BCF.

US GAAP	IFRS
received, equal to the intrinsic value of the conversion feature, to equity.	

10.8 Puttable shares/redeemable upon liquidation

10.8.1 Puttable shares

Puttable shares are more likely to be classified as financial liabilities under IFRS.

The potential need to classify certain interests in open-ended mutual funds, unit trusts, partnerships, and the like as liabilities under IFRS could lead to situations where some entities have no equity capital in their financial statements.

US GAAP	IFRS
Puttable shares	**Puttable shares**
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. As discussed for contingently redeemable instruments, SEC registrants would classify these instruments as "mezzanine." Such classification is encouraged, but not required, for private companies.	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. 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. However, an entity is required to classify puttable instruments as equity when they have particular features and meet certain specific conditions in IAS 32. This exemption does not apply to puttable instruments issued by a subsidiary. Even if the puttable instruments are classified as equity in the financial statements of the issuing subsidiary, they are always shown as financial liabilities in the consolidated financial statements of the parent.

10.8.2 *Redeemable upon liquidation*

Differences with respect to the presentation of these financial instruments issued by a subsidiary in the parent's consolidated financial statements can drive substantially different results.

US GAAP	IFRS
Redeemable upon liquidation	**Redeemable upon liquidation**
ASC 480 scopes out instruments that are redeemable only upon liquidation. Therefore, such instruments may achieve equity classification for finite-lived entities.	For instruments issued out of finite-lived entities that are redeemable upon liquidation, equity classification is appropriate only if certain conditions are met.
In classifying these financial instruments issued by a subsidiary in a parent's consolidated financial statements, US GAAP scopes out mandatorily redeemable noncontrolling interests from 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.	However, when classifying redeemable financial instruments issued by a subsidiary (either puttable or redeemable upon liquidation) in the 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.

10.9 *Receivables from shareholders*

Receivables from shareholders are generally required to be presented as contra-equity under US GAAP, whereas under IFRS they might qualify for presentation as an asset.

US GAAP	IFRS
Public companies are required to record notes or other receivables from a parent or another affiliate as contra-equity. For private companies, there is no authoritative guidance that deals directly with advances to and receivables from shareholders. Generally, advances to or receivables from shareholders should be recognized as a reduction of equity. However, there may be some circumstances in which it is acceptable to classify the advance or receivable as an asset.	A company should recognize a receivable from a shareholder if it has a contractual right to receive cash or another financial asset.

Measurement

10.10 *Initial measurement of a liability with a related party*

Fundamental differences in the approach to related-party liabilities under the two accounting models may impact the values at which these liabilities initially are recorded. The IFRS model may, in practice, be more challenging to implement.

US GAAP	IFRS
When an instrument is issued to a related party at off-market terms, one should consider which model the instrument falls within the scope of as well as the facts and circumstances of the transaction (i.e., the existence of unstated rights and privileges) in determining how the transaction should be recorded. There is, however, no requirement to initially record the transaction at fair value. The presumption in ASC 850 that related party transactions are not at arm's length and the associated disclosure requirements also should be considered.	When an instrument is issued to a related party, the financial liability initially should be recorded at fair value, which may not be the value of the consideration received. The difference between fair value and the consideration received (i.e., any additional amount lent or borrowed) is accounted for as a current-period expense, income, or as a capital transaction based on its substance.

10.11 *Effective-interest-rate calculation*

Differences between the expected lives and the contractual lives of financial liabilities have different implications under the two frameworks unless the instruments in question are carried at fair value. The difference in where the two accounting frameworks place their emphasis (contractual term for US GAAP and expected life for IFRS) can impact carrying values and the timing of expense recognition.

Similarly, differences in how revisions to estimates get treated also impact carrying values and expense recognition timing, with the potential for greater volatility under IFRS.

US GAAP	IFRS
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, a shorter life may	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.

US GAAP	IFRS
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 life or the estimated life as a policy decision.	Generally, if the entity revises its estimate after initial recognition (for reasons unrelated to a modification), the carrying amount of the financial liability should be revised to reflect actual and revised estimated cash flows at the original effective interest rate, with a cumulative-catch-up adjustment being recorded in profit and loss. Revisions of the estimated life or of the estimated future cash flows may exist, for example, in connection with debt instruments that contain a put or call option that does not need to be bifurcated or whose coupon payments vary. Payments may vary because of an embedded feature that does not meet the definition of a derivative because its underlying is a nonfinancial variable specific to a party to the contract (e.g., cash flows that are linked to earnings before interest, taxes, depreciation, and amortization; sales volume; or the earnings of one party to the contract). Generally, floating rate instruments (e.g., LIBOR plus spread) issued at par are not subject to the cumulative-catch-up approach; rather, the effective interest rate is revised as market rates change.

10.12 Modification or exchange of debt instruments and convertible debt instruments

Differences in when a modification or exchange of a debt instrument would be accounted for as a debt extinguishment can drive different conclusions as to whether extinguishment accounting is appropriate.

US GAAP	IFRS
When a debt modification or exchange of debt instruments occurs, the first step is to consider whether the modification or exchange qualifies for troubled debt restructuring. If this is the case, the restructuring follows the specific troubled debt restructuring guidance. If the modification or exchange of debt instruments does not qualify for	Under IFRS, there is no concept of troubled debt restructuring. A substantial modification of the terms of an existing financial liability or part of the financial liability should be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

US GAAP	IFRS
troubled debt restructuring, one has to consider whether the modification or exchange of debt instruments has to be accounted for as a debt extinguishment. An exchange or modification of debt instruments with substantially different terms is accounted for as a debt extinguishment. In order to determine whether the debt is substantively different, a quantitative assessment must be performed. If the present value of the cash flows under the new terms of the new debt instrument differs by at least 10% from the present value of the remaining cash flows under the original debt, the exchange is considered an extinguishment. The discount rate for determining the present value is the effective rate on the old debt. If either the new or the original debt instrument is callable/puttable, separate cash flow analyses are performed assuming exercise and non-exercise of the call or put. If the debt modifications involve changes in noncash embedded conversion features, the following two-step test is required: **Step 1**—If the change in cash flows as described above is greater than 10% 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.	In this regard, the terms are substantially different if the present value of the cash flows discounted using the original effective interest rate under the new terms is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability. Unlike US GAAP, there is no specific guidance for callable/puttable debt. However, in applying the 10% test under IFRS, entities generally use the expected cash flows of the borrowing rather than assume immediate prepayment. If this test is met, the exchange is considered an extinguishment. It is clear that if the discounted cash flows change by at least 10%, the original debt should be accounted for as an extinguishment. It is not clear, however, in IFRS 9 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% or (2) only the 10% test (quantitative test) as discussed above.
Step 2—If the test in Step 1 is not met, the following should be assessed: □ If the modification or exchange affects the terms of an embedded conversion option, whether the difference between the fair value of the option before and after the modification or exchange is at least 10% of the carrying value of the original debt instrument prior to the modification or exchange.	For debt instruments with embedded derivatives that are bifurcated and measured at FVTPL, the modification of the host contract and the embedded derivative should be assessed together when applying the 10% 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% test.

US GAAP	IFRS
◻ Whether a substantive conversion option is added or a conversion option that was substantive at the date of modification is eliminated. If either of these criteria is met, the exchange or modification would be accounted for as an extinguishment.	
Generally, when a term loan or debt security are modified and the modification is accounted for as an extinguishment, new fees paid to, or received from, the existing lender are expensed. New fees paid to third parties are capitalized and amortized as a debt issuance cost. When a term loan or debt security are modified and the modification is not accounted for as an extinguishment, new fees paid to, or received from, the existing lender, are capitalized and amortized as part of the effective yield. New fees paid to third parties are expensed.	IFRS 9 does not distinguish between costs and fees payable to third parties, such as lawyers and accountants, and those payable directly to the lender. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognized as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the liability's carrying amount and are amortized over the modified liability's remaining term.

10.13 *Accounting for debt modifications*

Under US GAAP, when debt is modified, no gain or loss is recognized due to changes in cash flows, whereas under IFRS, a modification gain or loss is recognized. However, under IFRS, certain changes in cash flows may not meet the definition of a modification and therefore not trigger a gain or loss. In addition, differences exist in the treatment of related fees and costs.

US GAAP	IFRS
Under US GAAP, when debt is modified, generally no gain or loss is recorded. A new effective interest rate is established based on the carrying value of the debt and the revised cash flows.	Under IFRS, when renegotiation or modification of terms do not result in derecognition, the carrying amount of the liability is recalculated using the modified cash flows discounted at the original effective interest rate. A modification gain or loss is recognized in profit or loss. However, in some cases when the changes in cash flows represent movements in market rates of interest, a treatment similar to US GAAP (where the interest rate is reset) could be applied. This would be the case, for

US GAAP	IFRS
	example, for instruments prepayable by the borrower at par or with only an insignificant penalty, which effectively enables the borrower to have the lender agree to reset the cash flows to the then market rate.
New fees paid to, or received from, existing lenders are capitalized and amortized as part of the effective yield, whereas new fees paid to third parties are expensed.	Costs and fees that are incremental and directly attributable to the modification are spread over the expected life by adjusting the effective interest rate. Conversely, payments that represent compensation for the change in the cash flows of the liability should be expensed as part of the gain or loss on modification.
	Incremental and directly attributable costs or fees might include amounts paid to third parties. Some amounts paid directly to the lender might also qualify – for example, if they compensate the lender for similar costs that it pays to third parties.

10.14 Transaction costs (also known as debt issue costs)

The balance sheet presentation of transaction costs for US GAAP is generally aligned to IFRS. However, there may still be differences in the accounting and presentation of commitment fees incurred to obtain lines of credit.

US GAAP	IFRS
When the financial liability is not carried at fair value through income, transaction costs, including third party costs and creditor fees, are deducted from the carrying value of the financial liability and are not recorded as separate assets. Rather, they are accounted for as a debt discount and amortized using the effective interest method.	When the financial liability is not carried at fair value through income, transaction costs including third party costs and creditor fees are deducted from the carrying value of the financial liability and are not recorded as separate assets. Rather, they are accounted for as a debt discount and amortized using the effective interest method.
Transaction costs are expensed immediately when the financial liability is carried at fair value, with changes recognized in profit and loss.	Transaction costs are expensed immediately when the financial liability is carried at fair value, with changes recognized in profit and loss.
As it relates to the commitment fee incurred to obtain a line of credit, the	The accounting for commitment fees incurred to obtain a line of credit under

US GAAP	IFRS
SEC would not object to an entity deferring and presenting such costs as an asset and subsequently amortizing them ratably over the term of the debt arrangement.	IFRS requires allocation between amounts that are expected to be drawn down and those that are not. To the extent there is evidence that it is probable that some or all of the facility will be drawn down and the loan commitment is not within the scope of IFRS 9, the commitment fee is allocated between the amounts that are expected to be drawn down and the amounts that are not expected to be drawn down. The fee related to the portion expected to be drawn down is accounted for as a transaction cost under IFRS 9 (i.e., the fee is deferred and deducted from the carrying value of the financial liabilities when the draw down occurs). The fee related to the portion not expected to be drawn down is capitalized as a prepayment for liquidity services and amortized over the period of the facility.

10.15 Eligibility for fair value option

The IFRS eligibility criteria for use of the fair value option are more restrictive than under US GAAP.

US GAAP	IFRS
With some limited exceptions for certain financial liabilities addressed by other applicable guidance (e.g., financial instruments that are in whole or in part classified by the issuer as a component of shareholder's equity, such as a convertible debt security with a non-contingent BCF), US GAAP permits entities to elect the fair value option for any recognized financial liability.	IFRS permits entities to elect the fair value option for financial liabilities when: □ a contract contains one or more embedded derivatives and the entire contract is not measured at fair value through profit or loss (unless the embedded derivative does not significantly modify the cash flows or it is clear with little or no analysis that separation of the embedded derivative(s) is prohibited), or □ it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as "an accounting mismatch"), or □ a group of financial instruments is managed and its performance is evaluated on a fair value basis in accordance with a risk management strategy.

US GAAP	IFRS
The fair value option may only be elected upon initial recognition of the financial liability or upon some other specified events identified in ASC 825-10-25-4 and 5. See SD 11.3 for information on the normal purchase normal sale exception.	The fair value option may only be elected upon initial recognition of the financial liability. See SD 11.3 for information on the use of the fair value options for contracts that meet the "own use" scope exception.

10.16 Instrument-specific credit risk in financial liabilities under the fair value option

For both US GAAP and IFRS, the impact of changes in instrument-specific credit risk on financial liabilities for which the fair value option has been elected is reported in other comprehensive income.

US GAAP	IFRS
When the fair value option is elected for financial liabilities, changes in fair value due to changes in instrument-specific credit risk will be recognized separately in OCI. An accommodation is available in certain cases when this creates accounting mismatch (see FV 5.6.3). The accumulated gains and losses due to changes in instrument-specific credit risk are recycled from accumulated other comprehensive income and recognized in earnings over the life of the liability, or upon settlement if it is settled before maturity.	For liabilities designated at FVTPL (except for loan commitments and financial guarantees), changes in fair value related to changes in own credit risk are presented separately in OCI. However, this does not apply if the recognition of fair value changes due to own credit risk in OCI would create an accounting mismatch. Unlike under US GAAP, amounts in OCI relating to changes in own credit risk are not recycled to the income statement under IFRS, even when the liability is derecognized and the amounts are realized. However, transfers within equity are allowed.

10.17 Nonrecourse liabilities

US GAAP provides narrowly-focused guidance on nonrecourse liabilities for consolidated collateralized financing entities (CFE) that measure financial assets and financial liabilities at fair value to eliminate the earnings volatility from the measurement difference. IFRS does not provide such guidance.

US GAAP	IFRS
US GAAP provides an alternative measurement for CFEs that allows the use of the more observable of the fair value of the financial assets or the fair value of the financial liabilities of the CFE to measure both the financial assets and the financial liabilities. This eliminates the measurement difference that may exist when financial assets and financial liabilities of the CFE are measured at fair value independently.	IFRS does not provide a separate measurement approach for nonrecourse liabilities. Financial assets and liabilities follow their respective classification and measurement models.

10.18 Recent/proposed guidance

10.18.1 Financial instruments with down round features

On July 13, 2017, the FASB issued ASU 2017-11, *I. Accounting for Certain Financial Instruments with Down Round Features II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception*. The new guidance is intended to reduce the complexity associated with issuers' accounting for certain financial instruments with characteristics of liabilities and equity. Specifically, the Board determined that a down round feature (as defined) would no longer cause a freestanding equity-linked financial instrument (or an embedded conversion option) to be accounted for as a derivative liability at fair value with changes in fair value recognized in current earnings. The amendments also require entities that present earnings per share (EPS) in accordance with ASC 260 to recognize the effect of the down round feature when it is triggered. That effect (the incremental fair value arising from the decrease in the strike or conversion price) is treated as a dividend and as a reduction of income available to common shareholders in basic EPS. In addition, the Board re-characterized the indefinite deferral of certain provisions of ASC 480, *Distinguishing Liabilities from Equity,* to a scope exception. The re-characterization has no accounting effect.

The changes are effective for public business entities in 2019. All other entities have an additional year. Early adoption is permitted for all entities, including in an interim period.

IFRS does not provide a similar exception. Freestanding warrants and embedded conversion options in debt instruments containing down round features require liability classification.

10.18.2 Financial instruments with characteristics of equity

The IASB has an active project on its agenda to address the challenges in applying IAS 32. On June 28, 2018, the board issued the Discussion Paper, *Financial Instruments* *with Characteristics of Equity*. The Discussion Paper sets out the Board's preferred approach to classification of a financial instrument, from the perspective of the issuer, as a financial liability or an equity instrument. The Discussion Paper also explores enhanced presentation and disclosure requirements that would provide further information about the effects that financial instruments have on the issuer's financial position and financial performance.

The Board's preferred approach would classify a financial instrument as a financial liability if it contains:

a) an unavoidable contractual obligation to transfer cash or another financial asset at a specified time other than at liquidation; and/or

b) an unavoidable contractual obligation for an amount independent of the entity's available economic resources.

The Board's preferred approach would also require additional information to be provided through separate presentation on the face of the financial statements, as well as through disclosure in the notes to the financial statements.

Chapter 11: Derivatives and hedging

11.1 Derivatives and hedging

Derivatives and hedging represent some 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 and complex guidance.

11.1.1 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 as derivatives at fair value through the income statement under IFRS. There are also differences in the identification of embedded derivatives within both financial and nonfinancial host contracts that should be carefully considered. In terms of measurement of derivatives, day one gains or losses cannot be recognized under IFRS unless the fair value (1) is evidenced by comparison to other observable current market transactions of the same instrument or (2) is based on a valuation technique whose variables include only data from observable markets. Under US GAAP, day one gains or losses are recognized, even if the fair value is based on unobservable inputs.

Hedge accounting models

Both the IASB and the FASB have issued recent hedge accounting guidance.

The FASB updated its hedge accounting guidance when it issued ASU 2017-12 in August 2017. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019 and interim periods beginning after December 15, 2020. Early adoption is permitted. The new guidance is intended to simplify certain accounting requirements for hedging activities, resolve practice issues, and better align hedge accounting with an organization's risk management activities.

The IASB's hedge accounting guidance, IFRS 9, *Financial Instruments,* was effective for annual periods beginning on or after January 1, 2018. Similar to the FASB, the goal of the IASB was to simplify hedge accounting, align it more closely with entities' risk management activities, and provide decision-useful information about an entity's risk management strategies.

Under IFRS, entities have an accounting policy choice to apply the IFRS 9 hedge accounting guidance or to continue applying the IAS 39 hedge accounting guidance. This policy choice is applied to all of the entity's hedges, except those in fair value macro hedging relationships. The IASB is planning to propose a macro hedge accounting model in a separate project, which is still ongoing. In the meantime, if an entity adopts IFRS 9 for hedge accounting, it may apply the "macro hedging" provisions of IAS 39 for a fair value hedge of the interest rate exposure of a portfolio of financial assets and/or financial liabilities (and only for such hedges) rather than the new IFRS 9 requirements. If an entity chooses not to adopt IFRS 9 for hedge accounting when it adopts the other parts of IFRS 9, it can still choose to adopt IFRS 9's hedging provisions at a later date. However, once an entity has adopted IFRS 9 for hedge accounting, it cannot revert back to IAS 39.

Although both IFRS 9 and the amended ASC 815 guidance permit more hedging strategies to qualify for hedge accounting, the frameworks retain complex (though different) requirements for hedge accounting. Both the criteria to qualify for hedge accounting and the accounting for qualifying hedges are different. IFRS 9 has made it easier to qualify for hedge accounting than under IAS 39 by permitting hedging of more components of items, and eliminating the 80-125% effectiveness requirement. US GAAP maintained more stringent qualifying criteria as compared to IFRS 9, including a requirement to perform rigorous assessments of effectiveness in many cases. But the amendments to US GAAP simplified subsequent reporting as compared to the previous ASC 815 guidance by eliminating the requirement to separately measure ineffectiveness for cash flow and net investment hedging relationships in earnings in each reporting period.

This chapter compares the IFRS 9 hedge accounting model and the ASC 815 hedge accounting model (after adoption of ASU 2017-12). For a discussion of the key changes introduced by IFRS 9 and a comparison to ASC 815 (prior to the adoption of ASU 2017-12) and IAS 39, refer to Dataline 2014-03, *Accounting for hedging activities, IASB new general hedge accounting requirements*.

For more detailed guidance on ASC 815, see PwC's derivatives and hedging guide. For more detailed guidance on IFRS 9's hedging provisions, see PwC's In depth: Achieving hedge accounting in practice under IFRS 9.

Technical references

US GAAP

ASC 815, ASC 830

IFRS

IFRS 9, IFRS 7, IFRIC 16

Note

The following discussion captures a number of the more significant differences between ASC 815 (after adoption of ASU 2017-12) and IFRS 9. It summarizes the differences between IFRS and US GAAP that we generally consider to be the most significant or pervasive, and should be read in combination with the authoritative literature and a thorough analysis of all the facts and circumstances.

Derivative definition and scope

11.2 *Net settlement provisions*

More instruments will qualify as derivatives under IFRS.

Some instruments, such as option and forward agreements to buy unlisted equity investments, are accounted for as derivatives under IFRS but not under US GAAP.

US GAAP	IFRS
To meet the definition of a derivative, a financial instrument or other contract must require or permit net settlement.	IFRS does not include a requirement for net settlement within the definition of a derivative. It only requires settlement at a future date.
The scope of ASC 815 excludes instruments linked to unlisted equity securities when such instruments fail the net settlement requirement and are, therefore, not accounted for as derivatives.	Under IFRS, instruments linked to unlisted equity securities are required to be recorded at fair value.
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).	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 IFRS 9 for the acquirer; however, the option may be classified as equity from the seller's perspective.

11.3 *Own use versus normal purchase normal sale*

Under IFRS, contracts that meet the "own use" criteria are scoped out of derivative accounting. However, a fair value option is available if it eliminates or significantly reduces an accounting mismatch. Under US GAAP, these contracts are accounted for as derivatives unless an entity elects the "normal purchase normal sale" (NPNS) exception.

US GAAP	IFRS
There are many factors to consider in determining whether a contract related to nonfinancial items can qualify for the NPNS exception.	Similar to US GAAP, there are many factors to consider in determining whether a contract related to nonfinancial items qualifies for the "own use" exception.
If a contract meets the requirements of the NPNS exception, the reporting entity must document that it qualifies	While US GAAP requires documentation to apply the NPNS exception, IFRS requires a contract to be accounted for as

US GAAP	IFRS
in order to apply the exception—otherwise, it will be considered a derivative.	own use (i.e., not accounted for as a derivative) if the own use criteria are satisfied. However, IFRS 9 provides a fair value option for own use contracts in situations in which the use of the option would eliminate or significantly reduce an accounting mismatch. For example, an entity in the utility industry that hedges its physically settled contracts with energy derivatives could use the option for the physically settled contracts to reduce the measurement inconsistency between these contracts and the energy derivatives, and thus achieve offsetting effects without the need to apply hedge accounting. This fair value option is irrevocable and only available at inception.

Embedded derivatives

Under IFRS, embedded derivatives are no longer bifurcated from hybrid financial assets, and instead are part of the classification assessment of the entire financial asset (see SD 7.1 for further information on financial assets). This discussion is therefore only applicable to embedded derivatives in hybrid contracts when the host is not a financial asset (i.e., the asset is within the scope of IFRS 9).

11.4 Reassessment of embedded derivatives

Differences with respect to the reassessment of embedded derivatives may result in significantly different outcomes under the two frameworks. Generally, reassessment is more frequent under US GAAP.

US GAAP	IFRS
If a hybrid instrument contains an embedded derivative that is not clearly and closely related at inception, and it is not bifurcated (because it does not meet the definition of a derivative), it must be continually reassessed to determine whether bifurcation is required at a later date. Once it meets the definition of a derivative, the embedded derivative is bifurcated and measured at fair value with changes in fair value recognized in earnings. Similarly, the embedded derivative in a hybrid instrument that is not clearly and closely related at inception and is	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 cash flows that would otherwise be required under the contract.

US GAAP	IFRS
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. An embedded derivative that is clearly and closely related is not reassessed subsequent to inception for the "clearly and closely related" criterion. For nonfinancial host contracts, the assessment of whether an embedded foreign currency derivative is clearly and closely related to the host contract should be performed only at inception of the contract.	

11.5 Calls and puts in debt instruments

IFRS and US GAAP have fundamentally different approaches to assessing whether calls and puts embedded in debt host instruments require bifurcation. Additionally, under IFRS, the embedded derivative analysis is only performed for the issuer of the debt instrument and not the holder, since there is no assessment of embedded derivatives for financial assets (see SD 7.1).

US GAAP	IFRS
Multiple tests are required to evaluate whether an embedded call or put (i.e., a feature that can accelerate repayment of principal of a debt instrument) is clearly and closely related to the debt host. If any of the conditions outlined in the following tests occurs, the call or put is not clearly and closely related to the debt host and bifurcation is generally required. **Test 1**—Upon exercise of the call or put, a debt instrument's settlement amount changes based on anything other than interest rates or credit risk. **Test 2**—A debt instrument involves a substantial premium or discount and the call or put that can accelerate repayment of principal is contingently exercisable.	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 features do not require bifurcation.

US GAAP	IFRS
Test 3—If the only underlying is an interest rate or interest rate index and either (a) there is a substantial premium or discount (but the put or call is not contingently exercisable), or (b) there is no substantial premium or discount, an additional test is required. If the debt instrument can either (a) be settled in such a way that the holder would not recover substantially all of its recorded investment or (b) the embedded derivative would both (1) at least double the holder's initial rate of return and (2) the resulting rate of return would be double the then current market rate of return, then the call or put is not clearly and closely related. However, certain exceptions are provided for this test. See FG 1.6.1.2.	

11.6 Nonfinancial host contracts—currencies commonly used

Although IFRS and US GAAP have similar guidance in determining when to separate foreign currency embedded derivatives in a nonfinancial host, there is more flexibility under IFRS in determining that the currency is closely related.

US GAAP	IFRS
US GAAP requires bifurcation of a foreign currency embedded derivative from a nonfinancial host unless the payment is denominated in (1) the functional currency of a substantial party to the contract, (2) the currency in which the price of the good or service is routinely denominated in international commerce (e.g., US dollar for crude oil transactions), (3) the local currency of a substantial party to the contract, or (4) a foreign currency used because a substantial party to the contract uses the currency as if it were the functional currency because it operates in a highly inflationary environment. Evaluation of foreign currency embedded derivatives in nonfinancial contracts is only performed at contract inception.	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 under IFRS if payments are denominated in a currency that is commonly used in contracts to purchase or sell such nonfinancial items in the economic environment in which the transaction takes place, provided the host contract is not leveraged and does not contain an option feature. 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. If the company determines that the euro is a currency commonly used in Russia, bifurcation of a foreign currency

US GAAP	IFRS
	embedded derivative from the nonfinancial host contract would not be required under IFRS.

Measurement of derivatives

11.7 *Day one gains and losses*

Day one gains and losses occur when the entity uses a model to measure the fair value of the instrument and the model price at initial recognition is different from the transaction price.

The ability to recognize day one gains and losses is different under both frameworks, with gain/loss recognition more common under US GAAP.

US GAAP	IFRS
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 in which the reporting entity could transact. For example, banks can access wholesale and retail markets; the wholesale price may result in a day one gain compared to the transaction price in the retail market. In these cases, entities must recognize day one gains and losses even if some inputs to the measurement model are not observable.	Day one gains and losses are recognized only when the fair value is evidenced by a quoted price in an active market for the same instrument or is based on a valuation technique that only uses data from observable markets.

Hedge accounting models

11.8 *Hedge effectiveness criterion*

Both US GAAP and IFRS permit application of hedge accounting to only certain eligible hedging instruments and hedged items and require formal designation and documentation of a hedging relationship at the beginning of the relationship and an assessment of effectiveness. However, the detailed requirements for hedge effectiveness vary between the two frameworks. Unlike US GAAP, there is no high effectiveness criterion to qualify for hedge accounting under IFRS. Instead, IFRS 9 requires an economic relationship between the hedged item and the hedging instrument, which is a less restrictive test.

US GAAP	IFRS
Hedging relationships are required to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk. The term "highly effective" has been interpreted in practice to mean that the change in fair value/cash flows of the designated component of the hedging instrument is within 80 to 125% of the change in fair value/cash flows of the designated proportion of the hedged item attributable to the risk being hedged.	A hedging relationship needs to meet the following effectiveness requirements: 1. There is an economic relationship between the hedged item and the hedging instrument that gives rise to offset. 2. The effect of credit risk does not dominate the value changes that result from that economic relationship. 3. The hedge ratio is the one the entity actually uses under its risk management strategy unless it would create ineffectiveness inconsistent with the purpose of hedge accounting.

11.8.1 *Nature and timing of effectiveness assessments*

Both US GAAP and IFRS require initial and ongoing assessments of effectiveness. However, the nature and timing of these effectiveness assessments vary between the two frameworks.

US GAAP	IFRS
In certain cases, an initial quantitative assessment is required. In addition, periodic effectiveness assessments need to be performed on both a prospective basis (to reconfirm forward-looking expectations) and a retrospective basis (to determine whether the hedge was highly effective). Effectiveness assessments are required at hedge inception and periodically thereafter, with an assessment required whenever financial statements or earnings are reported, and at least every three months. The initial assessment may be completed by the end of the quarter. Additionally, simplified approaches exist for nonpublic nonfinancial institutions. When assessing effectiveness of hedges of forecasted transactions, entities can ignore timing differences between the hedged transactions and the maturity date of the	A retrospective effectiveness assessment is not required. However, an entity must make an ongoing assessment of whether the hedge continues to meet the three hedge effectiveness criteria described in SD 11.8. There is no requirement to perform effectiveness assessments every three months. The ongoing effectiveness assessment needs to be performed at each reporting date (which may only be semi-annually or annually) or upon a significant change in circumstances. It is only a forward-looking test. The requirement to maintain the hedge ratio (#3 in SD 11.8) ensures alignment with the economic hedging strategy. The hedge ratio must be rebalanced to maintain the hedge ratio that the entity actually uses to achieve its economic

US GAAP	IFRS
hedging instrument within 31 days or a fiscal month (when that is the only difference between the derivative and the hedged forecasted transactions).	hedging strategy. We expect that rebalancing will rarely occur in practice.

11.8.2 Recognition of ineffectiveness

IFRS requires measurement and recognition of ineffectiveness in a hedging relationship even though the hedge meets the effectiveness criteria. US GAAP no longer has a concept of ineffectiveness that is separately measured and disclosed, although there may still be an income statement impact for certain hedges. Both IFRS and US GAAP permit an entity to exclude certain components from the assessment of effectiveness and separately account for them, which may improve hedge effectiveness, as discussed in 11.8.3.

US GAAP	IFRS
For cash flow and net investment hedges, hedge ineffectiveness is not separately measured and recognized in income each reporting period. If the hedge is highly effective, all changes in the fair value of the derivative hedging instrument will be recorded in other comprehensive income (OCI) (in cumulative translation adjustment (CTA) for net investment hedges), unless different recognition is prescribed/elected for any excluded components. Any difference between the gain or loss on the hedged item and the derivative (except for the excluded component) is recognized when the hedged item affects earnings, at which time the amount deferred in AOCI from the hedging instrument is released to earnings. On the other hand, for fair value hedges, because the change in fair value of the hedged item attributable to the hedged risk and the derivative hedging instrument are both recorded in current earnings, if the hedge is not perfectly effective, there will be an income statement impact. While not identified as ineffectiveness, a reporting entity is required to disclose the change in fair value of the hedged item attributable to the hedged risk and the change in fair value of the derivative.	For cash flow hedges, the effective portion of the change in the fair value of the hedging instrument is recognized in OCI. The amount recognized in OCI should be the lower of (1) the cumulative gain or loss on the hedging instrument from the inception of the hedge, and (2) the cumulative change in the fair value (present value) of the expected cash flows on the hedged item from the inception of the hedge. The remaining ineffective portion of the change in the fair value of the hedging instrument (if any) is recognized in profit or loss. For hedges of a net investment in a foreign operation, the effective portion of the change in the fair value of the hedging instrument is recognized in OCI and the ineffective portion of the hedging relationship is recognized in profit or loss. For fair value hedges, both the effective and ineffective portions of the hedge relationship are recorded in profit or loss. IFRS 7 requires disclosure of ineffectiveness.

11.8.3 *Amounts permitted to be excluded from the assessment of effectiveness*

Both US GAAP and IFRS permit an entity to exclude certain components of the change in the fair value of a hedging instrument from the assessment of effectiveness. However, the standards diverge in certain respects on what is permitted to be excluded.

<table>
<tr><th>US GAAP</th><th>IFRS</th></tr>
<tr><td>An entity may elect to exclude certain components of the change in value of the derivative from the assessment of effectiveness for fair value and cash flow hedges:

□ For forwards and future contracts when the spot method is used, an entity can exclude forward points (the difference between the spot price and the forward price).
□ For currency swaps, an entity may exclude the portion of the change in fair value attributable to a cross-currency basis spread.
□ For options (including eligible collars), the assessment can be based on changes in the intrinsic value of the option or the minimum value (intrinsic value plus the impact of discounting). An entity can also exclude the following portions of the change in time value from the assessment of effectiveness:
o the portion attributable to the passage of time,
o the portion attributable to changes in volatility, or
o the portion attributable to changes in interest rates.

For derivatives designated as net investment hedges, an entity is only permitted to use either (1) the spot method in which the entire difference between the spot price and the forward or futures price is excluded or (2) the full fair value method. Further, an entity is not permitted to exclude only part of the spot-forward difference when using the spot method.

US GAAP prohibits the exclusion of any other components of the hedging instrument.</td><td>IFRS 9 only permits three components to be excluded from the effectiveness assessment:
□ the forward element of a forward contract,
□ the foreign currency basis spread, and
□ the time value of an option.

IFRS 9 does not prescribe a specific methodology for calculating the value of the excluded components. However, a discounted calculation (such as discounted spot or discounted intrinsic value) is generally required since IFRS requires an entity to consider the time value of money when measuring hedge effectiveness.

Additionally, entities can elect to exclude only the foreign currency basis spread component of the spot-forward difference for forward contracts, which is not permitted under US GAAP.</td></tr>
</table>

11.8.3.1 Accounting for amounts excluded from the assessment of effectiveness

US GAAP and IFRS diverge regarding how to account for a component excluded from the assessment of effectiveness.

US GAAP	IFRS
For cash flow, fair value, and net investment hedges, an entity may choose between two methods to account for an excluded component: *Amortization approach* The initial value of the excluded component is recognized in earnings using a systematic and rational method over the life of the hedging instrument, with any difference between the change in fair value of the excluded component and the amount in earnings recognized in OCI (CTA for net investment hedges). *Mark-to-market approach* The changes in fair value of the excluded component are recognized in current earnings. Unlike IFRS, US GAAP does not have a specific concept of aligned time value (i.e., time value that only relates to the hedged item) or aligned forward element. When using the spot method, discounting of the spot rate is not required (and in the case of a net investment hedge, discounting is not permitted).	IFRS 9 has specific guidance by type of derivative. *Options* For cash flow, fair value, and net investment hedges, if an entity elects to designate only the intrinsic value of the option as the hedging instrument, it must account for the changes in the "aligned time value" (i.e., when the critical terms of the option and hedged item are aligned) in OCI and hold those changes in a hedging reserve in equity. Recognition of the aligned time value in profit or loss will depend on whether the hedge is transaction-related (and recorded in profit or loss at the same time as the hedged item) or time–period-related (and recorded in profit or loss using a systematic and rational basis over the period of the hedge). *Forwards points and currency basis spread* An entity may recognize changes in value due to changes in forward points or foreign currency basis spread in profit or loss immediately or defer them using the recognition guidance for options. *Aligned portion* Recognition of the excluded component applies to the aligned portion, i.e., the portion for which the critical terms such as notional, price, term and underlying of the derivative and the hedged item are aligned. This is called the "aligned time value" or "aligned forward element." IFRS 9 specifies a particular calculation methodology that can be complex to apply when the actual time value or forward element is lower than the aligned time value or forward element at inception of the hedge. When the change in spot rate is the designated hedged risk, entities still need

US GAAP	IFRS
	to consider the time value of money and, when appropriate, measure the hedged item using the discounted spot rate. However, for a net investment hedge, we believe that an entity can choose not to impute a time period into the hedging relationship and designate the hedged risk without discounting.

11.9 Eligible hedged items

Several differences exist between the two frameworks as it relates to the eligibility of the hedged item.

11.9.1 Eligible hedged items - Components of nonfinancial items

Under both US GAAP and IFRS, an entity is permitted to hedge a component of a nonfinancial item. However, IFRS 9 permits more nonfinancial components to qualify as hedged items.

US GAAP	IFRS
US GAAP permits cash flow hedges of the variability in cash flows attributable to changes in contractually specified components of forecasted purchases or sales of nonfinancial items, subject to specific criteria. A contractually specified component is an index or price explicitly stated in the contract or governing agreements to purchase or sell the nonfinancial item that is not solely linked to the entity's own operations.	IFRS 9 permits entities to hedge risk components for nonfinancial items, provided such components are separately identifiable and reliably measurable. They do not have to be contractually specified, as under US GAAP. In assessing whether a risk component of a nonfinancial item is eligible for designation as a hedged risk, an entity should take into consideration factors such as: □ Whether the risk component is contractually specified (the contract entails a formula based pricing structure such as "commodity X plus a margin") □ If not, the particular market structure to which the risk relates and in which the hedging activity takes place

11.9.2 Eligible hedged items - Hedges of groups of items

Both US GAAP and IFRS permit an entity to hedge groups of items, but IFRS permits more groups of items to qualify as the hedged item. In particular, IFRS 9 permits hedging groups of offsetting exposures, while US GAAP specifically prohibits it.

US GAAP	IFRS
If an entity wishes to designate a group of individual items as the hedged item in a hedging relationship, the individual items or transactions must share the same risk exposure for which they are designated as being hedged. A quantitative evaluation, known as the “similar assets/liabilities test,” of whether a portfolio of assets or liabilities share the same risk exposure is generally required.	IFRS 9 allows hedges of: □ groups of similar items without a requirement that the fair value change of each individual item be proportional to the overall group (e.g., hedging a portfolio of S&P 500 shares with a S&P 500 futures contract), and □ groups of offsetting exposures (e.g., exposures resulting from forecasted sale and purchase transactions). IFRS 9 stipulates additional qualifying criteria. These include: □ The group consists of items that are eligible as hedged items on an individual basis □ The hedged items are managed together on a group basis for risk management purposes □ A cash flow hedge in which the variability in cash flows is not expected to be approximately proportional to the overall group is a hedge of foreign currency risk, and the hedge designation specifies the reporting period when the forecasted transactions are expected to affect profit or loss and their nature and volume. See SD 11.12 on presentation of gains and losses on hedging instruments for a discussion of grouping items with offsetting disclosures.

11.9.3 Eligible hedged items - Hedging pools of prepayable financial assets

Both US GAAP and IFRS permit an entity to hedge layers of items, provided that certain criteria are met. However, US GAAP and IFRS differ in the application of the guidance to interest rate fair value hedges of layers of prepayable financial assets not expected to be prepaid during the hedge period.

US GAAP	IFRS
A “last-of-layer approach” permits the designation of a portion of a closed pool of prepayable assets, beneficial interests secured by prepayable assets, or a combination that is not expected to be prepaid during the hedge period as the hedged item in a fair value hedge of the	IFRS 9 allows a layer of a group to be designated as the hedged item. A layer component can be specified from a defined, but open, population or from a defined nominal amount. If a layer component is designated in a fair value hedge, an entity must specify it from a

US GAAP	IFRS
benchmark interest rate. When an entity executes a partial-term hedge of the benchmark interest rate, the entity is able to ignore the impact of prepayment and credit risk by assuming that prepayments and defaults relate to the portion of the portfolio that is not part of the designated hedged item (the "last of layer"). For this strategy, a similar assets test may be performed qualitatively and only at inception.	defined nominal amount. A layer of a contract that includes a prepayment option that is affected by changes in the hedged risk is only eligible as a hedged item in a fair value hedge if the layer includes the effect of the prepayment option when determining the change in fair value of the hedged item. In other words, the prepayment option cannot be ignored. In this situation, if an entity hedges with a hedging instrument that does not have option features that mirror the layer's prepayment option, hedge ineffectiveness would arise. For macro hedges of interest rate risk, IFRS 9 permits an entity to elect to apply the requirements in IAS 39 for fair value portfolio hedges instead of applying IFRS 9 in full. Under IAS 39's portfolio hedge model, it may apply fair value hedge accounting in a portfolio of dissimilar items (i.e., macro hedging) whereby the hedged portion may be designated as an amount of currency of a prepayable item, rather than individual assets or liabilities. Further, under this approach in IAS 39, 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. Expected rather than contractual repricing dates may be used. In such a strategy, the change in fair value of the hedged item is presented as a separate line item in the balance sheet and is not allocated to individual assets or liabilities.

11.9.4 Eligible hedged items - Aggregated exposures

IFRS permits an entity to combine a derivative and nonderivative exposure together and to designate them together as the hedged item in a hedging relationship. This is not permitted under US GAAP.

US GAAP	IFRS
US GAAP does not permit hedge accounting for hedged items that are	Aggregated exposures can be designated as hedged items. An aggregated

US GAAP	IFRS
remeasured for changes in fair value through earnings (or a forecasted acquisition of an asset or incurrence of a liability that subsequently will be similarly remeasured at fair value). Therefore, items meeting the definition of a derivative are not permitted to be the hedged item in a hedging relationship either by themselves or when combined with other nonderivatives.	exposure is a combination of (1) an exposure that qualifies as a hedged item and (2) a derivative. This includes a forecasted transaction of an aggregated exposure (i.e., uncommitted but anticipated future transactions that would give rise to an exposure and a derivative) as long as the aggregated exposure is highly probable and, once it has occurred, would be eligible as a hedged item. For example, an entity could hedge the forecasted issuance of variable-rate debt even if the currency of issuance is not yet known. If the debt is not issued in the entity's functional currency, but the entity plans to enter into a cross-currency swap to convert the exposure back into its functional currency, it can designate as the hedged item highly probable variable interest payments arising from either (1) debt denominated in the functional currency or (2) a combination of foreign currency debt and a cross-currency swap that will swap the foreign currency debt to functional currency debt.

11.9.5 Eligible hedged items - Partial term hedging

Both US GAAP and IFRS permit partial-term hedging of a financial instrument. However, US GAAP is more prescriptive about the timing of the assumed beginning and maturity of the hedged item.

US GAAP	IFRS
US GAAP allows a partial-term fair value hedge of interest rate risk in which the hedged item is designated as selected consecutive contractual interest payments. For example, entities can hedge the interest rate payments in the first two years, the last two years, or in years two through four in debt with a five-year term. Or, for hedges of a single financial instrument, an entity could simultaneously enter into a hedge of year 1 with a swap in one hedging relationship and years 3 and 4 with another swap in a	IFRS similarly permits designation of a derivative as hedging a financial instrument (the hedged item) for only a portion of its cash flows or fair value, if effectiveness can be measured and the other hedge accounting criteria are met. Under IFRS 9, partial-term hedging of forecasted transactions of nonfinancial items, such as purchases and sales, is not permitted. However, the terms of the hedged item and hedging instrument do not need to match exactly to achieve hedge accounting. If the mismatch is not so long as to invalidate the economic

different hedging relationship. Partial-term hedging is achieved by assuming that (1) the term begins when the first hedged cash flow begins to accrue, and (2) the maturity of the hedged item is the same date as the last hedged cash flow. To achieve #2, the payments made at the contractual maturity of the hedged item are assumed to be made at the conclusion of the hedged term. In a cash flow hedge of interest rate risk, the hedged forecasted transactions are future interest payments. An entity may choose to hedge only certain selected interest payments to be paid under the terms of a debt agreement.	relationship, an entity can designate the hedge for the full period. However, the difference in terms will result in ineffectiveness. Ineffectiveness arises regardless of whether the designated hedged risk is the forward or the spot foreign currency rate because the requirement in IFRS 9 to consider the time value of money is applicable in both circumstances.

11.9.6 Eligible hedged items - Variable-rate financial assets and liabilities

Both US GAAP and IFRS permit designation of the contractually specified interest rate as the hedged risk in a cash flow hedge of interest rate risk of a variable-rate financial instrument. Under IFRS 9, the interest rate does not need to be contractually specified; it only needs to be separately identifiable and reliably measurable. However, IFRS 9 does not permit the designated interest rate component to exceed the contractual cash flows.

US GAAP	IFRS
US GAAP allows hedging the interest rate risk associated with the contractually specified index rate of an existing or forecasted issuance/purchase of a variable rate financial instrument. The rate does not need to be a benchmark interest rate. If an entity desires to hedge interest payments from a forecasted issuance/purchase and does not know whether it will be variable rate or fixed rate, the entity must designate a rate that would qualify both as a contractually specified rate and a benchmark interest rate.	IFRS similarly allows a portion of specific interest payments to qualify as a hedged risk, provided it is separately identifiable and reliably measurable. It does not have to be contractually specified. However, under IFRS 9, a designated portion of the cash flows cannot be greater than the cash flows of the whole financial asset or financial liability. Consequently, an entity that issues a debt instrument whose effective interest rate at designation is below the designated interest rate component cannot designate a component of the liability equal to the benchmark interest rate. For example, if an entity issues debt that pays a rate of LIBOR minus 1%, it cannot designate the hedged item as only the LIBOR component of the cash flows. However, IFRS permits the entity to designate as a hedged item the change in cash flows of the entire liability (LIBOR minus 1%) that is attributable to changes in

US GAAP	IFRS
	LIBOR. In practice, this may have a similar result, unless the debt contains a floor or contractually permits other variability besides the referenced interest rate.

11.9.7 *Eligible hedged items - Fixed-rate financial assets and liabilities*

Both US GAAP and IFRS permit the designation of the entire contractual cash flows or a component of the contractual cash flows in a fair value hedge of interest rate risk of a fixed-rate financial instrument. US GAAP also permits a hedge of the benchmark component for fair value hedges of other risks, regardless of whether the coupon or yield is more or less than the benchmark rate.

US GAAP	IFRS
The interest rate risk that can be hedged in a fixed-rate financial asset or liability is explicitly limited to benchmark interest rates. In each financial market, generally only the most widely used and quoted rates are considered benchmark interest rates. In the United States, the benchmark rates currently allowed to be hedged under US GAAP are: □ the interest rates on direct Treasury obligations of the US government, □ the London Interbank Offered Rate (LIBOR) swap rate, □ the Fed Funds Effective Swap Rate (also referred to as the Overnight Index Swap Rate or OIS), and □ the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate. In calculating the change in value of the hedged item for interest rate changes, an entity can use either the full contractual coupon cash flows or the benchmark rate component as determined at hedge inception. A hedge of the benchmark component of coupons is permitted for all fair value hedges, regardless of whether	Similar to US GAAP, IFRS 9 permits an entity to hedge the full contractual coupon or just the interest rate component of the contractual coupon. IFRS allows a portion of a specific risk in a fixed-rate financial asset or liability to be designated as a hedged item, provided it is separately identifiable and reliably measurable. In certain circumstances, an inflation risk component could be considered separately identifiable and reliably measurable even if not contractually specified. Unlike US GAAP, IFRS 9 does not contain a list of acceptable benchmark rates. Additionally, IFRS 9 does not permit use of a designated component of the cash flows that exceeds the total fair value or cash flows of a hedged item. For a fixed rate sub-LIBOR debt, an entity would designate changes in fair value of all the cash flows attributable to changes in LIBOR. If a fixed-rate financial instrument is hedged after its origination/issuance and interest rates have risen, the entity can designate a risk component equal to a benchmark rate that is higher than the contractual rate paid on the item as long as LIBOR is less than the effective interest rate based on the hedged item's fair value at designation. In that case, the cash flows used for the hedged item would consist of the contractual interest and the difference between the hedged item's fair value at designation and the amount

US GAAP	IFRS
the coupon or yield is more or less than the benchmark rate. In other words sub-benchmark hedging is allowed. Under US GAAP, an entity should consider the effect of a prepayment option that is exercisable during the hedged term when hedging interest rate risk of a prepayable item. In evaluating the impact to the prepayment option, an entity is explicitly permitted to consider either (1) all factors that would cause a borrower to prepay, or (2) only how changes in the benchmark interest rate affect prepayments.	repayable at maturity (discount). While IFRS 9 allows an entity to designate the interest rate component as the hedged risk, it does not specifically provide the approach laid out under US GAAP when considering the impact of a prepayment option. However, in practice, changes in fair value attributable to the referenced interest rate may be designated as the hedged risk, which has the same effect.

11.9.8 Eligible hedged items - Hedging more than one risk

IFRS provides greater flexibility than US GAAP with respect to utilizing a single hedging instrument to hedge more than one risk in two or more hedged items. This allows entities to adopt new and sometimes more complex strategies to achieve hedge accounting while managing certain risks under IFRS.

US GAAP	IFRS
US GAAP does not allow a single hedging instrument to hedge more than one risk in two or more hedged items and does not permit creation of a hypothetical component in a hedging relationship of more than one risk with a single hedging instrument. An exception is a basis swap designated as a cash flow hedge of both a floating rate asset and a floating rate liability.	IFRS 9 permits designation of a single hedging instrument to hedge more than one risk in two or more hedged items. A single hedging instrument may be designated as a hedge of more than one type of risk, provided that there is a specific designation of the hedging instrument and of the different risk positions as hedged items. Those hedged items can be in different hedging relationships. In the application of this guidance, a single derivative may be separated by inserting an additional (hypothetical) leg if each portion of the contract is designated as a hedging instrument in a qualifying and effective hedge relationship. For example, an entity whose functional currency is the Japanese yen (JPY) that has a fixed-rate loan receivable denominated in British pounds (GBP) and a variable-rate liability denominated in US dollars (USD) with the same

US GAAP	IFRS
	principal amount can enter into a single foreign currency forward contract to hedge the FX exposure on the principal payments of the liability and the note receivable. This would be achieved by splitting a GBP / USD forward into two forwards by imputing two JPY legs into the contract.

11.9.9 Eligible hedged items - Business combinations

IFRS permits hedging foreign currency risk in a business combination, but US GAAP does not.

US GAAP	IFRS
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). Additionally, US GAAP does not permit cash flow hedges of forecasted transactions involving business combinations.	An entity is permitted to hedge foreign exchange risk in a firm commitment to acquire a business or a forecasted business combination if the transaction is highly probable.

11.10 Eligible hedging instruments

Several differences exist between the two frameworks as it relates to the eligibility of the hedging instruments.

11.10.1 Eligible hedging instruments - nonderivatives

Both US GAAP and IFRS permit nonderivatives to be designated as hedging instruments in certain cases. IFRS generally permits nonderivatives to be designated as hedging instruments in more instances than US GAAP. Nonderivative financial instruments are most commonly used as hedges in hedge relationships involving foreign currency risk. In this way, US GAAP and IFRS are similar. As a result, there is not a substantive difference in practice in most cases.

US GAAP	IFRS
Generally, a nonderivative may not be used as a hedging instrument. However, certain nonderivative financial	Nonderivative financial instruments classified at fair value through profit or loss are permitted to be used as hedging

US GAAP	IFRS
instruments that may give rise to a foreign currency transaction gain or loss may be designated in a hedge of foreign currency risk in fair value hedges of firm commitments and net investment hedges.	instruments for all types of risks (except for hedges of financial liabilities when changes in fair value as a result of credit risk are presented in OCI). The foreign currency component of nonderivative financial instruments can be designated as a hedge of FX risk (except for equity instruments for which changes in fair value are recorded in OCI).

11.10.2 *Foreign currency risk - location of hedging instrument*

IFRS permits a parent company to hedge exposures of an indirect subsidiary regardless of the functional currency of intervening entities within the organizational structure. The rules under US GAAP for hedges of foreign exchange risk for forecasted transactions (cash flow hedges) or net investments in foreign operations are prescriptive regarding the functional currency and structure of the entities involved.

US GAAP	IFRS
Either the operating unit that has the foreign currency exposure or another member of the consolidated group that has the same functional currency as that operating unit must be a party to the hedging instrument. However, for another member of the consolidated group to enter into the hedging instrument, there cannot be an intervening entity with a different functional currency. Instead, entities may designate intercompany derivatives between the subsidiary with the exposure and the entity that is a party to an offsetting external derivative if certain criteria are met.	IFRS does not require the entity with the hedging instrument to have the same functional currency as the entity with the hedged item or the operating unit exposed to the risk being hedged within the consolidated group to be a party to the hedging instrument. For example, IFRS allows a parent company with a functional currency different from that of a subsidiary to achieve cash flow hedge accounting for the subsidiary's transactional foreign currency exposure (i.e., an exposure in a currency other than the subsidiary's functional currency). The same flexibility regarding location of the hedging instrument applies to net investment hedges.

11.11 *Cash flow hedging and basis adjustments*

For hedges of a forecasted purchase of a nonfinancial item, US GAAP and IFRS differ with regards to the accounting (at the time of acquisition of the nonfinancial item) for the fair value changes of the hedging instrument that were deferred in AOCI. This results in different amounts in AOCI and different carrying amounts of the nonfinancial items between US GAAP and IFRS. However, the ultimate effect on earnings is the same.

US GAAP	IFRS
US GAAP prohibits adjusting the basis of the hedged item in a cash flow hedge, and requires the fair value changes deferred in AOCI to be released out of AOCI into earnings when the hedged forecasted transaction impacts earnings.	IFRS 9 requires mandatory basis adjustment of the nonfinancial hedged item once it is recognized. Accordingly, fair value changes in the hedging instrument that are deferred in AOCI (referred to as the "cash flow hedge reserve") are included in the value of the hedged item on its initial recognition. The basis adjustment does not flow back through OCI. It is a direct transfer from equity to the hedged item. Similar accounting is required if a hedged forecasted transaction for a nonfinancial asset or a nonfinancial liability becomes a firm commitment for which fair value hedge accounting is applied.

11.12 Presentation of hedging instrument gains or losses

US GAAP is more prescriptive regarding the presentation of gains and losses from hedges than IFRS.

US GAAP	IFRS
For fair value hedges, the entire change in the fair value of the hedging instrument is presented in the same income statement line item as the earnings effect of the hedged item. For cash flow hedges, the entire change in fair value of the hedging instrument (except for excluded components) should be recorded in other comprehensive income (OCI) and reclassified to earnings in the same income statement line item used to present the earnings effect of the hedged item when the hedged item impacts earnings. Splitting gains and losses into more than one income statement line item is generally not appropriate. However, if the hedging instrument offsets changes in fair value or cash flows that are reported in more than one income statement line item, the changes in fair value of the hedging instrument is split	IFRS 9 generally has no requirements regarding the income statement presentation of gains and losses from a hedging instrument. However, in practice, we believe most entities present gains and losses from a hedging instrument in the same income statement line item as the hedged transaction. We believe ineffectiveness should be presented in a manner consistent with the entity's policy for trading derivatives. This might mean that the results of hedge ineffectiveness are included in the same line item as the impact of the related hedged item or in "other operating income and expense" or a separate line item if the amount is significant. For cash flow hedges of a group of items with no offsetting risk position, the presentation of gains and losses should

among the line items that include the earnings effect of the hedged item. For cash flow and fair value hedges, amounts excluded from the assessment of effectiveness are presented in the same income statement line item that is used for the hedged item. For net investment hedges, the entire change in fair value of the hedging instrument included in the hedge effectiveness assessment is recorded in CTA and reclassified to earnings in the same income statement line item used to present the earnings effect of the hedged item (when the subsidiary is sold or substantially liquidated). US GAAP is silent on the income statement geography for excluded components for net investment hedges.	be apportioned to the line items affected by the hedged items on a systematic and rational basis. The net gains or losses arising from a single hedging instrument should not be presented as gross amounts in different line items. For a hedge of a group of items with offsetting risk positions whose hedged risk affects different line items in the statement of profit or loss and OCI, any hedging gains or losses in that statement must be presented in a separate line from those affected by the hedged items. Consequently, the amount in the line item that relates to the hedged item itself (e.g., revenue or cost of sales) remains unaffected. In practice, this makes hedges of a group of items less attractive, and we expect many entities to designate just a part of one of the gross positions (rather than the net position).

11.13 Voluntary dedesignation of a hedging relationship

Under both US GAAP and IFRS, an entity is required to discontinue a hedging relationship if the respective qualifying criteria are no longer met. However, voluntary dedesignation is not allowed under IFRS 9. In practice, this may have a limited impact because IFRS requires discontinuance of the hedging relationship when the risk management objective is no longer met. This likely includes most instances when an entity might choose to voluntarily dedesignate a hedging relationship.

US GAAP	IFRS
An entity is permitted to dedesignate a hedging relationship voluntarily at any time.	Under IFRS 9, an entity cannot voluntarily dedesignate a hedging relationship that: □ still meets the risk management objective on the basis of which it qualified for hedge accounting (i.e., the entity still pursues that risk management objective), and □ continues to meet all other qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable).

11.14 Novations, rollovers, and replacements

Both US GAAP and IFRS permit continuance of a designated hedging relationship when a contract is modified in certain circumstances. However, the circumstances under which the hedge relationship can continue after a modification differ under the two frameworks.

US GAAP	IFRS
A change in the counterparty to a derivative that has been designated as the hedging instrument does not, in and of itself, require dedesignation of that hedging relationship, provided that all other hedge accounting criteria continue to be met. However, US GAAP requires an entity to dedesignate a hedging relationship upon expiration of the derivative or a change to the critical terms of the derivative or hedging relationship.	IFRS explicitly permits the continuation of hedge accounting when the counterparty to a derivative changes through novation to a clearing counterparty (such as a central clearing party) as a consequence of laws or regulations. However, in practice, there may be other scenarios when a novation, in and of itself, would not require a dedesignation of the hedging relationship. IFRS permits the continuation of hedge accounting upon the replacement or rollover of a hedging instrument into another hedging instrument if it is part of the entity's documented hedging strategy.

Chapter 12: Consolidation

12.1 Consolidation

IFRS is a principles-based framework, and the approach to consolidation reflects that structure. IFRS provides indicators of control, some of which individually determine the need to consolidate. However, where control is not apparent, consolidation is based on an overall assessment of all of the relevant facts, including the allocation of risks and benefits between the parties. The indicators provided under IFRS help the reporting entity in making that assessment. Consolidation in financial statements is required under IFRS when an entity is exposed to variable returns from another entity and has the ability to affect those returns through its power over the other entity.

US GAAP has a two-tier consolidation model: one focused on voting rights (the voting interest model) and the second focused on a qualitative analysis of power over significant activities and exposure to potentially significant losses or benefits (the variable interest model). Under US GAAP, all entities are first evaluated to determine whether they are variable interest entities (VIEs). If an entity is determined not to be a VIE, it is assessed on the basis of voting and other decision-making rights under the voting interest model.

Even in cases for which both US GAAP and IFRS look to voting rights to drive consolidation, differences can arise. Examples include cases in which de facto control (when a minority shareholder has the practical ability to exercise power unilaterally) exists and how the two frameworks address potential voting rights. As a result, careful analysis is required to identify any differences.

Differences in consolidation under US GAAP and IFRS may also arise when a subsidiary's set of accounting policies differs from that of the parent. While under US GAAP it is acceptable to apply different accounting policies within a consolidation group to address issues relevant to certain specialized industries, exceptions to the requirement to consistently apply standards in a consolidated group do not exist under IFRS. In addition, potential adjustments may occur in situations where a parent company has a fiscal year-end different from that of a consolidated subsidiary (and the subsidiary is consolidated on a lag). Under US GAAP, significant transactions in the gap period may require disclosure only, whereas IFRS may require recognition of transactions in the gap period in the consolidated financial statements.

Technical references

US GAAP

ASC 205, ASC 323, ASC 323-10-15-8 through 15-11, ASC 325-20, ASC 810, ASC 810-10-25-1 through 25-14, ASC 810-10-60-4, SAB Topic 5H, SAB Topic 5H (2)-(6)

IFRS

IAS 1, IAS 27 (amended 2011), IAS 28 (amended 2011), IAS 36, IAS 39, IFRS 9, IFRS 5, IFRS 10, IFRS 11, IFRS 12

Note

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

General requirements

12.2 Requirements to prepare consolidated financial statements

IFRS does not provide industry-specific exceptions to the requirement for consolidation of controlled entities, with the exception of specific guidance for investment entities. IFRS, in limited circumstances, may be more flexible with respect to the ability to issue nonconsolidated financial statements.

US GAAP	IFRS
The guidance applies to legal structures. There is a scope exception for registered money market funds and similar unregistered money market funds. Industry-specific guidance precludes consolidation of controlled entities by certain types of organizations, such as investment companies and broker/dealers. While the FASB and the IASB definitions of an investment company/entity are converged in most areas, there are several key differences (see SD 12.3). In addition, unlike the IASB standard, US GAAP retains the specialized investment company accounting in consolidation by a non-investment company parent.	Parent entities prepare consolidated financial statements that include all subsidiaries. An exemption applies when all of the following conditions apply: □ Parent is a wholly- or partially-owned subsidiary and the owners of the non-controlling interests have been informed about and do not object to the parent not presenting consolidated financial statements □ The parent's debt or equity securities are not publicly traded and the parent is not in the process of issuing any class of instruments in public securities markets □ The ultimate or any intermediate parent of the parent publishes consolidated financial statements available for public use that comply with IFRS

US GAAP	IFRS
Consolidated financial statements are presumed to be more meaningful and are required for SEC registrants. With the exception of the items noted above, there are no exemptions for consolidating subsidiaries in general-purpose financial statements.	A subsidiary is not excluded from consolidation simply because the investor is a venture capital organization, mutual fund, unit trust, or similar entity. However, an exception is provided for an investment entity (as defined in SD 12.3) from consolidating its subsidiaries unless those subsidiaries are providing investment-related services. Instead, the investment entity measures those investments at fair value through profit or loss. The exception from consolidation only applies to the financial reporting of an investment entity. This exception does not apply to the financial reporting by a non-investment entity, even if it is the parent of an investment entity. When separate financial statements are prepared, investments in subsidiaries, joint ventures, and associates can be accounted for at either: □ Cost □ Under the equity method, or □ Fair value The same accounting is required for each category of investments. However, investments in associates or joint ventures held by venture capital organizations, mutual funds, unit trusts or similar entities or investments entities accounted for at fair value in the consolidated financial statements should be measured at fair value in the separate financial statements.

12.3 Investment company/entity definition

The US GAAP and IFRS definitions of an investment entity are substantially converged; however, differences do exist. Investment companies measure their investments at fair value, including any investments in which they have a controlling financial interest.

US GAAP	IFRS

An investment company is an entity with the following fundamental characteristics:
□ It is an entity that does both of the following:
  ○ Obtains funds from one or more investors and provides the investor(s) with investment management services
  ○ Commits to its investor(s) that's it business purpose and only substantive activities are investing the funds solely for returns from capital appreciation, investment income, or both
□ The entity or its affiliates do not obtain or have the objective of obtaining returns or benefits from an investee or its affiliates that are not normally attributable to ownership interests or that are other than capital appreciation or investment income
An investment company would also be expected to have all of the following typical characteristics:
□ It has more than one investment
□ It has more than one investor
□ It has investors that are not related parties of the parent and the investment manager
□ It has ownership interests in the form of equity or partnership interests
□ It manages substantially all of its investments on a fair value basis
An entity may still be considered an investment company if it does not exhibit one or more of the typical characteristics, depending on facts and circumstances.
  ○ All entities subject to the Investment Company Act of 1940 are investment companies.
	The IFRS definition of an investment entity is substantially converged with the US GAAP definition with the following exceptions:
	□ The IFRS definition requires an entity to measure and evaluate the performance of substantially all of its investments on a fair value basis
	□ The IFRS definition does not provide for entities that are subject to certain regulatory requirements (such as the Investment Company Act of 1940) to qualify as investment entities without meeting the stated criteria

12.4 Consolidation model

Differences in consolidation under current US GAAP and IFRS can arise as a result of:

- Differences in how economic benefits are evaluated when the consolidation assessment considers more than just voting rights (i.e., differences in methodology)
- Specific differences or exceptions, such as:
  - The consideration of variable interests
  - De facto control
  - How potential voting rights are evaluated
  - Guidance related to de facto agents and related parties
  - Reconsideration events

US GAAP	IFRS
All consolidation decisions are evaluated first under the VIE model. US GAAP requires an entity with a variable interest in a VIE to qualitatively assess the determination of the primary beneficiary of the VIE. In applying the qualitative model, an entity is deemed to have a controlling financial interest if it meets both of the following criteria: □ Power to direct activities of the VIE that most significantly impact the VIE's economic performance (power criterion) □ Obligation to absorb losses from or right to receive benefits of the VIE that could potentially be significant to the VIE (losses/benefits criterion) In assessing whether an enterprise has a controlling financial interest in an entity, it should consider the entity's purpose and design, including the risks that the entity was designed to create and pass through to its variable interest holders.	IFRS focuses on the concept of control in determining whether a parent-subsidiary relationship exists. An investor controls an investee when it has all of the following: □ Power, through rights that give it the current ability, to direct the activities that significantly affect (the relevant activities that affect) the investee's returns □ Exposure, or rights, to variable returns from its involvement with the investee (returns must vary and can be positive, negative, or both) □ The ability to use its power over the investee to affect the amount of the investor's returns In assessing control of an entity, an investor should consider the entity's purpose and design to identify the relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities, and who is exposed or has rights to the returns from those activities. Only substantive rights can provide power.

US GAAP	IFRS
Only one enterprise, if any, is expected to be identified as the primary beneficiary of a VIE. Although more than one enterprise could meet the losses/benefits criterion, only one enterprise, if any, will have the power to direct the activities of a VIE that most significantly impact the entity's economic performance.	The greater an investor's exposure to variability of returns, the greater its incentive to obtain rights to give it power (i.e., it is an indicator of power and is not by itself determinative of having power).
Increased skepticism should be given to situations in which an enterprise's economic interest in a VIE is disproportionately greater than its stated power to direct the activities of the VIE that most significantly impact the entity's economic performance. As the level of disparity increases, the level of skepticism about an enterprise's lack of power is expected to increase.	
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.	○ When an entity is controlled by voting rights, control is presumed to exist when a parent owns, directly or indirectly, more than 50 percent of an entity's voting power. Control also exists when a parent owns half or less of the voting power but has legal or contractual rights to control either the majority of the entity's voting power or the board of directors. Control may exist even in cases where an entity owns little or none of a structured equity. The application of the control concept requires, in each case, judgment in the context of all relevant factors.

12.5 Accounting policies and reporting periods

In relation to certain specialized industries, US GAAP allows more flexibility for use of different accounting policies within a single set of consolidated financial statements.

In the event of nonuniform reporting periods, the treatment of significant transactions in any gap period varies under the two frameworks, with the potential for earlier recognition under IFRS.

US GAAP	IFRS
Consolidated financial statements are prepared by using uniform accounting policies for all of the entities in a group. Limited exceptions exist when a subsidiary has specialized industry accounting principles. Retention of the specialized accounting policy in consolidation is permitted in such cases.	Consolidated financial statements are prepared by using uniform accounting policies for like transactions and events in similar circumstances for all of the entities in a group.
The consolidated financial statements of the parent and the subsidiary are usually drawn up at the same reporting date. However, the consolidation of subsidiary accounts can be drawn up at a different reporting date, provided the difference between the reporting dates is no more than three months. Recognition is given, by disclosure or adjustment, to the effects of intervening events that would materially affect consolidated financial statements.	The consolidated financial statements of the parent and the subsidiary are usually drawn up at the same reporting date. However, the subsidiary accounts as of a different reporting date can be consolidated, provided the difference between the reporting dates is no more than three months. Adjustments are made to the financial statements for significant transactions that occur in the gap period.

Equity investments/investments in associates and joint ventures

12.6 Potential voting rights

The consideration of potential voting rights might lead to differences in whether an investor has significant influence.

US GAAP	IFRS
Potential voting rights are generally not considered in the assessment of whether an investor has significant influence.	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 generally not, however, considered in the measurement of the equity earnings recorded by the investor.

12.7 Definition and types of joint ventures

Differences in the definition or types of joint arrangements may result in different arrangements being considered joint ventures, which could affect reported figures, earnings, ratios, and covenants.

US GAAP	IFRS
The term *joint venture* refers only to jointly controlled entities, where the arrangement is carried on through a separate entity. A *corporate joint venture* is defined as a corporation owned and operated by a small group of businesses as a separate and specific business or project for the mutual benefit of the members of the group. Most joint venture arrangements give each venturer (investor) participating rights over the joint venture (with no single venturer having unilateral control), and each party sharing control must consent to the venture's operating, investing, and financing decisions.	A *joint arrangement* is a contractual agreement whereby two or more parties undertake an economic activity that is subject to joint control. *Joint control* is the contractually agreed sharing of control of an economic activity. Unanimous consent is required for the relevant activities (as discussed in SD 12.4) of the parties sharing control, but not necessarily of all parties in the arrangement. IFRS classifies joint arrangements into two types: □ Joint operations, which give parties to the arrangement direct rights to the assets and obligations for the liabilities □ Joint ventures, which give the parties rights to the net assets of the arrangement

12.8 Accounting for joint arrangements

Under IFRS, classification of joint arrangement as a joint venture or a joint operation determines the accounting by the investor. Under US GAAP, the proportional consolidation method is allowed for entities in certain industries.

US GAAP	IFRS
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.	The classification of a joint arrangement as a joint venture or a joint operation determines the investor's accounting. An investor in a joint venture must account for its interest using the equity method in accordance with IAS 28. An investor in a joint operation accounts for its share of assets, liabilities, income and expenses based on its direct rights and obligations. If the joint operation constitutes a business, the investor must apply the relevant principles on business combination accounting contained in IFRS 3, *Business Combinations*, and other standards, and disclose the related information required under those standards.

US GAAP	IFRS
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.	A joint operator that increases its interest in a joint operation that constitutes a business should not remeasure previously held interests in the joint operation when joint control is retained. Similarly, when an entity that has an interest (but not joint control) obtains joint control, previously held interests are not remeasured.

12.9 Accounting for contributions to a jointly controlled entity

Gain recognition upon contribution to a jointly controlled entity is more likely under IFRS.

US GAAP	IFRS
Prior to adoption of ASC 606, *Revenue from Contracts with Customers*, a venturer records its contributions to a joint venture at cost (i.e., the amount of cash contributed and the carrying value of other nonmonetary assets contributed). When a venturer contributes appreciated noncash assets and others have invested cash or other hard assets, it might be appropriate to recognize a gain for a portion of the appreciation. Practice and existing literature vary in this area. As a result, the specific facts and circumstances affect gain recognition and require careful analysis. Upon adoption of the revenue guidance in ASC 606, *Revenue from Contracts with Customers*, contributions to joint ventures will be measured at fair value at the venturer level in accordance with ASC 610-20, *Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets*. When an investor contributes a subsidiary or group of assets that constitute a business to a joint venture, the investor should apply the deconsolidation and derecognition	A venturer that contributes nonmonetary assets—such as shares; property, plant, and equipment; or intangible assets—to a jointly controlled entity in exchange for an equity interest in the jointly controlled entity generally recognizes in its consolidated income statement the portion of the gain or loss attributable to the equity interests of the other venturers, except when: □ The significant risks and rewards of ownership of the contributed assets have not been transferred to the jointly controlled entity, □ The gain or loss on the assets contributed cannot be measured reliably, or □ The contribution transaction lacks commercial substance. When the nonmonetary asset is a business, a policy choice is currently available for full or partial gain or loss recognition. IAS 28 (Amended 2011) provides an exception to the recognition of gains or losses only when the transaction lacks commercial substance.

US GAAP	IFRS
guidance in ASC 810-10-40 and record any consideration received for its contribution at fair value (including its interest in the joint venture). This generally results in a gain or loss on the contribution.	

12.10 Equity method of accounting—exemption from applying the equity method

An exemption from applying the equity method of accounting (i.e., use of the fair value through profit or loss option) is available to a broader group of entities under US GAAP.

US GAAP	IFRS
Equity method investments are considered financial assets and therefore are eligible for the fair value accounting option. An entity can measure an investment in associates or joint ventures at fair value through profit or loss, regardless of whether it is a venture capital or similar organization.	An entity can only elect fair value through profit or loss accounting for equity method investments held by venture capital organizations, mutual funds, unit trusts, and similar entities, including investment-linked insurance funds. If an associate or joint venture is an investment entity, the equity method of accounting is applied by either (1) recording the results of the investment entity that are at fair value or (2) undoing the fair value measurements of the investment entity. In other instances, an entity must apply the equity method to its investments in associates and joint ventures unless it is exempt from preparing consolidated financial statements.

12.11 Equity method of accounting—classification as held for sale

Application of the equity method of accounting may cease before significant influence is lost under IFRS (but not under US GAAP).

US GAAP	IFRS
Under US GAAP, if an equity method investments is classified as held for sale, an investor applies equity method accounting until significant influence is lost.	If an equity method investment meets the held for sale criteria in accordance with IFRS 5, an investor records the investment at the lower of its (1) fair value less costs to sell or (2) carrying amount as of the date the investment is classified as held for sale.

12.12 Equity method of accounting—acquisition date excess of investor's share of fair value over cost

IFRS may allow for day one gain recognition (whereas US GAAP would not).

US GAAP	IFRS
Any acquisition date excess of the investor's share of the net fair value of the associate's identifiable assets and liabilities over the cost of the investment is included in the basis differences and is amortized—if appropriate—over the underlying asset's useful life. If amortization is not appropriate, the difference is included in the gain/loss upon ultimate disposition of the investment.	Any acquisition date excess of the investor's share of net fair value of the associates' identifiable assets and liabilities over the cost of the investment is recognized as income in the period in which the investment is acquired.

12.13 Equity method of accounting—conforming accounting policies

A greater degree of conformity is required under IFRS.

US GAAP	IFRS
The equity investee's accounting policies do not have to conform to the investor's accounting policies if the investee follows an acceptable alternative US GAAP treatment.	An investor's financial statements are prepared using uniform accounting policies for similar transactions and events. This also applies to equity method investees.

12.14 Equity method of accounting—impairment

Impairment losses may be recognized earlier, and potentially may be reversed, under IFRS.

US GAAP	IFRS
An investor should determine whether a loss in the fair value of an investment below its carrying value is a temporary decline. If it is other than temporary, the investor calculates an impairment as the excess of the investment's carrying amount over the fair value. Reversals of impairments on equity method investments are prohibited.	An investor should assess whether objective indicators of impairment exist based on the "loss event" criteria in IAS 28. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is considered objective evidence of impairment. If there are objective indicators that the investment may be impaired, the investment is tested for impairment in accordance with IAS 36. Impairments of equity method investments can be reversed in accordance with IAS 36.

12.15 Equity method of accounting—losses in excess of an investor's interest

Losses may be recognized earlier under US GAAP.

US GAAP	IFRS
Even without a legal or constructive obligation to fund losses, a loss in excess of the investment amount (i.e., a negative or liability investment balance) should be recognized when the imminent return to profitable operations by an investee appears to be assured.	Unless an entity has incurred a legal or constructive obligation, losses in excess of the investment are not recognized. The concept of an imminent return to profitable operations does not exist under IFRS.

12.16 Equity method of accounting—loss of significant influence or joint control

The potential for greater earnings volatility exists under IFRS.

US GAAP	IFRS
If an investment no longer qualifies for equity method accounting (for example, due to a decrease in the level of ownership), the investment's initial basis is the previous carrying amount of the investment. Under ASC 321, which was effective for calendar year-end public business entities on January 1, 2018, the cost method is not permitted. An initial gain or loss is generally recorded to recognize the investment at fair value and the investment is subsequently measured at fair value with gains or losses recorded to earnings. If the investment does not have a readily determinable fair value, a practical expedient can be elected to measure it at cost minus impairment, adjusted for changes for observable transactions. It is currently unclear whether the transaction resulting in loss of significant influence should be considered an observable transaction under this expedient. For entities that have not adopted ASC 321 applying the cost method 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. If the security has a readily determinable fair value, changes in fair value are recorded to earnings or other comprehensive income depending on whether it is considered a trading or available for sale security.	If an entity loses significant influence or joint control over an equity method investment and the retained interest is a financial asset, the entity should measure the retained interest at fair value. The resultant gain or loss is recognized in the income statement. In contrast, if an investment in an associate becomes an investment in a joint venture, or vice versa, such that the equity method of accounting continues to apply, no gain or loss is recognized in the income statement.

12.17 Accounting for investments in qualified affordable housing projects

US GAAP permits reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met.

US GAAP	IFRS
An investor that owns a passive investment in limited liability entities that manage or invest in qualified affordable housing projects can use the proportional amortization method if certain conditions are met. Under the proportional amortization method, the initial cost of the investment is amortized in proportion to the tax benefits received over the period that the investor expects to receive the tax credits and other benefits. Both the amortization expense determined under the proportional amortization method and the tax benefits received will be recognized as a component of income taxes. Use of the proportional amortization method for investments that meet the requisite conditions is an accounting policy election. Once elected, the proportional amortization method should be applied to all qualifying investments.	IFRS does not contain any guidance specific to accounting for investments in qualified affordable housing projects.

Disclosure

12.18 Disclosures

US GAAP and IFRS both require extensive disclosure about an entity's involvement in VIEs/structured entities, including those that are not consolidated.

US GAAP	IFRS
Guidance applies to both nonpublic and public enterprises. The principal objectives of VIE disclosures are to provide financial statement users with an understanding of the following:	IFRS has disclosure requirements for interests in subsidiaries, joint arrangements, associates, and unconsolidated structured entities which include the following:

US GAAP	IFRS
□ Significant judgments and assumptions made by an enterprise in determining whether it must consolidate a VIE and/or disclose information about its involvement in a VIE □ The nature of restrictions on a consolidated VIE's assets and on the settlement of its liabilities reported by an enterprise in its statement of financial position, including the carrying amounts of such assets and liabilities □ The nature of, and changes in, the risks associated with an enterprise's involvement with the VIE □ How an enterprise's involvement with the VIE affects the enterprise's financial position, financial performance, and cash flows The level of disclosure to achieve these objectives may depend on the facts and circumstances surrounding the VIE and the enterprise's interest in that entity. Additional detailed disclosure guidance is provided for meeting the objectives described above. Specific disclosures are required for (1) a primary beneficiary of a VIE and (2) an entity that holds a variable interest in a VIE (but is not the primary beneficiary).	□ Significant judgments and assumptions in determining if an investor has control or joint control over another entity, and the type of joint arrangement □ The composition of the group and interests that non-controlling interests have in the group's activities and cash flows □ The nature and extent of any significant restrictions on the ability of the investor to access or use assets, and settle liabilities □ The nature and extent of an investor's interest in unconsolidated structured entities □ The nature of, and changes in, the risks associated with an investor's interest in consolidated and unconsolidated structured entities □ The nature, extent and financial effects of an investors' interests in joint arrangements and associates, and the nature of the risks associated with those interests □ The consequences of changes in ownership interest of a subsidiary that do not result in loss of control □ The consequences of a loss of control of a subsidiary during the period An entity is required to consider the level of detail necessary to satisfy the disclosure objectives of enabling users to evaluate the nature and associated risks of its interests, and the effects of those interests on its financial statements. Additional detailed disclosure guidance is provided for meeting the objectives described above.

US GAAP	IFRS
	If control of a subsidiary is lost, the parent shall disclose the gain or loss, if any, and: □ Portion of that gain or loss attributable to recognizing any investment retained in former subsidiary at its fair value at date when control is lost □ Line item(s) in the statement of comprehensive income in which the gain or loss is recognized (if not presented separately in the statement of comprehensive income) Additional disclosures are required in instances when separate financial statements are prepared for a parent that elects not to prepare consolidated financial statements, or when a parent, venturer with an interest in a jointly controlled entity, or investor in an associate prepares separate financial statements.

12.19 Recent/proposed guidance

12.19.1 FASB reorganization of the consolidation guidance

The FASB is working on a project to clarify the consolidation guidance by reorganizing its content. The reorganization will include the introduction of two separate sub-topics, one for VIEs and the other for voting interest entities. The reorganized content will be included in a new codification topic, ASC 812, with ASC 810 being superseded in its entirety. These sub-topics will reflect differences from the consolidation guidance under IFRS.

The FASB is also working on a project to make targeted improvements to the related party guidance for VIEs. In June 2017, a proposed accounting standard update was issued. The FASB continues to redeliberate and a final accounting standard which is expected to be released in the fourth quarter of 2018.

12.19.2 IASB proposes amendments to remeasuring previously held interests

In December 2017, the IASB amended IFRS 3, *Business Combinations,* and IFRS 11*, Joint Arrangements*. The amendments to IFRS 3 and IFRS 11 clarify that:

- □ when an entity obtains control of a business that is a joint operation, it would remeasure previously held interests in that business, and

- when an entity obtains joint control of a business that is a joint operation, the entity would not remeasure previously held interests in that business.

These amendments apply to annual reporting periods beginning on or after January 1, 2019. Early adoption is permitted.

12.19.3 IASB amendments to IFRS 10, Consolidated Financial Statements and IAS 28, Investments in Associates and Joint Ventures: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

In September 2014, the IASB issued an amendment to IFRS 10 and IAS 28 to clarify the accounting treatment for sales or contribution of assets between an investor and its associates or joint ventures.

The amendments resolve a current inconsistency between IFRS 10 and IAS 28. The accounting treatment depends on whether the nonmonetary assets sold or contributed to an associate or joint venture constitute a business.

Full gain or loss would be recognized by the investor when the nonmonetary assets constitute a business. If the assets do not meet the definition of a business, the gain or loss would be recognized by the investor to the extent of the other investors' interests.

In December 2015, the IASB deferred the effective date of these amendments indefinitely.

Chapter 13: Business combinations

13.1 Business combinations

IFRS and US GAAP are largely converged in this area. The business combinations standards under US GAAP and IFRS are close in principles and language. However, some differences remain between US GAAP and IFRS pertaining to (1) the definition of control, (2) recognition of certain assets and liabilities based on the reliably measurable criterion, (3) accounting for contingencies, and (4) accounting for noncontrolling interests. Significant differences also continue to exist in subsequent accounting. Different requirements for impairment testing and accounting for deferred taxes (e.g., the recognition of a valuation allowance) are among the most significant.

Technical references

US GAAP

ASC 205-20, ASC 350-10, ASC 350-20, ASC 350-30, ASC 360-10, ASC 805, ASC 810

IFRS

IAS 12, IAS 38, IAS 39, IFRS 2, IFRS 3, IFRS 10, IFRS 13

PwC Guide

Business combinations and noncontrolling interests, 2015 global second edition

Note

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

Determining whether the acquisition method should be applied

13.2 Definition of control

Determining whether the acquisition method applies to a transaction begins with understanding whether the transaction involves the acquisition of one or more businesses and whether it is a business combination within the scope of the business combinations guidance.

The business combinations guidance states that for a business combination to occur, an acquirer must obtain control over a business. US GAAP and IFRS define control differently. Consequently, the same transaction may be accounted for as a business combination under US GAAP, but not under IFRS, or vice versa. The table below highlights various considerations in determining control under US GAAP and IFRS.

US GAAP	IFRS
Consolidation decisions are evaluated first under the variable interest entity model. ▫ Qualitatively assess if the variable interest meets both criteria: ○ Power to direct activities that most significantly impact economic performance ○ Potential to receive significant benefits or absorb significant losses All other entities are evaluated under the voting interest model. See SD 12 for further information on the concept of control and the consolidation model under US GAAP.	An investor has control over an investee when all of the following elements are present: ▫ Power over the investee ▫ Exposure, or rights, to variable returns from its involvement with the investee ▫ Ability to use power to affect the returns See SD 12 for further information on the concept of control and the consolidation model under IFRS.

Acquired assets and liabilities

13.3 *Acquired contingencies*

There are significant differences related to the recognition of contingent liabilities and contingent assets.

US GAAP	IFRS
Acquired assets and liabilities subject to contingencies are recognized at fair value if fair value can be determined during the measurement period. If fair value cannot be determined, companies should typically account for the acquired contingencies using existing guidance. If recognized at fair value on acquisition, an acquirer should develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature.	The acquiree's contingent liabilities are recognized at the acquisition date provided their fair values can be measured reliably. The contingent liability is measured subsequently at the higher of the amount initially recognized less, if appropriate, cumulative amortization recognized under the revenue guidance (IFRS 15) or the best estimate of the amount required to settle the present obligation at the end of the reporting period (under the provisions guidance—IAS 37). Contingent assets are not recognized.

13.4 Assignment/allocation and impairment of goodwill

The definition of the levels at which goodwill is assigned/allocated and tested for impairment varies between the two frameworks. Specifically, in determining the unit of account for goodwill impairment testing, US GAAP uses a segment reporting framework while IFRS focuses on the lowest level of identifiable cash flows.

Additional differences in the impairment testing methodologies could create further variability in the timing and extent of recognized impairment losses.

In January 2017, the FASB issued ASU 2017-04 to simplify the accounting for goodwill impairment. The guidance removes Step 2 of the goodwill impairment test. The change makes US GAAP more similar to IFRS because IFRS also has a single step for goodwill impairment. However, other differences remain.

US GAAP	IFRS
Goodwill is assigned to an entity's reporting units, defined as the same as, or one level below, an operating segment. The determination of reporting units is based on a segment reporting structure. Goodwill is tested for impairment at least on an annual basis and between annual tests if an event occurs or circumstances change that may indicate an impairment. When performing the goodwill impairment test, an entity may first assess qualitative factors to determine whether the quantitative goodwill impairment test is necessary. If the entity determines, based on the qualitative assessment, that it is more likely than not that the fair value of a reporting unit is below its carrying amount, the impairment test is performed. An entity can bypass the qualitative assessment for any reporting unit in any period and proceed directly to the quantitative assessment. Prior to adoption of ASU 2017-04, goodwill is tested for impairment using a two-step test: □ In Step 1, the fair value and the carrying amount of the reporting unit, including goodwill, are compared. If the fair value of the reporting unit is less than the	Goodwill is allocated to a cash-generating unit (CGU) or group of CGUs (not larger than an operating segment) based on how goodwill is monitored for internal management purposes. A CGU is the smallest identifiable group of assets that generates cash inflows largely independently of other assets or groups of assets. Goodwill is tested for impairment at least on an annual basis and between annual tests if an event occurs or circumstances change that may indicate an impairment. Goodwill impairment testing is performed using a one-step approach: The recoverable amount of the CGU or group of CGUs (i.e., the higher of its fair value less costs of disposal and its value in use) is compared with its carrying amount. Any impairment loss is recognized in operating results as the excess of the carrying amount over the recoverable amount. The impairment loss is allocated first to goodwill and then on a pro rata basis to the other assets of the CGU or group of CGUs to the extent that the impairment loss exceeds the carrying value of goodwill.

carrying amount, Step 2 is completed to determine the amount of the goodwill impairment loss, if any.

- Goodwill impairment is measured as the excess of the carrying amount of goodwill over its implied fair value. The implied fair value of goodwill—calculated in the same manner that goodwill is determined in a business combination—is the difference between the fair value of the reporting unit and the fair value of the various assets and liabilities included in the reporting unit.

Any loss recognized is not permitted to exceed the carrying amount of goodwill. The impairment charge is included in operating income.

For reporting units with zero or negative carrying amounts, an entity must first perform a qualitative assessment to determine whether it is more likely than not that a goodwill impairment exists. An entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that goodwill impairment exists.

ASU 2017-04 removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. As a result, goodwill impairment will be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill.

The same one-step impairment test will be applied to goodwill at all reporting units, even those with zero or negative carrying amounts. Entities will be required to disclose the amount of goodwill at reporting units with zero or negative carrying amounts.

Private companies have the option to amortize goodwill on a straight-line basis over a period of up to ten years, and apply a trigger-based, single-step impairment test at either the entity level or the reporting unit level at the company's election.

13.5 Indefinite lived intangible asset impairment

The levels at which impairment testing is performed for indefinite lived intangible assets is different under US GAAP and IFRS, which may lead to different impairment conclusions.

US GAAP	IFRS
An indefinite lived asset is considered impaired when the asset's carrying amount exceeds its fair value. The test is performed at the individual asset level.	Impairment should be identified at the individual asset level, when possible. When the recoverable amount of the individual asset cannot be identified, the recoverable amount should be calculated for the CGU to which the asset belongs.

13.6 Contingent consideration—seller accounting

Entities that sell a business that includes contingent consideration might encounter significant differences in the manner in which such contingent considerations are recorded.

US GAAP	IFRS
Under US GAAP, the seller should determine whether the arrangement meets the definition of a derivative. If the arrangement meets the definition of a derivative, the arrangement should be recorded at fair value. If the arrangement does not meet the definition of a derivative, the seller should make an accounting policy election to record the arrangement at either fair value at inception or at the settlement amount when the consideration is realized or is realizable, whichever is earlier.	Under IFRS, a contract to receive contingent consideration that gives the seller the right to receive cash or other financial assets when the contingency is resolved meets the definition of a financial asset. When a contract for contingent consideration meets the definition of a financial asset, it is measured in accordance with IFRS 9, typically at fair value through profit or loss.

Other

13.7 Noncontrolling interests

Noncontrolling interests are measured at full fair value under US GAAP whereas IFRS provides two valuation options, which could result in differences in the carrying values of noncontrolling interests.

US GAAP	IFRS
Noncontrolling interests are measured at fair value.	Entities have an option, on a transaction-by-transaction basis, to measure noncontrolling interests at their proportion of the fair value of the identifiable net assets or at 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 fair value option results in full goodwill being recorded on both the controlling and noncontrolling interest.

13.8 Combinations involving entities under common control

Under US GAAP, there are specific rules for common-control transactions.

US GAAP	IFRS
Combinations of entities under common control are generally recorded at predecessor cost, reflecting the transferor's carrying amount of the assets and liabilities transferred.	IFRS does not specifically address such transactions. In practice, entities develop and consistently apply an accounting policy; management can elect to apply the acquisition method of accounting or the predecessor value method to a business combination involving entities under common control. The accounting policy can be changed only when criteria for a change in an accounting policy are met in the applicable guidance in IAS 8 (i.e., it provides more reliable and more relevant information).

13.9 Identifying the acquirer

Different entities might be determined to be the acquirer when applying purchase accounting.

Impacted entities should refer to the Consolidation chapter for a more detailed discussion of differences related to the consolidation models between the frameworks that might create significant differences in this area.

US GAAP	IFRS
The acquirer is determined by reference to ASC 810–10, under which generally the party that holds greater than 50% of the voting shares has control. In addition, control might exist when less than 50% of voting shares are held if the acquirer is the primary beneficiary of a variable interest entity in accordance with ASC 810.	The acquirer is determined by reference to the consolidation guidance, under which generally the party that holds greater than 50% of the voting rights has control. In addition, control might exist when less than 50% of the voting rights are held, if the acquirer has the power to most significantly affect the variable returns of the entity in accordance with IFRS 10.

13.10 Push-down accounting

The lack of push-down accounting under IFRS can lead to significant differences in instances where push down accounting was utilized under US GAAP.

US GAAP	IFRS
Companies have the option to apply pushdown accounting in their separate financial statements upon a change-in-control event. The election is available to the acquired company, as well as to any direct or indirect subsidiaries of the acquired company. If an acquired company elects to apply pushdown accounting, the acquired company should reflect the new basis of accounting established by the parent for the individual assets and liabilities of the acquired company arising from the acquisition in its standalone financial statements. Goodwill should be calculated and recognized consistent with business combination accounting. Bargain purchase gains, however, should not be recognized in the income statement of the acquired company that applies pushdown accounting. Instead, they should be recognized in additional paid-in capital within equity. Debt (including acquisition related debt) and any other liabilities of the acquirer should be recognized by the acquired company only if they represent an obligation of the acquired company pursuant to other applicable guidance in US GAAP.	There is no discussion of pushdown accounting under IFRS. There may be situations in which transactions, such as capital reorganizations, common control transactions, etc., may result in an accounting outcome that is similar to pushdown accounting where the new basis of accounting established by the parent, including goodwill and purchase price adjustments, is reflected in the company's standalone financial statements.

13.11 Measurement period adjustment

In September 2015, the FASB issued guidance that simplifies the accounting for measurement period adjustments. Prior to the new guidance, US GAAP and IFRS were converged with respect to the treatment of measurement period adjustments. The new guidance has created a difference between US GAAP and IFRS.

US GAAP	IFRS
An acquirer has up to one year from the acquisition date (referred to as the measurement period) to finalize the accounting for a business combination. If during the measurement period, the measurements are not finalized as of the end of a reporting period, the acquirer should record the cumulative impact of measurement period adjustments made to provisional amounts in the period that the adjustment is determined. However, the acquirer should present separately on the face of the income statement or disclose in the notes the portion of the adjustment to each income statement line items that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date.	An acquirer has up to one year from the acquisition date (referred to as the measurement period) to finalize the accounting for a business combination. An acquirer should retrospectively record measurement period adjustments made to provisional amounts as if the accounting was completed at the acquisition date. The acquirer should revise comparative information for prior periods presented in the financial statements as needed, including making any change in depreciation, amortization, or other income effects recognized in completing the initial accounting.

13.12 Employee benefit arrangements and income tax

Accounting for share-based payments and income taxes in accordance with separate standards not at fair value might result in different results being recorded as part of purchase accounting.

13.13 Recent/proposed guidance

13.13.1 Clarifying the definition of a business

On January 5, 2017, the FASB issued Accounting Standards Update 2017-01, which revises the definition of a business. The changes to the definition of a business will likely result in more acquisitions being accounted for as asset acquisitions across most industries, particularly real estate and pharmaceuticals.

Under the amendment, when substantially all of the fair value of gross assets acquired is concentrated in a single identifiable asset (or a group of similar identifiable assets), the assets acquired would not represent a business. This provision introduces a gating criteria that, if met, would eliminate the need for further assessment (the screen test).

To be considered a business, an acquisition would have to include, at a minimum, an input and a substantive process that together contribute to the ability to create outputs. The proposal provides a framework to evaluate when an input and substantive process is present (including for early stage companies that have not generated outputs), and removes the current requirement to assess if a market participant could replace any missing elements.

The amendment narrows the definition of outputs so that the term is consistent with how outputs are described in Topic 606, Revenue from Contracts with Customers. Under the proposed definition, an output is the result of inputs and processes that provide goods or services to customers, other revenue, or investment income, such as dividends and interest.

In February 2017, the FASB issued ASU 2017-05, *Other income – Gains and Losses from the Derecognition of Nonfinancial Assets* (the second phase of the broader definition of a business project) to clarify the scope of ASC 610-20, including what constitutes an "in substance nonfinancial asset," and provide guidance on partial sales of nonfinancial and in substance assets. See SD 6.23.3 for further discussion of the amendment.

The FASB has also added phase three to its agenda to revisit the accounting differences that currently exist between asset and business acquisitions and disposals (for example, whether transaction costs should be treated similarly for business and asset acquisitions).

13.13.2 IASB amendments to IFRS 3, Business Combinations

The IASB is expected to issue amendments to IFRS 3, *Business Combinations*, in the fourth quarter of 2018 to clarify the definition of a business. The amendments are expected to be similar to the amendments by the FASB in ASU 2017-01. The most significant difference is that US GAAP requires application of the screen test, but the corresponding concentration test in the IFRS 3 amendment is expected to be optional. The IFRS 3 amendments will likely result in more acquisitions being classified as asset acquisitions. However, the impact to IFRS is expected to be less significant than the change to US GAAP.

Chapter 14: Other accounting and reporting topics

14.1 Other accounting and reporting topics

In addition to areas previously discussed, differences exist in a multitude of other standards, including translation of foreign currency transactions, calculation of earnings per share, disclosures regarding operating segments, and discontinued operations treatment. Differences also exist in the presentation and disclosure of annual and interim financial statements; however, each of the boards has several projects in progress which may impact some of these differences.

Technical references

US GAAP

ASC 205, ASC 205-20, ASC 230, ASC 260, ASC 280, ASC 360-10, ASC 830, ASC 830-30-40-2 through 40-4, ASC 850, ASC 853

IFRS

IAS 1, IAS 7, IAS 8, IAS 21, IAS 23, IAS 24, IAS 29, IAS 32, IAS 33, IFRS 1, IFRS 5, IFRS 7, IFRS 8, IFRIC 12

Note

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

14.2 Balance sheet—offsetting assets and liabilities

Differences in the guidance covering the offsetting of assets and liabilities under master netting arrangements, repurchase and reverse-repurchase arrangements, and the number of parties involved in the offset arrangement could change the balance sheet presentation of items currently shown net (or gross) under US GAAP. Consequently, more items are likely to appear gross under IFRS.

US GAAP	IFRS
The guidance states that "it is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except where a right of setoff exists." A right of setoff is a debtor's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor. A debtor having a valid right of setoff may offset the related asset and liability and report the net amount. A right of setoff exists when all of the following conditions are met: □ Each of two parties owes the other determinable amounts □ The reporting party has the right to set off the amount owed with the amount owed by the other party □ The reporting party intends to set off □ The right of setoff is enforceable by law. 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. Repurchase agreements and reverse-repurchase agreements that meet certain conditions are permitted, but not required, to be offset in the balance sheet.	Under the guidance, a right of setoff is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. Two conditions must exist for an entity to offset a financial asset and a financial liability (and thus present the net amount on the balance sheet). The entity must both: □ Currently have a legally enforceable right to set off, and □ Intend either to settle on a net basis or to realize the asset and settle the liability simultaneously. If both criteria are met, offsetting is required. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor, provided that there is an agreement among the three parties that clearly establishes the debtor's right of setoff. Master netting arrangements do not provide a basis for offsetting unless both of the criteria described earlier have been satisfied.

14.3 Balance sheet—disclosures for offsetting assets and liabilities

While differences exist between IFRS and US GAAP in the offsetting requirements, the boards were able to reach a converged solution on the nature of the disclosure requirements.

US GAAP	IFRS
The balance sheet offsetting disclosures are limited to derivatives, repurchase agreements, and securities lending transactions to the extent that they are (1) offset in the financial statements or (2) subject to an enforceable master netting arrangement or similar agreement.	The disclosure requirements are applicable for (1) all recognized financial instruments that are set off in the financial statements and (2) all recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in the financial statements.

14.4 Balance sheet: classification—post-balance sheet refinancing agreements

Under IFRS, the classification of debt does not consider post-balance sheet refinancing agreements. As such, more debt is classified as current under IFRS.

US GAAP	IFRS
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.	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.
SEC registrants subject to S-X Article 5 for commercial and industrial companies are required to present a classified balance sheet, but no other Articles within S-X contain this requirement. ASC 210-10-05-4 notes that most reporting entities present a classified balance sheet.	The presentation of a classified balance sheet is required, except when a liquidity presentation is reliable and more relevant.

14.5 Balance sheet: classification—refinancing counterparty

Differences in the guidance for accounting for certain refinancing arrangements may result in more debt classified as current under IFRS.

US GAAP	IFRS
A short-term obligation may be excluded from current liabilities if the entity intends to refinance the obligation on a long-term basis and the intent to refinance on a long-term basis is supported by an ability to consummate the refinancing as demonstrated by meeting certain requirements. The refinancing does not necessarily need to be with the same counterparty.	If an entity expects and has the discretion to refinance or roll over an obligation for at least 12 months after the reporting period under an existing loan financing, it classifies the obligation as noncurrent, even if it would otherwise be due within a shorter period. In order for refinancing arrangements to be classified as noncurrent, the arrangement should be with the same counterparty.

14.6 Income statement and statement of comprehensive income

The most significant difference between the frameworks is that under IFRS an entity can present expenses based on their nature or their function.

US GAAP	IFRS
The income statement may be presented in either (1) a single-step format, whereby all expenses are classified by function and then deducted from total income to arrive at income before tax, or (2) a multiple-step format separating operating and nonoperating activities before presenting income before tax.	While certain minimum line items are required, no prescribed statement of comprehensive income format exists. Entities that disclose an operating result should include all items of an operating nature, including those that occur irregularly or infrequently or are unusual in amount, within that caption.

US GAAP	IFRS
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. All items included in other comprehensive income are subject to recycling.	Expenses may be presented either by function or by nature, whichever provides information that is reliable and more relevant depending on historical and industry factors and the nature of the entity. Additional disclosure of expenses by nature, including depreciation and amortization expense and employee benefit expense, is required in the notes to the financial statements if functional presentation is used on the face of the income statement. Entities should not mix functional and nature classifications of expenses by excluding certain expenses from the functional classifications to which they relate. Entities are required to present items included in other comprehensive income that may be reclassified into profit or loss in future periods separately from those that will not be reclassified. The share of other comprehensive income of associates and joint ventures accounted for using the equity method must be grouped into those that will and will not be reclassified to profit or loss.

14.7 Statements of equity

IFRS requires a statement of changes in equity to be presented as a primary statement for all entities.

US GAAP	IFRS
Permits the statement of changes in shareholders' equity to be presented either as a primary statement or within the notes to the financial statements.	A statement of changes in equity is presented as a primary statement for all entities.

14.8 Statement of cash flows

Differences exist between the two frameworks for the presentation of the statement of cash flows that could result in differences in the actual amount shown as cash and cash equivalents in the statement of cash flows (including the presentation of restricted cash) as well as changes to each of the operating, investing, and financing activity sections.

Upon adoption of ASU 2016-18, restricted cash will generally be included as part of cash and cash equivalents under US GAAP but not under IFRS. For public business entities, ASU 2016-18 is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted.

US GAAP	IFRS
Under US GAAP (after adoption of ASU 2016-18), restricted cash is presented together with cash and cash equivalents on the statement of cash flows. The statement of cash flows shows the change during the period in total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. As a result, transfers between restricted cash and unrestricted cash are not presented in the statement of cash flows and direct changes in restricted cash are not disclosed as noncash transactions. Entities are, however, required to reconcile the total amount of cash, cash equivalent, and restricted cash presented on the statement of cash flows to the balance sheet, as well as disclose the nature and extent of the restrictions.	Entities need to consider whether restricted funds meet the definition of cash and cash equivalents. This is to ensure that only those items that are available to meet short-term cash commitments are classified as cash or cash equivalents. Funds that do not meet the criteria should not be presented as part of cash and cash equivalents.
Bank overdrafts are not included in cash and cash equivalents; changes in the balances of bank overdrafts are classified as financing cash flows.	Cash and cash equivalents may also include bank overdrafts repayable on demand that form an integral part of an entity's cash management. Short-term bank borrowings are not included in cash or cash equivalents and are considered to be financing cash flows.
There is no requirement for expenditures to be recognized as an asset in order to be classified as investing activities.	Only expenditures that result in a recognized asset are eligible for classification as investing activities.
US GAAP is prescriptive on the cash flow classification of certain items. For example, specific guidance exists in areas such as distributions received from equity method investees, debt prepayments and extinguishments costs and sales of trade receivables.	IFRS is generally less prescriptive in the classification of certain items in the statement of cash flows. The general principle is that cash flows are classified in the manner most appropriate to the business.

US GAAP	IFRS
Dividends paid are required to be classified in the financing section of the cash flow statement and interest paid (and expensed), interest received, and dividends received from investments are required to be classified as cash flows from operations. If the indirect method is used, amounts of interest paid (net of amounts capitalized) during the period must be disclosed. Taxes paid are generally classified as operating cash flows; specific rules exist regarding the classification of the tax benefit associated with share-based compensation arrangements. If the indirect method is used, amounts of taxes paid during the period must be disclosed.	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. The total amount of interest paid during a period, whether expensed or capitalized, is disclosed in the statement of cash flows. Taxes paid should be classified within operating cash flows unless specific identification with a financing or investing activity exists.

14.9 Disclosure of critical judgements and significant estimates

An increased prominence exists in the disclosure of an entity's critical judgements and disclosures of significant accounting estimates under IFRS in comparison to the requirements of US GAAP.

US GAAP	IFRS
For SEC registrants, disclosure of the application of critical accounting policies and significant estimates is normally made in the *Management's Discussion and Analysis* section of SEC filings such as Forms 10-K or 20-F.	Within the notes to the financial statements, entities are required to disclose both: □ The judgments that management has made in the process of applying its accounting policies that have the most significant effect on the amounts recognized in those financial statements □ Information about the key assumptions concerning the future—and other key sources of estimation uncertainty at the balance sheet date—that have significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year

14.10 Capital management disclosures

Entities applying IFRS are required to disclose information that will enable users of its financial statements to evaluate the entity's objectives, policies, and processes for managing capital.

US GAAP	IFRS
There are no specific requirements of capital management disclosures under US GAAP. For SEC registrants, disclosure of capital resources is normally made in the *Management's Discussion and Analysis* section of SEC filings such as Forms 10-K or 20-F.	Entities are required to disclose the following: □ Qualitative information about their objectives, policies, and processes for managing capital □ Summary quantitative data about what they manage as capital □ Changes in the above from the previous period □ Whether during the period they complied with any externally imposed capital requirements to which they are subject and, if not, the consequences of such non-compliance The above disclosure should be based on information provided internally to key management personnel.

14.11 Comparative financial information

IFRS specifies the periods for which comparative financial information is required, which differs from both US GAAP and SEC requirements.

US GAAP	IFRS
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.	One year of comparatives is required for all numerical information in the financial statements, with limited exceptions in disclosures. A third statement of financial position at the beginning of preceding period is required for first-time adopters of IFRS and in situations where a retrospective application of an accounting policy, retrospective restatement or reclassification having a material effect on the information in the statement of financial position at the beginning of the preceding period have occurred. Restatements or reclassifications in this context are in relation to correction of

US GAAP	IFRS
	errors, or changes in presentation of previously issued financial statements.

14.12 Basic earnings-per-share calculation—mandatorily convertible instruments

Differences in the treatment of shares issuable on conversion of a mandatorily convertible instrument could result in a different denominator for basic EPS.

US GAAP	IFRS
Current practice is not to include shares issuable pursuant to conversion of a mandatorily convertible instrument in the computation of basic EPS, unless the instrument is determined to be a participating security (in which case it would be included in the calculation of the basic EPS numerator). Such shares should be included in the computation of diluted EPS using the if-converted method.	Ordinary shares that are issuable on the conversion of a mandatorily convertible instrument should be included in basic EPS from the date the contract is entered into, since the issuance of ordinary shares for such instrument is solely dependent on the passage of time.

14.13 Diluted earnings-per-share calculation—year-to-date period calculation

Differences in the calculation methodology could result in different denominators being utilized in the diluted earnings-per-share (EPS) year-to-date period calculation.

US GAAP	IFRS
In computing diluted EPS, the treasury stock method is applied each interim period to instruments such as options and warrants. US GAAP requires that the number of incremental shares included in the year-to-date EPS denominator be computed by using the average number of incremental shares from each interim diluted EPS computation. Specific rules apply when there are mixtures of net profit and net loss in different interim periods.	The guidance states that dilutive potential common shares shall be determined independently for each period presented, not a weighted average of the dilutive potential common shares included in each interim computation.

14.14 Diluted earnings-per-share calculation—contracts that may be settled in stock or cash (at the issuer's election)

Differences in the treatment of convertible debt securities may result in lower diluted EPS under IFRS.

US GAAP	IFRS
Certain securities give the issuer a choice of either cash or share settlement. These contracts would typically follow the if-converted or treasury stock method, as applicable. 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 settled in cash.	Contracts that can be settled in either common shares or cash at the election of the issuer are always presumed to be settled in common shares and are included in diluted EPS if the effect is dilutive; that presumption may not be rebutted.

14.15 Diluted earnings-per-share calculation—contingently convertible instruments

The treatment of contingency features in the dilutive EPS calculation may result in higher diluted EPS under IFRS.

US GAAP	IFRS
Contingently convertible debt securities with a market price trigger (e.g., debt instruments that contain a conversion feature that is triggered upon an entity's stock price reaching a predetermined price) should always be included in diluted EPS computations if dilutive—regardless of whether the market price trigger has been met. That is, this type of contingency feature should be ignored.	The potential common shares arising from contingently convertible debt securities would be included in the dilutive EPS computation only if the contingency condition was met as of the reporting date.

14.16 Participating securities and the two-class method

The scope of instruments to which the two-class method applies is wider under US GAAP. In addition, under US GAAP, losses are allocated to participating instruments only if certain conditions are met.

US GAAP	IFRS
The two-class method is applied to all instruments that participate in dividends with common stock according to a predetermined formula. It applies regardless of whether the instrument is convertible or non-convertible. It also applies to both instruments classified as liabilities and those classified as equity.	The two-class method applies to equity instruments that participate in dividends with ordinary shares according to a predetermined formula; it does not apply to participating instruments classified as liabilities. Also, the two-class method is only explicitly required to be applied to participating equity instruments that are not convertible to ordinary shares.
A reporting entity should only allocate losses to participating securities if, based on the contractual terms of the participating securities, the securities have a contractual obligation to share in the losses of the reporting entity on a basis that is objectively determinable.	No explicit guidance limits allocation of losses to participating securities.

14.17 Trigger to release amounts recorded in the currency translation account

Different recognition triggers for amounts captured in the currency translation account (CTA) could result in more instances where amounts included in CTA are released through the income statement under IFRS compared with US GAAP.

US GAAP	IFRS
CTA is released through the income statement in the following situations: □ When control of a foreign entity, as defined, is lost, the entire CTA balance is released. □ Complete or substantially complete liquidation of a foreign entity, as defined, results in full release of CTA. □ When a portion of an equity method investment that is itself a foreign entity, as defined, is sold but significant influence or joint control	The triggers for CTA release noted in the US GAAP column apply for IFRS, except with regards to the loss of significant influence or joint control, where IFRS requires that the entire balance of CTA be released into the income statement. In addition, when a partial liquidation occurs, an entity has an accounting policy choice whether to (1) treat such an event as a partial disposal and release a portion of the CTA on a proportionate basis or (2) not recognize any disposal as the parent continues to own the same percentage share of the subsidiary.

US GAAP	IFRS
is retained, a portion of CTA is released, on a proportionate basis. ▫ When a reporting entity has an investment in a foreign entity accounted for by the equity method, and the reporting entity increases its stake in the subject foreign entity such that control is acquired. It is treated as if the equity method investment were sold, and used to purchase a controlling interest in the foreign entity. ▫ When significant influence or joint control over an equity method investee is lost, a proportionate amount of CTA is released into the income statement (through the level at which significant influence or joint control is lost). The remaining CTA balance becomes part of the cost basis of the investment retained.	Under US GAAP, release of CTA is only appropriate on complete or substantially complete liquidation.
If a company settles or partially settles an intercompany transaction for which settlement was not previously planned (and therefore had been considered of a long-term-investment nature), the related foreign currency exchanges gains and losses previously included in CTA are not released to the income statement, unless the repayment transaction effectively constitutes a substantial liquidation of the foreign entity.	Where a subsidiary that is a foreign operation repays a quasi-equity loan, but there is no change in the parent's proportionate percentage shareholding, there is an accounting policy choice regarding whether the CTA should be released.

14.18 Translation in consolidated financial statements

IFRS does not require equity accounts to be translated at historical rates.

US GAAP	IFRS
Equity is required to be translated at historical rates.	IFRS does not specify how to translate equity items. Entities have a policy choice to use either the historical rate or the closing rate. The chosen policy should be applied consistently. If the closing rate is used, the resulting exchange differences are recognized in equity and thus the policy choice has no impact on the amount of total equity

14.19 Determination of functional currency

Under US GAAP, there is no hierarchy of indicators to determine the functional currency of an entity, whereas a hierarchy exists under IFRS.

US GAAP	IFRS
There is no hierarchy of indicators to determine the functional currency of an entity. In those instances in which the indicators are mixed and the functional currency is not obvious, management's judgment is required to determine the currency that most faithfully portrays the primary economic environment of the entity's operations.	Primary and secondary indicators should be considered in the determination of the functional currency of an entity. If indicators are mixed and the functional currency is not obvious, management should use its judgment to determine the functional currency that most faithfully represents the economic results of the entity's operations by focusing on the currency of the economy that determines the pricing of transactions (not the currency in which transactions are denominated).

14.20 Hyperinflation

Basis of accounting in the case of hyperinflationary economies are different under US GAAP and IFRS.

US GAAP	IFRS
Under US GAAP inflation-adjusted financial statements are not permitted. Instead, the financial statements of a foreign entity in a highly inflationary economy shall be remeasured as if the functional currency were the reporting currency. Once a reporting entity determines that it has a foreign entity operating in a highly inflationary economy, the reporting currency should be considered the foreign entity's functional currency on a prospective basis. The new accounting basis of monetary and nonmonetary assets and liabilities should be the last translated balances prior to the designation as highly inflationary.	IFRS require financial statements prepared in the currency of a hyper-inflationary economy to be stated in terms of the measuring unit current at the end of the reporting period. Prior year comparatives must be restated in terms of the measuring unit current at the end of the latest reporting period.

14.21 Interim financial reporting—allocation of costs in interim periods

IFRS requires entities to account for interim financial statements via the discrete-period method. The spreading of costs that affect the full year is not appropriate. This could result in increased volatility in interim financial statements.

The tax charge in both frameworks is based on an estimate of the annual effective tax rate applied to the interim results plus the inclusion of discrete income tax-related events during the quarter in which they occur. See SD 8.16 for related discussion.

US GAAP	IFRS
US GAAP views interim periods primarily as integral parts of an annual cycle. As such, it allows entities to allocate among the interim periods certain costs that benefit more than one of those periods.	Interim financial statements are prepared via the discrete-period approach, wherein the interim period is viewed as a separate and distinct accounting period, rather than as part of an annual cycle.

14.22 Definition of discontinued operations

The definitions of discontinued operations under IFRS and US GAAP focus on similar principles and apply to a component of an entity that has either been disposed of or is classified as held for sale. Under US GAAP, to qualify as a discontinued operation, a disposal must result in a strategic shift that has a major effect on an entity's operations and financial results. While this concept may be implicit in the IFRS definition, the significance of the line of business or geographical area of operations will determine whether the disposal qualifies for discontinued operations presentation under US GAAP. US GAAP also includes several examples that provide guidance on how to interpret the definition of discontinued operations. IFRS does not contain similar examples. The definitions under IFRS and US GAAP are summarized in the table below.

US GAAP	IFRS
A disposal of a component of an entity or a group of components of an entity shall be reported in discontinued operations if the disposal represents (a) a strategic shift that has (or will have) a major effect on an entity's operations and financial results or (b) a business that on acquisition meets the criteria to be classified as held for sale.	A discontinued operation is a component of an entity that either has been disposed of or is classified as held for sale and (a) represents a separate major line of business or geographic area of operations, (b) is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations, or (c) is a subsidiary acquired exclusively with a view to resale.

14.23 Discontinued operations—unit of account upon which to perform a discontinued operations assessment

IFRS and US GAAP both refer to a component of an entity when describing those operations that may qualify for discontinued operations reporting; however, the definition of "component of an entity" for purposes of applying the discontinued operations guidance differs under IFRS and US GAAP. In practice, this difference generally does not result in different conclusions regarding whether or not a component of an entity that either has been disposed of, or is classified as held for sale, qualifies for discontinued operations reporting.

US GAAP	IFRS
A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. A component of an entity may be a reportable segment or an operating segment, a reporting unit, a subsidiary, or an asset group.	A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. In other words, a component of an entity will have been a cash-generating unit or a group of cash-generating units while being held for use.

14.24 Related parties—disclosure of commitments

Disclosures of related party transactions under IFRS should include commitments to related parties.

US GAAP	IFRS
There is no specific requirement to disclose commitments to related parties under US GAAP.	Disclosure of related party transactions includes commitments if a particular event occurs or does not occur in the future, including recognized and unrecognized executory contracts. Commitments to members of key management personnel would also need to be disclosed.

14.25 Related parties—disclosure of management compensation

Under IFRS, a financial statement requirement exists to disclose the compensation of key management personnel.

US GAAP	IFRS
Disclosure of the compensation of key management personnel is not required within the financial statements. SEC regulations require key management compensation to be disclosed outside the financial statements.	The compensation of key management personnel is disclosed within the financial statements in total and by category of compensation. Other transactions with key management personnel also must be disclosed.

14.26 Related parties—disclosure of transactions with the government and government-related entities

There are exemptions from certain related party disclosure requirements under IFRS that do not exist under US GAAP.

US GAAP	IFRS
There are no exemptions available to reporting entities from the disclosure requirements for related party transactions with governments and/or government-related entities.	A partial exemption is available to reporting entities from the disclosure requirements for related party transactions and outstanding balances with both: □ A government that has control, joint control, or significant influence over the reporting entity □ Another entity that is a related party because the same government has control, joint control, or significant influence over both the reporting entity and the other entity

14.27 Operating segments—segment reporting

A principles-based approach to the determination of operating segments in a matrix-style organizational structure could result in entities disclosing different operating segments.

US GAAP	IFRS
Entities that utilize a matrix form of organizational structure are required to determine their operating segments on the basis of products or services offered, rather than geography or other metrics.	Entities that utilize a matrix form of organizational structure are required to determine their operating segments by reference to the core principle (i.e., an entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates).

14.28 Service concession arrangements

Service concession arrangements may be in the scope of ASC 853, *Service Concession Arrangements*, for US GAAP or IFRIC 12, *Service Concession Arrangements*, for IFRS if they meet certain criteria. The above authoritative literature provides guidance on the accounting by private entity operators for public-to-private service concession arrangements (for example, airports, roads, and bridges) that are controlled by the public sector entity grantor. The operator also may provide construction, upgrading, or maintenance services in addition to operations. Under both US GAAP and IFRS, the infrastructure used in these arrangements should not be recognized as property, plant, and equipment by the operator. ASC 853 does not specify how an operator should account for the various aspects of a service concession arrangement other than to refer the operator to follow other applicable US GAAP. IFRIC 12 requires the operator to follow specific existing IFRS for various aspects of a service concession arrangement and provides additional guidance for other aspects.

US GAAP	IFRS
The operator should not account for these arrangements as leases. For the operator's revenue and costs relating to the construction, upgrade, or operation services, the standard refers the operator to the revenue recognition and other applicable guidance. In the absence of specific guidance, the operator needs to determine if it is able to recognize an asset for the consideration to be received by the operator in exchange for construction and upgrade services, and/or defer the costs associated with such services. An intangible asset would not be recognized as the consideration received for construction services.	Generally, the operator would not account for these arrangements as leases, unless the operator has a right to use some physically separable, independent, and cash generating portion of the infrastructure, or if the facilities are used to provide purely ancillary unregulated services. In these cases, there may in substance be a lease from the grantor to the operator, which should be accounted for in accordance with IAS 17 or IFRS 16. The operator will account for construction or upgrade services and operation services in accordance with IFRS 15.

US GAAP	IFRS
	The consideration to be received by the operator in exchange for construction or upgrade services may result in the recognition of a financial asset, an intangible asset or a combination of both. It is necessary to account for each component separately. The operator recognizes a financial asset to the extent that it has an unconditional right to receive a specified or determinable amount of cash or other financial assets for the construction services. The operator recognizes an intangible asset to the extent that it has a right to charge fees to users of the public services. Accordingly, determining who is the customer in a service concession arrangement depends on the nature of the consideration received by the operating entity and the facts and circumstances of the arrangement.
Additionally, in some of these arrangements, the operator will pay the grantor to enter into an operating agreement. This would be considered consideration payable to a customer under US GAAP upon adoption of ASU 2017-10 because the grantor is determined to be the customer of the operating services in all service concession arrangements. This may result in an asset that will be amortized against revenue over the term of the operating agreement. Refer to SD 14.29.4 for more details of the ASU. Prior to adoption of ASU 2017-10, there was diversity in practice in how an operating entity determined the customer of the operation services.	Additionally, in some of these service concession arrangements, the operator will make payments to the grantor. If payments are for a right to a separate good or service, the operator applies the applicable IFRS guidance for that good or service. If payments are for the right to use a separate asset, the operator assesses whether the arrangement contains a lease. If the service concession arrangement results in the operator having only a contractual right to receive cash from the grantor, the operator accounts for those payments as a reduction of the transaction price under IFRS 15. If the service concession arrangement results in the operator having only a right to charge users of the public service, the operator has received an intangible asset in exchange for the payments to be made to the grantor.

US GAAP	IFRS
	The operator may have a contractual obligation to maintain or restore the infrastructure to a specified condition before it is returned to the grantor at the end of the arrangement, which should be recognized and measured in accordance with IAS 37.

14.29 Recent/proposed guidance

14.29.1 FASB and IASB insurance contracts projects

Prior to 2014, the FASB and IASB had been working jointly on developing a comprehensive converged standard on accounting for insurance contracts. In early 2014, the FASB decided to reduce the scope of its project to make targeted improvements to existing insurance guidance. The FASB's insurance project was divided to separately address short-duration and long-duration insurance contracts.

For short-duration contracts (principally property/casualty and health insurance contracts), the FASB issued guidance on enhanced disclosures in 2015, which was effective in 2016 for public business entities and 2017 for others.

For long-duration contracts (principally life and annuity contracts), the FASB issued Accounting Standards Update No. 2018-12, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*, on August 15, 2018. The new guidance is effective for public business entities for fiscal years and interim periods within those fiscal years beginning after December 15, 2020 (i.e., January 1, 2021 for public calendar year-end entities). All other insurance entities have an additional year to adopt. Early application is permitted. The new guidance results in the need to update assumptions used in calculating traditional insurance liabilities at a minimum on an annual basis, and discount cash flows using liability-based yields. It also simplifies the deferred acquisition cost amortization model and requires guarantees with capital market risk to be measured at fair value.

Unlike US GAAP, the IASB's insurance contracts project continued to develop a single, comprehensive principle-based standard to account for all types of insurance contracts, including reinsurance contracts that an insurer holds. In May 2017, the IASB published IFRS 17, *Insurance Contracts*. IFRS 17 replaces IFRS 4. IFRS 17 applies to annual periods beginning on or after January 1, 2021, with earlier application permitted if IFRS 15, *Revenue from Contracts with Customers*, and IFRS 9, Financial Instruments, are also adopted.

IFRS 17 requires a current measurement model with unearned profit recognized over the period the entity provides coverage and as the entity is released from risk. Estimates are remeasured in each reporting period. The measurement is based on discounted, probability-weighted cash flows, a risk adjustment, and a contractual service margin (CSM) representing the unearned profit on the contract. A simplified premium allocation approach is permitted for the liability for remaining coverage if it provides a measurement that is not materially different from the general model or if the coverage period is one year or less. Under the simplified approach, the liability for remaining coverage is recognized over the coverage period but is not remeasured, absent the existence of an onerous contract. However, claims incurred are measured based on discounted, risk-adjusted, probability-weighted cash flows.

For presentation and measurement, entities are required at initial recognition to disaggregate a portfolio (that is, contracts that are subject to similar risks and managed together as a single pool) into a minimum of three groups of contracts: onerous; no significant risk of becoming onerous; and remaining contracts. Contracts that are issued more than one year apart should not be in the same group, so the minimum groups may need to be divided further.

Changes in cash flows related to future services should be recognized against the CSM. The CSM cannot be negative, so changes in future cash flows that are greater than the remaining CSM are recognized in profit or loss. Interest is accreted on the CSM at rates locked in at initial recognition of a contract. To reflect the service provided, the CSM is released to profit or loss over the insurance coverage period as services are provided, based on coverage units. For contracts without direct participation features, the coverage period is the period over which the entity provides coverage for insured events. For insurance contracts with direct participation features, the coverage period includes the period during which the entity provides coverage for insured events or investment related services.

Under IFRS 17, entities have an accounting policy choice to recognize the impact of changes in discount rates and other assumptions that relate to financial risks either in profit or loss or in other comprehensive income (OCI). The OCI option for insurance liabilities reduces some volatility in profit or loss for insurers when financial assets are measured at amortized cost or fair value through OCI under IFRS 9.

The variable fee approach is required for insurance contracts that specify a link between payments to the policyholder and the returns on underlying items, such as some "participating," "with profits" and "unit-linked" contracts. The interest on the CSM for such contracts is accreted implicitly through adjusting the CSM for the change in the variable fee. The variable fee represents the entity's share of the fair value of the underlying items less amounts payable to policyholders that do not vary based on the underlying items. The CSM is also adjusted for the time value of money and the effect of changes in financial risks not arising from underlying items, such as options and guarantees.

The requirements in IFRS 17 align the presentation of revenue with other industries. Revenue is allocated to periods in proportion to the value of expected coverage and other services that the insurer provides in the period, and claims are presented when incurred. Investment components (that is, amounts repaid to policyholders even if the insured event does not occur) are excluded from revenue and claims.

Insurers are required to disclose information about amounts, judgments, and risks arising from insurance contracts. The disclosure requirements are more detailed than currently required under IFRS 4.

14.29.1.1 Amendments to IFRS 4: Applying IFRS 9, Financial Instruments with IFRS 4, Insurance Contracts

In September 2016, the IASB issued amendments to the existing insurance contracts standard, IFRS 4, *Applying IFRS 9, Financial Instruments with IFRS 4, Insurance Contracts*. The amendments address issues that may arise from implementing the new financial instruments standard, IFRS 9, before implementing the new insurance contracts standard, IFRS 17. The IASB decided to (1) permit entities whose activities are predominantly connected to insurance and that had not previously applied IFRS 9 (with limited exceptions) the option to defer the effective date of IFRS 9, until 2021 (the temporary exemption) and (2) permit entities that issue insurance contracts the option to recognize in other comprehensive income, rather than profit or loss, some of the additional accounting mismatches and temporary volatility that could occur when IFRS 9 is applied before IFRS 17 is implemented (the overlay approach).

14.29.2 IASB Exposure Draft, Classification of Liabilities (Proposed amendments to IAS 1)

In February 2015, the IASB issued an exposure draft to amend IAS 1. The proposed amendments attempt to clarify that the classification of a liability as either current or noncurrent is based on the entity's rights at the end of the reporting period, and make a clear link between the settlement of the liability and the outflow of resources from the entity. On January 10, 2017, the FASB issued an exposure draft on a similar topic called Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent). Refer to SD 14.29.3 for further discussion.

14.29.3 Proposed guidance on the classification of debt (current vs. noncurrent)

On January 10, 2017, the FASB issued an exposure draft for a proposed Accounting Standards Update, *Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent)*. The proposed amendments are meant to replace the current, fact-specific guidance with an overarching, cohesive principle.

The proposed amendments would prohibit an entity from considering a subsequent refinancing when determining the classification of debt as of the balance sheet date. That is, short-term debt that is refinanced on a long-term basis after the balance sheet date, but before the financial statements are issued, would be classified as of the balance sheet date as current.

The proposed amendments would continue to require an entity to classify a debt arrangement as a noncurrent liability if the entity receives a waiver of a debt covenant violation that meets certain conditions before the financial statements are issued (or are available to be issued).

The proposed amendments would make US GAAP more consistent with IFRS. However, differences would still remain related to the classification of debt arrangements with covenant violations.

Issuance of the final ASU is expected on the third quarter of 2018.

14.29.4 FASB guidance on service concession arrangements

In May 2017, the FASB issued ASU 2017-10, *Service Concession Arrangements (Topic 853): Determining the Customer of the Operation Services*. Previously, it was not clear whether the customer of the operation services was the grantor or a third-party user for certain service concession arrangements, which resulted in diversity in practice when applying certain aspects of the revenue guidance. ASU 2017-10 clarifies that the grantor, rather than a third-party user, is always the customer of the operation services in service concession arrangements within the scope of ASC 853.

The effective date and transition requirements for the guidance are generally the same as the effective date and transition requirements for ASC 606 (refer to SD 3.1). Early adoption is permitted.

14.29.5 Financial instruments with down round features

On July 13, 2017, the FASB issued ASU 2017-11, *I. Accounting for Certain Financial Instruments with Down Round Features II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception.*

See SD 10.18.1 for information on the impact of this guidance on EPS calculation.

Chapter 15: IFRS for small and medium-sized entities

15.1 IFRS for small and medium-sized entities

IFRS for Small and Medium-sized Entities (SMEs) provides an alternative accounting framework for entities meeting certain eligibility criteria. IFRS for SMEs is a self-contained, comprehensive standard specifically designed for entities that do not have public accountability and publish general purpose financial statements for external users.

This section is intended to provide an overview of IFRS for SMEs, its eligibility criteria, and some examples of the differences between IFRS for SMEs, full IFRS, and US GAAP.

15.1.1 What companies can use IFRS for SMEs?

The IASB has determined that any entity that does not have public accountability may use IFRS for SMEs. An entity has public accountability if (1) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market, or (2) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance entity, pension fund, or securities broker/dealer. The definition of a SME is, therefore, based on the nature of the entity rather than on its size.

To clarify, a subsidiary of a listed company that uses full IFRS is eligible to use IFRS for SMEs when preparing its own separate financial statements, provided that the subsidiary itself does not have public accountability. However, a subsidiary using IFRS for SMEs would need to convert its financial statements to full IFRS for consolidation into its parent's financial statements, as there are differences between the two accounting frameworks.

Beyond the scope determined by the IASB, companies are also subject to the laws of their local jurisdiction. Many countries require statutory reporting, and each country will individually decide whether IFRS for SMEs is an acceptable basis for such reporting. Some countries that use full IFRS for public company reporting have replaced their local GAAP with IFRS for SMEs (e.g., South Africa), or with a standard based on the IFRS for SMEs (e.g., the United Kingdom), while others currently have no plans to allow use of IFRS for SMEs for statutory purposes (e.g., France). Companies will need to understand on a country-by-country basis where IFRS for SMEs is allowed or required for statutory reporting.

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

IFRS for SMEs retains many of the accounting principles of full IFRS but simplifies a number of accounting principles that are generally less relevant for small and medium-sized entities. In addition, IFRS for SMEs significantly streamlines the volume and depth of disclosures required by full IFRS, yielding a complement of disclosures that are more user-friendly for SME stakeholders.

Certain more complex areas of full IFRS deemed less relevant to SMEs, including earnings per share, segment reporting, insurance, and interim financial reporting, are omitted from the IFRS for SMEs. In other instances, certain full IFRS principles are simplified to take into account the special needs of SMEs. Some examples of the differences between full IFRS and IFRS for SMEs include:

Business combinations—Under full IFRS, transaction costs are excluded from the consideration included in the accounting for business combinations (i.e., expensed as incurred), and a liability for contingent consideration that will be paid in cash is recognized regardless of the probability of payment. Under IFRS for SMEs, transaction costs are included in the cost of the acquisition, and contingent consideration is recognized only if it is probable the amount will be paid and its amount can be reliably measured.

Capitalization of interest—Under full IFRS, interest directly attributable to the acquisition, construction, or production of qualifying assets should be capitalized. Under IFRS for SMEs, all interest must be expensed.

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 using the cost model, 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 more often when an indicator of impairment exists. Under IFRS for SMEs, there is no concept of indefinite-lived intangible assets. IFRS for SMEs requires that goodwill and intangible assets be amortized over the useful life of the asset (or a term not to exceed 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.

Research and development costs—Under full IFRS, research costs are expensed but development costs meeting certain criteria are capitalized. Under IFRS for SMEs, all research and development costs are expensed.

Recognition of exchange differences—Under full IFRS, exchange differences that form part of an entity's net investment in a foreign operation (subject to strict criteria of what qualifies as net investment) are recognized initially in other comprehensive income and are recycled from equity to profit or loss on disposal of the foreign operation. Under IFRS for SMEs, recycling through profit or loss of any cumulative exchange differences that were previously recognized in OCI on disposal of a foreign operation is not permitted.

15.1.3 What are some of the differences between US GAAP and IFRS for SMEs?

In areas where US GAAP and IFRS are mostly converged (e.g., business combinations), the differences between US GAAP and IFRS for SMEs likely will seem similar to the differences noted above between full IFRS and IFRS for SMEs. However, there are other examples of differences between US GAAP and IFRS for SMEs:

Inventory—Under US GAAP, last in, first out (LIFO) is an acceptable method of measuring the cost of inventory. In addition, impairments to inventory value are permanent. Under IFRS for SMEs, use of LIFO is not allowed, and impairments of inventory may be reversed under certain circumstances.

Provisions—Under US GAAP, a provision is recorded if it is probable (generally regarded as 75 percent or greater) that an outflow will occur. If no best estimate of the outflow is determinable but a range of possibilities exists, then the lowest point of the range is the value that should be recorded. Under IFRS for SMEs, a provision is recorded if it is more likely than not (generally considered to be greater than 50 percent) that an outflow will occur. If no best estimate of the outflow is determinable but a range of possibilities exists, and each point in that range is as likely as any other, the midpoint of the range should be recorded.

Equity instruments—Under US GAAP, complex equity instruments, such as puttable stock and certain mandatorily redeemable preferred shares, may qualify as equity (or mezzanine equity). Under IFRS for SMEs, these types of instruments are more likely to be classified as a liability, depending on the specifics of the individual instrument.

Revenue on construction-type contracts—Under US GAAP ASC 605, the percentage-of-completion method is preferable, though the completed-contract method is required in certain situations. Under IFRS for SMEs, the completed-contract method is prohibited.

Finally, the Private Company Council (PCC) was established in 2012. The PCC is a sister entity to the FASB and is tasked with (1) identifying, deliberating and voting on proposed alternatives within existing US GAAP for private companies and (2) acting as the primary advisory body to the FASB for private company matters on its current technical agenda. Contrary to IFRS for SMEs, the alternatives proposed by the PCC do not represent a single comprehensive standard but separate individual accounting alternatives for private companies that are optional to adopt. As additional alternatives to existing US GAAP for private companies are proposed by the PCC and endorsed by the FASB, additional differences may be created for private companies between US GAAP and full IFRS or IFRS for SMEs.

While the PCC alternatives create optional simplifications to existing US GAAP, entities applying IFRS for SMEs may not generally elect to revert to full IFRS if they do not like the simplified accounting required by IFRS for SMEs. The one exception is in the area of financial instruments, when IFRS for SMEs specifically allows entities to choose to apply the recognition and measurement requirements of IFRS 9 as a policy election.

The FASB has issued accounting standards updates to US GAAP for private companies. These standards represent alternatives for private companies to existing US GAAP related to the accounting for goodwill subsequent to a business combination, the accounting for certain types of interest rate swaps, the application of variable interest entities guidance to common control leasing arrangements, and the accounting for identifiable intangible assets in a business combination. These alternatives to US GAAP are presented in each relevant chapter of this publication.

15.2 Recent/proposed guidance

15.2.1 IASB update to IFRS for SMEs

The Board intends to update IFRS for SMEs periodically (i.e., every three years or so) to minimize the impact of changing accounting standards on SME financial statement preparers and users of such financial statements. The last update was in 2015 with the related amendments being effective January 1, 2017. Accordingly, recently issued new standards including IFRS 9, IFRS 15, and IFRS 16 were not considered in the last update. The next comprehensive review of the IFRS for SMEs is expected to start in early 2019.

As IFRS for SMEs is designed to be a stable, stand-alone standard it was decided not to incorporate some significant changes in new or amended IFRS standards, including those in IFRS 10, *Consolidated financial statements*, and IAS 19, *Employee benefits*.

In addition to the IASB's periodic updates to IFRS for SMEs, the SME Implementation Group (SMEIG) considers implementation questions raised by users of IFRS for SMEs. When deemed appropriate, the SMEIG develops proposed guidance in the form of questions and answers (Q&As) which, if approved by the IASB, are issued as non-mandatory guidance. Over time, these Q&As are generally incorporated into either *IFRS for SMEs* (and made mandatory) and/or the IFRS Foundation's educational material (remaining non-mandatory).

Chapter 16: FASB/IASB project summary exhibit

16.1 FASB/IASB project summary exhibit

The following table presents a summary of the most notable projects on the agenda of the FASB and IASB, and the related discussion papers, exposure drafts, and final standards expected to be issued in the remainder of 2018. Although preliminary in some cases, the topics under consideration provide an overview of and insight into how each set of standards may further evolve. More information on the status of these projects can be found on each board's website. For the FASB, visit www.fasb.org. For the IASB, visit www.ifrs.org.

Standards, amendment to standards and other research projects	2018 Issuance anticipated
IASB projects	
Business combinations under common control	
Definition of a business (Amendments to IFRS 3)	F
Disclosure initiative – Definition of material	F
Management commentary	
Primary financial statements	
Rate regulated activities	
FASB projects	
Conceptual framework	
Disclosure framework	
Distinguishing liabilities from equity (including convertible debt)	
Financial performance reporting – disaggregation of performance information	
Segment reporting	
Explanation of symbols:	
ED = Exposure Draft F = Final	

Appendix A: Noteworthy updates since the previous edition

The 2018 edition incorporates updates, as necessary, to reflect the release and the effective date of the following standards, guidance, interpretations, and proposed guidance:

Chapter 4: Expense recognition–share-based payments

- FASB Accounting Standards Update No. 2018-07, *Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*

Chapter 5: Expense recognition–employee benefits

- **5.19.1:** IASB amendment to IAS 19, *Employee Benefits - Plan Amendment, Curtailment or Settlement*

Chapter 6: Assets–nonfinancial assets

- **6.24.1:** Latest developments on the joint FASB/IASB standard, *Leases*

Chapter 7: Assets—financial assets

- IASB IFRS 9, *Financial Instruments*
- FASB Accounting Standards Update No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*
- **7.10:** IASB amendments to IFRS 9, *Financial Instruments* - *Prepayment Features with Negative Compensation*

Chapter 8: Liabilities—taxes

- **8.8, 8.20.4:** IFRS Interpretations Committee agenda decision, *Interest and Penalties Related to Income Taxes (IAS 12)*
- **8.19:** FASB staff Q&As on implementation issues related to the Tax Cuts and Jobs Act of 2017.
- **8.20.5:** IASB amendments to IAS 12, *Income Taxes - Income Tax Consequences of Payments on Instruments Classified as Equity*
- **8.20.6:** FASB Accounting Standards Update No. 2018-02, *Income Statement — Reporting Comprehensive Income (Topic 220) - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*

Chapter 10: Financial liabilities and equity

- **10.13:** IASB amendments to IFRS 9, *Financial Instruments - Prepayment Features with Negative Compensation*
- **10.16:** IASB IFRS 9, *Financial Instruments*
- **10.18.2:** IASB Discussion Paper, *Financial Instruments with Characteristics of Equity*

Chapter 11: Derivatives and hedging

- IASB IFRS 9, *Financial Instruments*
- FASB Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*

Chapter 12: Consolidation

- **12.19.1:** FASB proposed Accounting Standards Update, *Consolidation (Topic 812): Reorganization*
- **12.19.2:** IASB amendments to IFRS 3, *Business Combinations*, and IFRS 11, *Joint Arrangements - Previously Held Interests in a Joint Operation*

Chapter 14: Other accounting and reporting topics

- **14.29:** Latest developments on the FASB and the IASB Insurance projects
- **14.29.1:** FASB Accounting Standards Update No. 2018-12, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*
- **14.29.5:** FASB Accounting Standards Update No. 2017-11, *I. Accounting for Certain Financial Instruments with Down Round Features II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception.*